

BANK OF MILLBROOK TRUST AND INVESTMENT SERVICES



QUARTERLY REVIEW AND OUTLOOK

PUBLICATION 49

JULY 2020

"If life were predictable, it would cease to be life." Eleanor Roosevelt

Life during a pandemic is anything but predictable. Living here in upstate New York, we should be proud of how we have endured, hopefully, the worst the Coronavirus has to throw at us. We are back to work in our offices and enjoying some of our regular summer routines, albeit in our masks. 2020 has proven to be a year which has tested our resilience.

When it comes to the stock market you hear a lot about bulls and bears. Currently, doves are being mentioned more often. In finance, it is in reference to the Federal Reserve being "dovish," or accommodative, on monetary policy. Federal Reserve chair Jerome Powell went on *60 Minutes* on May 17th and laid out that the Fed had plenty of ammunition to help our economy through this period of great uncertainty. He stated, "You wouldn't want to bet against the American economy. This economy will recover. Unemployment will get back down. We'll get through this." The Fed has already pumped close to \$3 trillion into the economy. The dovish monetary policy and aggressive fiscal stimulus mixed with reopening economies has proven potent, leading to a strong stock market in May and June.

Will the market continue to be strong is the question. Considering the rising COVID numbers coming out of the South and Southwest, we believe increased volatility is ahead of us. Add in a presidential election in the Fall and fear of a second wave and it is hard to remain optimistic about 2020. That said, we do agree with Mr. Powell and have faith in the American economy.

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As fiduciaries and investment advisors, we strive to design portfolios that will help our clients meet their financial goals while managing risk. Access to information and expertise is crucial to our success. We are pleased to announce that we have expanded our partnerships as a way to broaden our access to investment expertise. In addition to Northern Trust and Vanguard, we have hired FCI Advisors. FCI Advisors provides investment management services to community banks across the U.S., and in total, manages more than \$9 billion in assets. The firm has a deep understanding of how to manage multiple investment strategies in a fiduciary environment. In addition to research, portfolio construction and security selection, FCI Advisors will provide us with an expanded investment perspective to help us meet the needs of our clients.

The following Outlook on the economy, equity and fixed income markets is a sample of FCI's views. We think you will find their insights of interest.

We hope that you and your family are enjoying all of the outdoor activities the Hudson Valley has to offer. With best wishes,



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ECONOMIC OUTLOOK

Summary

After several months of cratering economic data due to the “Great Lockdown”, June brought some much needed relief. As many regions slowly lifted their “shelter-in-place” orders, growth began to pick up, albeit from significantly depressed levels. Nearly all economic releases during the month showed improvement for the first time since March, though most remain far from their pre-COVID levels. With that in mind, many respected economists now believe we are emerging from a recession that began in February, and likely ended in May. However, this does not mean we are in the clear, as they also believe that high unemployment will likely create lingering issues for the economy moving forward. This hopefully indicates the worst is behind us, though a great deal of uncertainty remains.

To illustrate this point, initial unemployment claims have decreased for 15 consecutive weeks, yet they still register weekly levels that would constitute pre-COVID records. The reported continuing claims number (the overall number of people receiving unemployment benefits) has also been trending lower for nearly two months, yet it doesn’t include independent contractors, self-employed, or “gig economy” workers who can now receive benefits due to the CARES Act, but would have otherwise been ineligible for unemployment assistance. When those individuals are included in the total, the continuing claims number is actually increasing substantially. The ambiguity in the data may ultimately cause more questions than answers.

In the short term, even with the job losses, overall income remains high due to the fiscal stimulus enacted by the government. With the extra boost in unemployment benefits set to expire at July month-end, and a virus that just won’t

go away, there is likely more for Congress to do. We are experiencing the onset of a “second wave” across the nation, and while it is unlikely that an uptick in cases will lead to another country-wide lockdown, it is highly probable that certain regions will experience some form of rolling economic shutdowns even if they are not mandated by the local or federal government. The extent to which that happens will determine the rate of growth in the economy but the hope is that the country will continue to re-open at a faster rate than hotspot regions cause closures.

