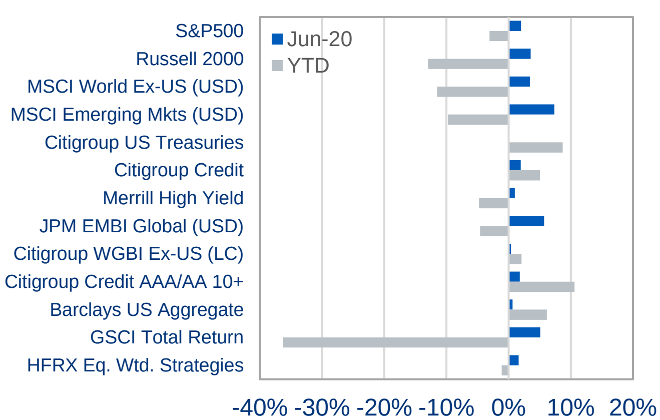
Global Market Review

Macro Summary

Global equity markets in June extended their extraordinary resurgence from the lows of March. Strong policy support and a bounce in economic activity as governments eased the lockdown fueled the rally. Credit markets and sovereign emerging market bonds also benefitted from renewed risk appetite, while advanced economy sovereign bond prices rose marginally. Oil prices jumped another 10% in June, bringing the quarter's gain to over 95%. The sharp equity and oil market rallies stand in stark contrast to the dismal state of the global economy, which faces a near certainty of a record contraction in 2020, and extreme uncertainty surrounding the pandemic's ultimate progression and impact on lives and livelihoods.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



Wild swings in sentiment and markets continue.

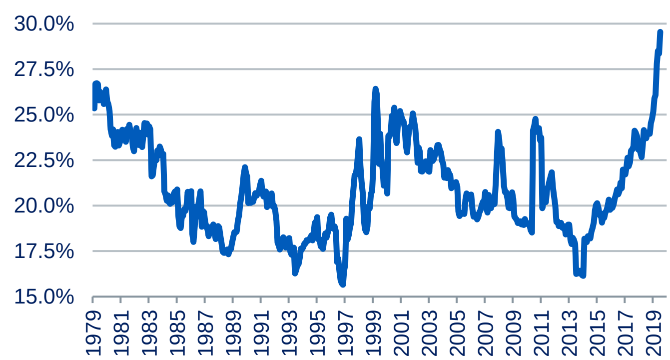
Volatility, Retail Traders, and Market Concentration

Following an 18.2% decline in Q1, the S&P 500 rose 20.5% in Q2, placing the quarter in the record books for one of the shortest and steepest recoveries from a bear market in history. Following this roller coaster ride, the index is down only 3.1% so far this year and a mere 7.8% from its all-time high, despite job losses of over 40 million between March and June, and the prospect that the U.S. economy will suffer in 2020 its deepest economic contraction since the Great Depression. The lopsided nature of the rally is striking as it continues the longstanding outperformance of a small number of large cap growth stocks in the tech sector. This dynamic has led to record high levels of U.S. equity market concentration, with 10 mega-cap stocks representing nearly 30% of the S&P 500 index (Exhibit 1). Also striking is the extremely large number of three-standard deviation one-day moves seen in U.S. equity as well as non-U.S. equity, commodity, and currency markets so far this year. U.S. retail investors appear to have been playing a larger-than-usual role in driving market dynamics, with strong growth in new on-line accounts and a high share of small-value trades in total trading volume.

Within U.S. equities, the divergence between the performance of growth versus value stocks widened further in June as growth stocks rose 4.3% versus the 0.5% decline of their value counterparts. So far this year, growth stocks are up 9.0% versus value's 16.7% decline, a divergence driven by a small number of mega-cap tech stocks. The tech (+14.8%) and consumer discretionary (+10.6%) sectors are the only ones to show gains so far this year, while energy (-37.1%) and financials (-24.6%) are the worst performing sectors.

Exhibit 1. Equity Market Concentration at Record Levels

Sources: Compustat and Strategic.



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Non-U.S. Equity Markets Outperform U.S.

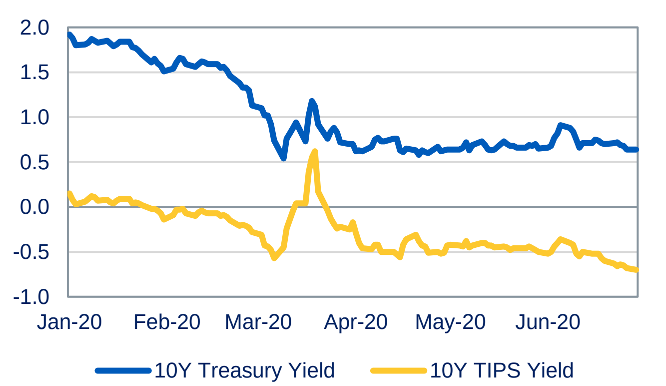
The MSCI World ex-US index of developed equity markets rose 3.4% in June bringing its rebound for the quarter to 15.3%. Nevertheless, it remains down 11.5% so far in 2020. European bourses – buoyed by strong policy support and measures to ease the lockdown reflecting progress in containing the spread of Covid-19 – led other regions in June and the quarter, recouping part of the losses of the first quarter. As in the U.S., the rebound in European as well as other advanced economy equity markets comes despite a grim economic outlook of steep economic contraction, disinflation, declining earnings, falling global trade, and mounting fiscal deficits and debt levels.

