

# RESEARCH REVIEW

OCTOBER 2020



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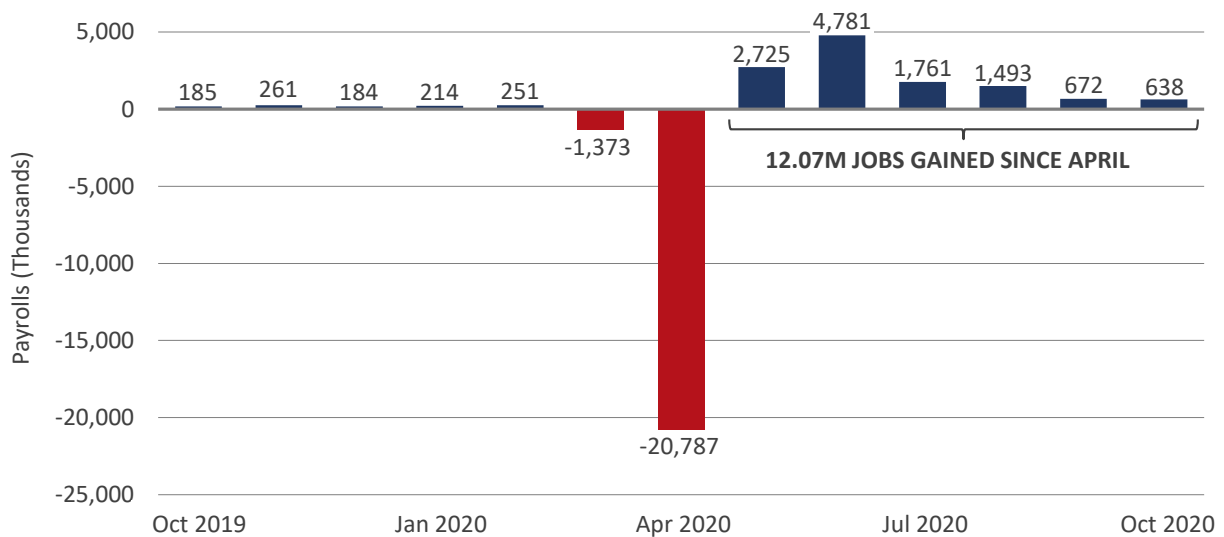
Market performance in October presented investors with increased dispersion; global equities generally posted negative performance—outside of a gain within the emerging markets—and the higher quality sectors of the fixed income market declined amid an increase in interest rates, while credit-oriented sectors eked out positive performance. The performance of real assets was similarly directionless, in aggregate, with REIT performance suffering against a backdrop of rising rates and continued fundamental headwinds, while commodities and global infrastructure posted declines and energy infrastructure sectors experienced gains. The ongoing rebound across the U.S. labor market, among other key areas of the economy, accelerated during the month, as COVID-19 cases increased.

## ECONOMIC UPDATE

### U.S. Labor Market Showing Strong Momentum Through October

The ongoing recovery across the U.S. labor market, a key pillar behind the domestic economic engine, displayed no apparent signs of letting up through October. Nonfarm payrolls, for example, surprised to the upside with a 638,000 print—versus the Bloomberg median consensus estimate of 580,000 jobs—and helped chip away at the more than 20 million jobs lost between March and April.

MONTHLY CHANGE IN NONFARM PAYROLLS

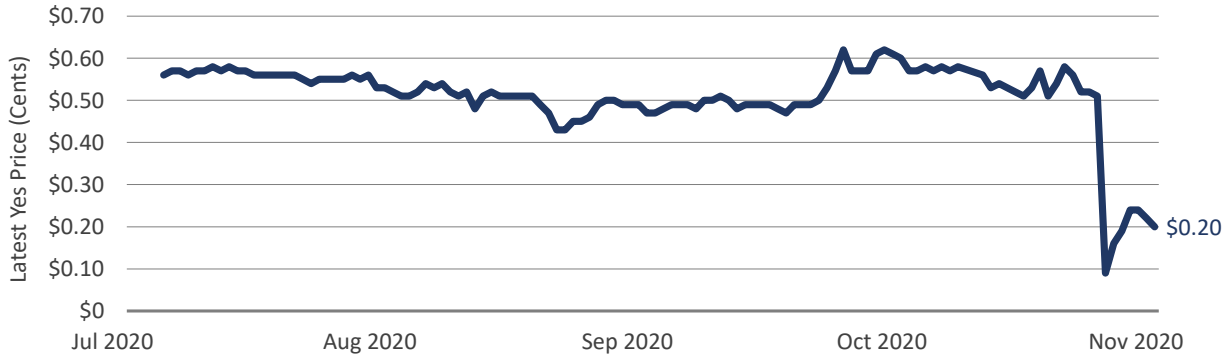


Data sources: BLS, NBER, Bloomberg, L.P., Data as of October 20, 2020

The headline unemployment rate, which surged to 14.7% in April, its highest level since at least 1948, also surprised to the upside, improving to 6.9% versus the sell-side estimate of 7.6%. While the pace of improvement in both payrolls and unemployment is likely to continue to moderate, the momentum behind the ongoing domestic economic recovery appeared strong through October, underscored by a rapidly improving labor situation.