Positives

Retail sales month-over-month (MoM) beat expectations (17.7% vs 8.4% expected)

Pending home sales MoM reached a record high (44.3% vs 19.3% expected)

The ISM Non-Manufacturing Index is back in expansionary territory (57.1)

Personal savings rates above 20% averaged below 9% pre-COVID

Negatives

New factory orders (ex-transportation) MoM missed estimates (2.6% vs. 6.5% expected)

Construction spending MoM decreased more than estimates (-2.1% vs +1.0% expected)



EQUITY OUTLOOK

Summary

Equity markets continued to march higher in June with the S&P 500 adding 2.0% during the month. The index's 20.5% rebound in the second quarter leaves it down just 3.1% year-to-date following the massive pandemic-fueled losses in the opening quarter of 2020. Investors remained focused on impact of fiscal and monetary stimulus and glimmers of hope around economic reopening.

Growth stocks regained momentum over value in June. The Russell 1000 Growth Index rose 4.4% while the Russell 1000 Value Index declined 0.7%. The market continues to reward those companies that are well-positioned to flourish in the current and post-pandemic economies. Information technology and consumer discretionary were the best performing sectors posting increases of 7.7% and 5.0% respectively. The laggards were utilities, which fell 4.7%, and health care, down 2.4%.

The United States has seen a surge in new COVID-19 cases primarily in states that were among the most aggressive to reopen. There has been much debate about whether this is a second wave or a reacceleration of the first. Regardless, while the media has focused much attention on the outbreak, capital markets are looking beyond the virus in an attempt to accurately determine stock valuations.

As long-term investors of client capital, we acknowledge the risk associated with the current conditions but value stocks based on future cash flows. By some measures stocks broadly look expensive, though given the low discount rate other valuation measures look quite reasonable. Headline risks

remain substantial and daily volatility will likely continue for the balance of the year. However, barring a major setback on the virus front, the current bull trend should remain intact over the near term.

Positives

Health care and pharmaceutical industries continue to make medical breakthroughs concerning the COVID-19 outbreak

Many retail investors have been on the sidelines throughout the rally

Accommodative Federal Reserve and global central bank policy

Negatives

Rising geopolitical tensions

As people let down their guard, additional virus waves appear possible

Unknowns

The presidential election is basically a coin flip at this time

Any additional round (or two) of stimulus is likely to be met by partisan bickering



FIXED INCOME OUTLOOK

Summary

At the conclusion of the June meeting of the Federal Reserve Open Market Committee (FOMC), Federal Reserve Chairman Powell confirmed they intend to keep the overnight rate unchanged (at 0.25%) through 2022. They also plan on continuing their open market operations by purchasing at least \$80 billion of U.S. Treasury securities and \$40 billion of mortgage-backed securities per month indefinitely. While they discussed the further step of yield curve targeting, it was not viewed favorably by many of the participants and will not likely become an “official policy tool” of the FOMC in the near term.

Even without the official yield targeting policy, the Federal Reserve is firmly in control of the front of the yield curve and heavily influencing longer maturities. As such, Treasury yields ended the month of June at levels nearly identical to where they began. Besides a four-day bump in yields following the release of May’s surprisingly strong payroll report, the 10-year note traded in a 13 basis point (bps) range, even narrower than the 20 bps range that has existed since late March. To put this stability in context, since the turn of the century there have only been three calendar quarters in which the 10-year traded in a range less than 30 bps on a nightly closing basis. The average trading range over the same 82 calendar quarters has been 73 bps.

The Treasury market delivered a modest 9 bps return for the month of June but the six-month return was still an outstanding 8.71%. With the Fed on hold and content at current yield levels, there is little opportunity for outsized returns from the Treasury market going forward. We expect more “coupon-like” returns in the coming months. If the spread of the coronavirus continues to reaccelerate, the Fed might target lower rates further out on the curve and employ more of their “unofficial policy tools.”

Corporate credits were again the star performers of the bond market for the third consecutive month. Investment-grade credit spreads narrowed by another 25 bps which lead this sector to deliver a return of 1.96% for the month of June. Intermediate corporate bonds had a return of 1.63% for June, far surpassing the intermediate Treasury market return of 0.08%. Given the Fed’s additional focus on the “smooth functioning of financial markets” and the support programs put to insure such, we believe investment-grade corporate bonds still have room to deliver solid returns in the second half of the year.

Positives

Investment-grade corporate bonds supported by Fed purchases

Federal Reserve’s rate policy will cap rates across the curve

Inflation likely to be lower, not higher, in the next few years

Negatives

Fed does not want to pursue a negative interest rate policy

Corporate debt issuance to set new record levels

Unknowns

The spread of the coronavirus and the progress toward a vaccine

Likelihood of new tariffs with China and Russia

Election outcome