LPL RESEARCH
MARKET INSIGHT QUARTERLY

THIRD QUARTER 2020 IN REVIEW

October 2020

Q3 GAINS PUSH STOCKS INTO THE GREEN FOR THE YEAR

Please note: All return figures are as of September 30, 2020, unless otherwise stated.

Past performance is not indicative of future results.

The economic forecasts set forth in the presentation may not develop as predicted.

- **Solid third quarter for stocks as the economic recovery continued.** The S&P 500 Index returned 8.9% during the third quarter, following one of its best quarters ever in the second quarter with more gains. The broader Russell 3000 Index fared even better during the quarter with its 9.2% return. Third quarter gains lifted the year-to-date total return for the S&P 500 (including dividends) back into positive territory at 5.6% as of September 30.

  Stocks were lifted by the stronger-than-expected economic rebound, as fiscal and monetary stimulus continued to provide support even as talks on another fiscal package stalled. Meanwhile, optimism around COVID-19 therapeutics and vaccine candidates continued to build, holding off any sustained weakness related to the November election and related policy uncertainty.

  Within the broad market, large caps outpaced small caps for the quarter, benefiting from their relatively better positioning for the pandemic, including a large technology weighting and generally stronger company balance sheets. Small caps fared slightly better in September as market participation broadened, but they still trail large caps year to date by more than 15 percentage points.

1 Q3 2020 AT A GLANCE

	Q3 2020
Gross Domestic Product*	29.2%
S&P 500 Index	8.9%
Bloomberg Barclays U.S. Aggregate Bond Index	0.6%
Bloomberg Commodity Index	9.1%

Source: LPL Research, Bloomberg, FactSet 09/30/20

*Bloomberg consensus as of September 30, 2020.

Figures for S&P 500 Index, Bloomberg Barclays Aggregate Bond Index, and Bloomberg Commodity Index are total returns from 07/01/20–09/30/20 (Q3).

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment.

The growth style of investing continued its impressive 2020 run during the quarter but underperformed during September—the first time in 12 months—as markets pulled back and rotated some from winners to laggards. Over the full quarter, growth got a boost from strong gains in the consumer discretionary and technology sectors, while value was hurt by weakness in the energy sector. Remarkably, growth has outperformed value by more than 35 percentage points year to date.

Consumer discretionary topped all equity sectors for the quarter, led by homebuilders. Energy struggled mightily with a nearly 20% decline, even though oil and natural gas prices rose. Technology leads all sectors year to date with a 28.7% return.

Looking at regions, emerging markets stocks outperformed those in the United States with a 9.7% quarterly return, based on the MSCI Emerging Markets (EM) index. China has led the way out of the global pandemic, helping to drive its market—and several other key Asian markets—higher.

Developed international stocks lagged during the quarter, based on the MSCI EAFE Index, due to weakness in France and the United Kingdom. Over the first nine months of 2020, emerging markets edged 0.9% lower, while developed international stocks lost 6.7%.

- **More economically sensitive and less interest-rate sensitive fixed income sectors fared best.** The broad bond market benchmark—the Bloomberg Barclays US Aggregate Bond Index—returned 0.6% during the third quarter, bringing its nine-month gain to 6.8%. Some of the most economically sensitive areas of the fixed income market fared best as the economy recovered, including high-yield corporate bonds, bank loans, and emerging market debt.
- Sectors with less interest-rate sensitivity—particularly bank loans—generally performed better during the quarter. While US Treasury yields remained broadly flat, the return of economic growth pushed investors to position for a rise in yields, increasing the attractiveness of these sectors. Treasury Inflation-Protected Securities (TIPS) got a boost and outperformed their nominal counterpart as markets priced in normalizing inflation.
- Municipal bonds also fared well during the quarter, outperforming Treasuries as well as the broader Bloomberg Barclays US Aggregate Bond Index. High-yield municipals, with exposure to revenue bonds, fared best as the economic recovery continued. While a fourth stimulus bill remained elusive, investors expect additional stimulus will include some funding for state and local governments, perhaps raising the attractiveness of municipal bonds.
- **Strong quarter but commodities still digging out of their 2020 hole.** The Bloomberg Commodity Index matched stocks with a third quarter gain of 9.1%, supported by firming global growth and a weakening US dollar. Despite the strong quarter, the broad commodity benchmark remained down 12.1% through the first nine months of 2020. Natural gas and silver were standout performers to the upside with gains of more than 30%, while copper also registered a double-digit percentage gain, signaling a potential pickup in global growth. Gold could not repeat its double-digit second quarter gain but did tack on another 5.3% in the third quarter to bring its year-to-date advance to 24.2%. Agriculture, which is trying to reverse a multi-year downtrend, moved solidly higher during the quarter, while crude oil lagged with a gain of only 2.4%.

US Treasuries may be considered "safe haven" investments but do carry some degree of risk including interest rate, credit, and market risk. They are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

Please see our annual *Midyear Outlook 2020* publication for additional descriptions and disclosures.