At the time of publication, odds of a “clean sweep” of the White House by Democrats—in which the Democratic party wins a majority in the Senate and House of Representatives, in addition to the presidency—appeared very low, with the odds tilted in favor of the Republicans retaining control of the Senate. The potential for gridlock with a divided Congress and a Democratic president may limit the size and scope of future fiscal stimulus measures, with a change in leadership at the Federal Reserve also likely to present investors with a clouded outlook for the near-term policy path.

**ODDS DEMOCRATS WIN WHITE HOUSE, SENATE, AND HOUSE**

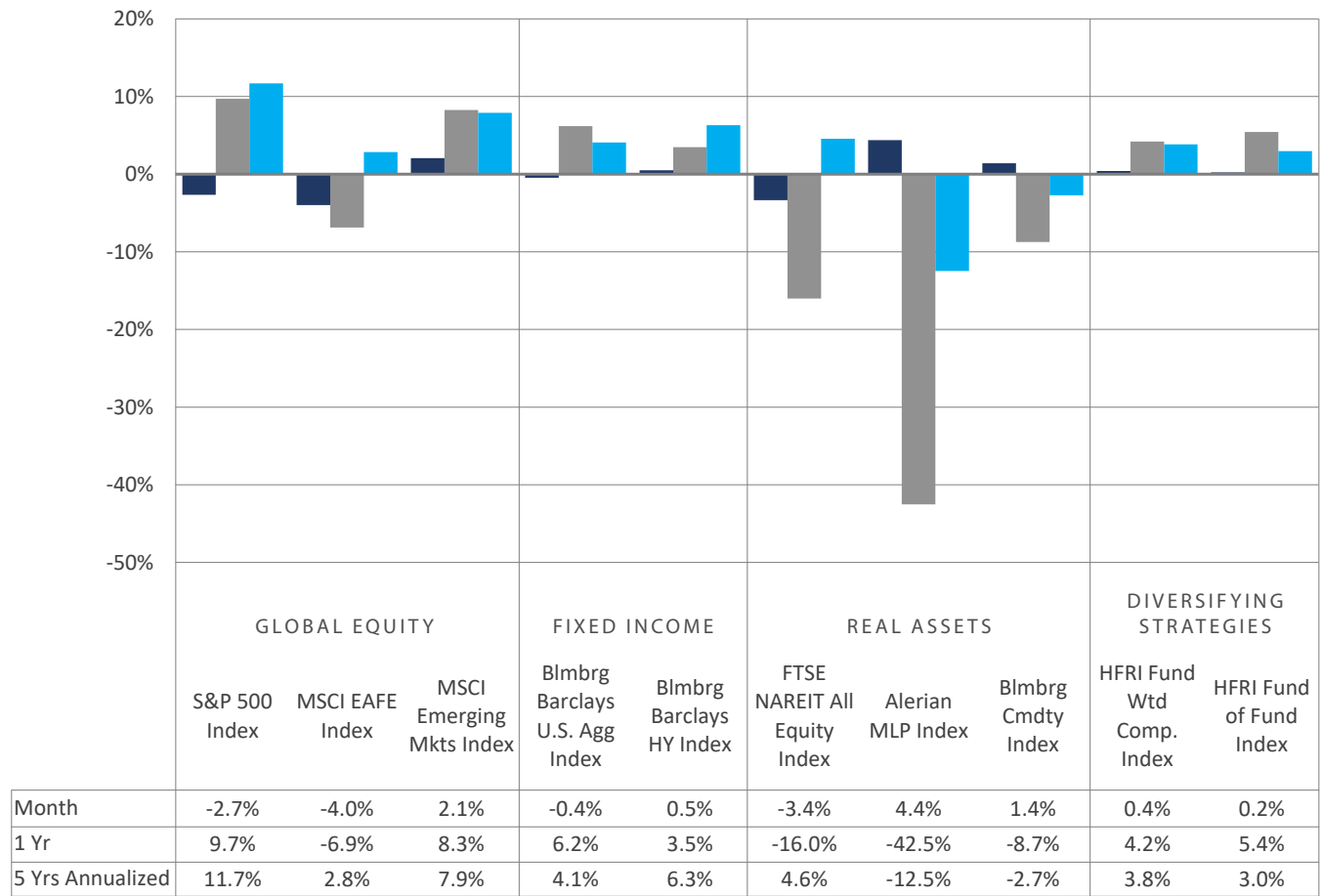


Data sources: predictit.org, Bloomberg, L.P., Data as of November 9, 2020

To summarize, market performance in October was directionless, in aggregate, with generally mixed performance among the largest asset classes. The ongoing recovery across the domestic labor market lost no steam during the month, underpinning the economic recovery that has taken place since March. Looming gridlock in Washington, however, could temper the boost the economy may receive from future stimulus.

**MARKET RETURNS**

**OCTOBER 2020**

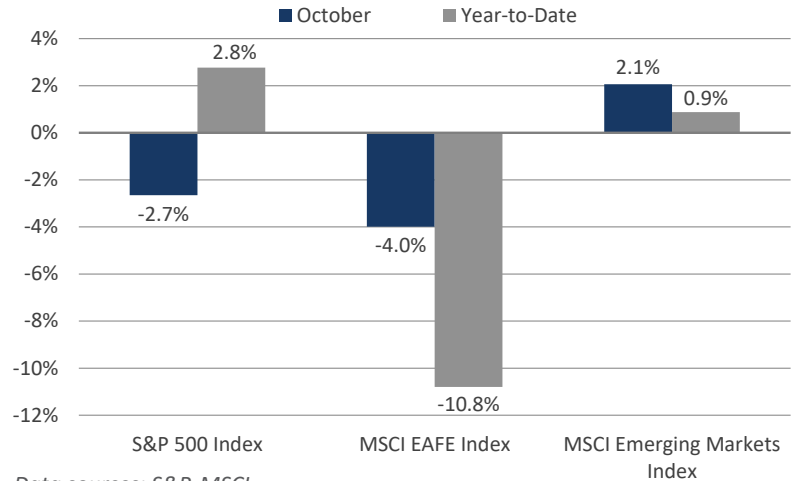


Data sources: Lipper, HedgeFund Research

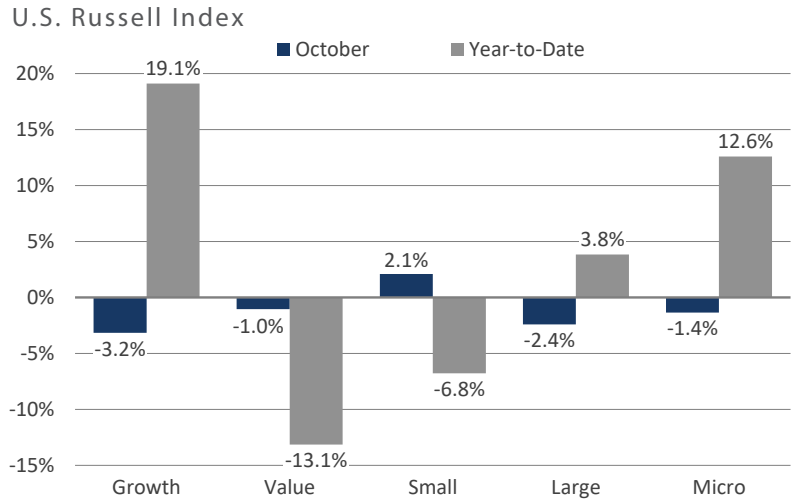
## GLOBAL EQUITY

- Global equity markets struggled in October due to heightened market volatility caused by the U.S. election, an impending additional stimulus package in the U.S., and the resurgence of new COVID-19 cases across the globe. Despite equity markets in the U.S. and Europe rebounding from September’s sell-off during the first half of October, returns were erased in the latter half of the month, due in part to concerns about the pandemic escalating. Europe remained heavily affected by a second wave of the virus and implemented fresh lockdowns, with restrictions at the national level.
- The U.S. economy continued to show signs of recovery during October and was met with an accommodative stance on interest rates from the Federal Reserve; however, the failure of Congress to approve a much-anticipated additional fiscal stimulus package disappointed markets.
- European governments sought national-level restrictions, unlike the tiered lockdowns implemented in the past few months, in the hopes of controlling COVID-19 more effectively. Despite all major economies extending furlough schemes, unemployment in the euro zone increased over the month and consumer sentiment fell, weighing on returns for European equities.
- The UK faced similar challenges as their continental neighbors and imposed national lockdown measures on October 31. Further contributing to negative pressures in the UK, Brexit talks stalled once again, though policymakers indicated that a deal could be reached by the end of the year.
- Japanese equities declined, in spite of continued success in containing COVID-19. The government introduced new domestic incentives to encourage private consumption during the month, and corporate earnings announcements suggested steady recovery as a significant proportion of corporations beat earnings estimates. Across Asia, the approval of new labor market and tax reforms propelled Indonesian equities.

