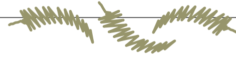
C Y P R E S S

Asset Management, Inc.



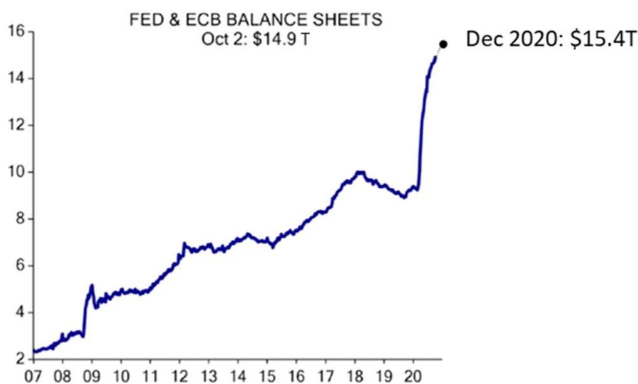
MARKET COMMENTARY **October, 2020**

The global economy is climbing out of the depths to which it plummeted during the Great Lockdown in April. Despite a September swoon the S&P 500 still managed to post its best 3Q since 2010, up almost 9%. The summer is typically a seasonally challenging period for stocks but a strong economic rebound boosted markets. Year to date stocks have increased 5.5% on a total return basis.

The “reopening” rebound has been supported by massive monetary and fiscal stimulus. A month ago, the Fed promised to hold interest rates steady at close to zero and keep them there until at least the end of 2023. The new guidance from the Fed implements a shift towards a more dovish long-term policy stance, and is likely to result in rock bottom rates for years to come. Chairman Powell called the forward guidance “powerful” and said the Fed Open Market Committee believes “policy and rates will remain highly accommodative until the economy is far along in recovery.” They are essentially promising to keep rates at zero even after inflation moves back above 2% annually in order to maximize employment and bring the jobless rate down as quickly as possible. GDP is now forecast to decline about 3.75% in 2020, considerably better than consensus forecast of a 7% drop in June. With stronger than expected recent job growth, the estimated end of year unemployment rate, at one time projected above 10%, has also come down to roughly 7.5%.

Massive Global Stimulus

The sum of the Fed and ECB balance sheets was up +64% y/y last week. And both are scheduled to increase further this year. This money has to go somewhere and is inflating assets.



Source: Evercore ISI

At the same time balance sheet expansion has continued, Global Short Rates have been making new lows. This unprecedented QE is one of the main reasons stock markets have rallied.

Main Street, Wall Street and the Recovery

Unprecedented Fed policy and stimulus have been good for assets and very good for stocks. A dovish Fed is a given and must be recognized by investors. When we look at the “real economy”, however, the picture is more mixed. Uncertainties remain high and the recovery is prone to setbacks. With the COVID-19 pandemic continuing to spread, many countries have slowed reopening and some are reinstating partial lockdowns. Sustainable global recovery is a long road back.

Printing and spending money could hit a wall at some point. One view is that the market is already approaching bubble territory because the Feds massive liquidity is *only* making its way into asset prices. If monetary policy were actually making its way into the real economy, commercial banks would be doing better, confirming a strong recovery. Or if policy successfully lifts inflation but does not lift growth, then the economy could run into a stagflation wall. This would lead to a market reckoning.

The bull case is that the overall economy continues to heal and the recovery fully shows up on Main Street as well as Wall Street. When this happens and Fed policy remains accommodative, longer rates should ultimately rise on renewed growth prospects. Rates could then gradually and naturally normalize.

Investment Strategy: Uncharted Territory

There are no easy answers in the current investment environment. Cash is generally considered to be a safe asset choice. But noted investor Ray Dalio has warned against holding too much cash and called it a quietly bad asset class and not a safe investment:

> *"I think that there is an instinct to think that cash is the lowest risk asset class, because it has less volatility, and also because we look at everything through the lens of cash - what is everything in dollars worth. But you don't realize that when there's so much production of debt, and so much production of cash, that it does poorly relative to other asset classes… It will also tax you around 2% a year, due to inflation.'' (*CNBC interview 10-7-2020*).*

We think Dalio makes a number of good points. But cash can still have value as a strategic investment over shorter time frames, particularly in times of higher uncertainty and volatility. We think diversification and balance and asset quality are more important than ever and this is reflected in our Cypress portfolio. For one of the only times in our investing careers, we even see a case for gold as a potentially strategic asset given the uncertainties alluded to above, such as inflation or even stagflation.

Moreover, we are in a period of not only considerable economic uncertainty, but social and political upheaval, and geopolitical challenges. The era of unfettered globalization has ended and is reversing. No matter the outcome of the presidential election, the decoupling of the U.S. and China is likely to continue. This creates risks and opportunities across the spectrum. Decoupling is a risk to American multinationals dependent on the markets of both countries and to smaller firms dependent on the global supply chain. It creates opportunities to bring home jobs and production that have been outsourced and to enhance our standard of living and national security.

As we have said before, made in America really means we cannot rely on others for the basic things we need or the skills that are vital to our security and health. The U.S. may be more dependent upon itself in the decade to come than it has been in half a century. If we don't tear ourselves apart first.