Emerging equity markets led all others in June, as the MSCI emerging markets index rose by 7.4%, bringing its quarterly gain to 18.1%. Chinese equities fared best on signs of renewed economic vigor as lockdowns were eased, with domestic A-Shares jumping 10% in June bringing its gain for the quarter to 16%. Emerging equity markets in Europe and Latin America also performed well in June, gaining 3.2% and 5.2%, respectively. For the year, however, emerging equities remain down nearly 10%.

Fed Helps Narrow Spreads and Support Issuance

While U.S. and non-U.S. equity markets looked forward to a much rosier future, U.S. bond yields told a far less optimistic story, pricing in continued subpar growth and disinflationary pressure. Reflecting this pattern, U.S. Treasuries with maturities of 10 years or longer have returned 21.2% so far this year. The real yield on 10-year TIPS remains negative (-0.7%) and implied inflation expectations suggest that inflation will average less than 1.5% for the next 10 years (Exhibit 2). Advanced sovereign bond markets outside of the U.S. gained about 1% in June and are up by the same amount so far in 2020 as yields have remained at very low and negative levels.

Exhibit 2. Treasuries Price in Low Inflation and Growth
Source: FRED. Data through June 30, 2020.



The FOMC meeting in June left interest rates unchanged as expected and struck a dovish note, confirming its commitment to maintain a brisk pace of asset purchases, including investment grade and high yield bonds. The Fed's stance supported a narrowing of U.S. credit spreads across the credit spectrum despite a record level of issuance. Spreads on investment grade bonds approached their lowest levels in 10 years in June, contributing to the 10.6% return on long-maturity investment grade bonds so far in 2020. U.S. corporate bond issuance in the second quarter set an all-time record, bringing total issuance to over $1 trillion this year, as companies rush to lock in low borrowing costs and shore up their balance sheets.

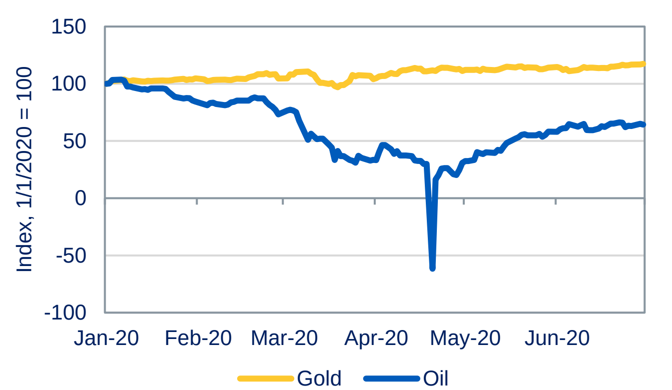
Hedge Funds Rise

The HFRX Equal Weighted Strategies index rose 1.6% in June, bringing its gains to 6.4% since end-March. The index nevertheless remains down 1.1% so far in 2020. With the exception of macro, all sub-strategies earned positive returns in June, led by event driven and convertible arbitrage strategies.

Wild Swings in Oil Prices Drive Commodity Returns

The miraculous resurrection of crude oil prices in the second quarter (+95%) after the death spiral of the first, owes much to the agreement reached in June by Saudi Arabia, Russia, and other major producers to limit production thus ending a ruinous fight for market share. Despite the recovery, oil prices remain down nearly 36% so far in 2020. In contrast to the violent swings in oil prices, gold has enjoyed steady gains (Exhibit 3). The GSCI is down 39% for the year, largely reflecting the ebb and flow of oil prices.

Exhibit 3. Combustible Oil Prices vs. Gold's Steady Gains
Source: FRED, Bloomberg.



Performance of Major Market Indices through 06-30-2020
Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	2.0%	20.5%	-3.1%	7.5%	10.7%	10.7%
Russell 2000	3.5%	25.4%	-13.0%	-6.6%	2.0%	4.3%
MSCI World Ex-US (USD)	3.4%	15.3%	-11.5%	-5.4%	0.8%	2.0%
MSCI Emerging Mkts (USD)	7.4%	18.1%	-9.8%	-3.4%	1.9%	2.9%
Citigroup US Treasuries	0.1%	0.6%	8.7%	10.4%	5.5%	4.0%
Citigroup Credit	1.9%	8.6%	5.0%	9.4%	6.2%	5.6%
Merrill High Yield	1.0%	10.3%	-4.8%	-1.1%	2.9%	4.6%
JPM EMBI Global (USD)	5.7%	8.1%	-4.6%	1.8%	2.3%	4.2%
Citigroup WGBI Ex-US (LC)	0.4%	1.2%	2.1%	2.5%	3.2%	3.1%
Citigroup Credit AAA/AA 10+	1.8%	6.9%	10.6%	17.0%	10.3%	9.5%
Barclays US Aggregate	0.6%	2.9%	6.1%	8.7%	5.3%	4.3%
GSCI Total Return	5.1%	10.5%	-36.3%	-33.9%	-8.7%	-12.5%
HFRX Eq. Wtd. Strategies	1.6%	6.4%	-1.1%	1.9%	0.3%	0.8%