A LOOK AHEAD

Our 2020 base case forecast calls for a 3–5% contraction in US gross domestic product (GDP), though as the fourth quarter began, the growth appeared to be tracking toward the upper end of our forecast. We expect economies in Europe to contract more than the United States or Japan in 2020, while China's economy has led the way out of the global recession and is expected to deliver modest 2% growth in GDP in 2020, based on the latest Bloomberg consensus forecasts.

Our year-end S&P 500 fair value target range is 3,450–3,500, based on a price-to-earnings ratio (PE) near 21 and our normalized earnings per share (EPS) estimate for the S&P 500 of $165. We believe this level of earnings power is achievable post-pandemic, potentially beginning in mid-2021. We anticipate further gains for this young bull market as the new economic expansion continues. We acknowledge the election is a wildcard, but history tells us election-related volatility tends to be temporary. We see a low probability of renewed widespread lockdowns to contain COVID-19, though the recent increase in cases bears watching.

We expect interest rates to remain at historically low levels, but the direction may be higher over the rest of 2020. Our year-end base-case forecast for the 10-year US Treasury yield is 1–1.5%, which would be the lowest level to end a year on record if realized and may result in little return from bonds over the rest of the year. We expect the Federal Reserve to remain highly accommodative with monetary policy for the foreseeable future.

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2 CONSUMER DISCRETIONARY LED

S&P 500 Sector Performance, Ranked by Third Quarter Returns

Sector	Q3 2020
Consumer Discretionary	15.1%
Materials	13.3%
Industrials	12.5%
Technology	12.0%
Consumer Staples	10.4%
Communication Services	8.9%
S&P 500	8.9%
Utilities	6.1%
Healthcare	5.9%
Financials	4.4%
Real Estate	1.9%
Energy	-19.7%

3 GROWTH LEADERSHIP CONTINUED IN Q3

Domestic and International Asset Class Performance, Ranked by Third Quarter Returns

Asset Class	Q3 2020
Large Growth	13.2%
Emerging Markets	9.7%
Mid Growth	9.4%
Russell 3000	9.2%
S&P 500	8.9%
Small Growth	7.2%
Mid Value	6.4%
Large Value	5.6%
Large Foreign	4.9%
Small Value	2.6%

4 ECONOMICALLY SENSITIVE FIXED INCOME LED IN Q3

Bond Market Performance, Ranked by Third Quarter Returns

Sector	Q3 2020
High-Yield Corporates	4.6%
Foreign Bonds (Unhedged)	4.6%
Preferred Stocks	4.1%
Bank Loans	3.5%
High-Yield Munis	3.1%
TIPS	3.0%
EM Debt	2.3%
Investment-Grade Corporates	1.5%
Munis	1.2%
Foreign Bonds (Hedged)	1.0%
Bloomberg Barclays U.S. Agg	0.6%
U.S. Treasuries	0.2%
MBS	0.1%

Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index so these are not actual results an investor would achieve.

Bond Market Asset Class Indexes: Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Preferred Securities – Merrill Lynch Preferred Stock Hybrid Securities Index; Treasury – Bloomberg Barclays U.S. Treasury Index; Mortgage-Backed Securities – Bloomberg Barclays U.S. MBS Index; Investment-Grade Corporate – Bloomberg Barclays U.S. Corporate Bond Index; Municipal – Bloomberg Barclays Municipal Bond Index; Municipal High-Yield – Bloomberg Barclays Municipal High Yield Index; TIPS – Bloomberg Barclays Treasury Inflation-Protected Securities Index; Bank Loans – Bloomberg Barclays U.S. High Yield Loan Index; High-Yield – Bloomberg Barclays U.S. Corporate High Yield Index; Emerging Market Debt – JP Morgan Emerging Markets Global Index; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged)

Sources: LPL Research, FactSet 09/30/20

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment. Past performance is no guarantee of future results.

The S&P 500 sectors are represented by the 10 S&P 500 Global Industry Classification Standard (GICS) indexes.

The domestic and international asset class sectors are based on the Russell Midcap Growth, Russell 1000 Growth, S&P 500, Russell 3000, MSCI EAFE, Russell 1000 Value, Russell Midcap Value, Russell 2000 Growth, Russell 2000 Value, MSCI Emerging Markets Indexes.

IMPORTANT DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual security. To determine which investment(s) may be appropriate for you, consult your financial professional prior to investing. The economic forecasts set forth in this material may not develop as predicted. All performance referenced is historical and is no guarantee of future results.

All information is believed to be from reliable sources; however, LPL Financial makes no representation as to its completeness or accuracy.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Yield is the income return on an investment. This refers to the interest or dividends received from a security and are usually expressed annually as a percentage based on the investment's cost its current market value or its face value.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

Small cap is a term used to classify companies with a relatively small market capitalization. The definition of small cap can vary, but it is generally a company with a market capitalization of between $300 million and $2 billion. The prices of small cap stocks are generally more volatile than large cap stocks.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

For a list of descriptions of the indexes referenced in this publication, please visit our website at lplresearch.com/definitions.

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