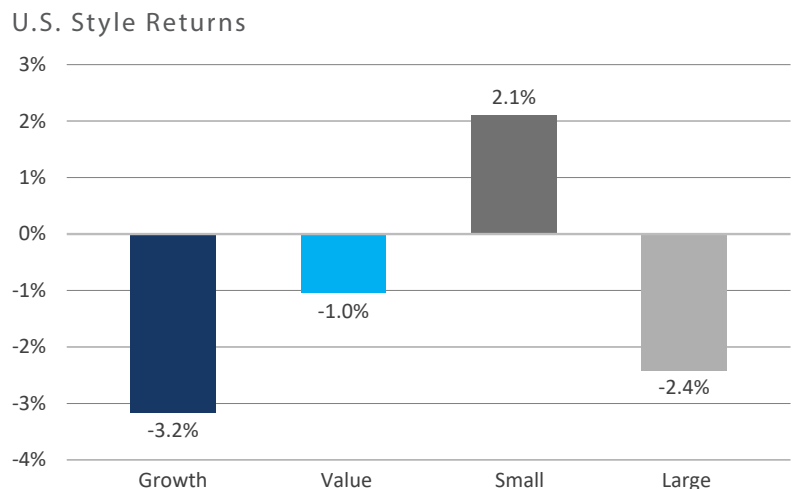
### EMERGING MARKET EQUITIES WERE THE STRONGEST Equity Indices Performance (Returns in U.S. Dollars)



### IN THE U.S., ONLY SMALL CAP POSTED POSITIVE RETURNS DURING OCTOBER



### GROWTH LAGGED VALUE



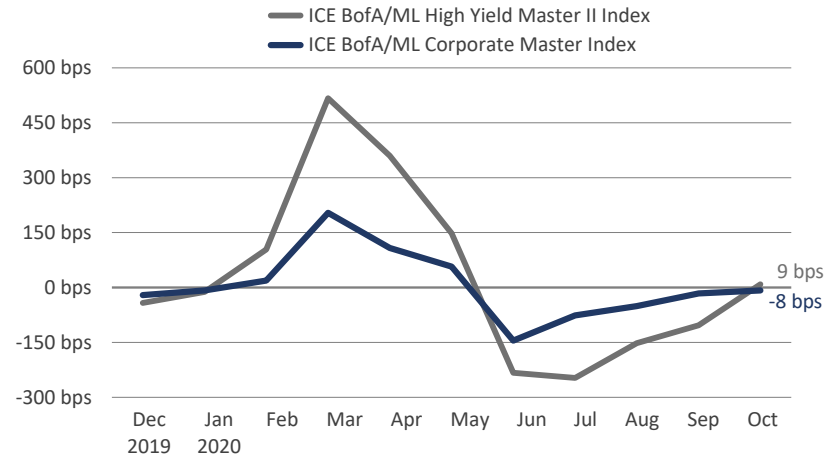
- Emerging markets posted positive returns for the month and outperformed the U.S. and international developed markets. In a reversal of long-term trends, value outperformed growth, while mid cap and small cap stocks outperformed large cap stocks for the second consecutive month.
- Strong positive results from emerging markets were primarily driven by the Philippines, Mexico, and China, all of which outperformed the MSCI Emerging Markets Index. The easing of lockdown restrictions supported strong performance in the Philippines, while the potential for reduced trade tensions between the U.S. and both Mexico and China contributed to returns of those countries. The strong rebound in China’s economy also positions the country for increased GDP growth in aggregate for the year, relative to 2019.

## FIXED INCOME

- The Federal Open Market Committee released the minutes from their September meeting, reiterating the central bank’s view that more fiscal stimulus is needed to preserve the economic recovery. Several members of the committee noted that their economic forecasts included assumptions of additional fiscal stimulus and that the recovery could stall if fiscal support was delayed. With respect to monetary policy, the committee reaffirmed their commitment to a prolonged accommodative stance.
- Bond prices in interest-rate sensitive sectors declined as 10-year Treasury yields rose for the second consecutive month. From a total return standpoint, this impact was exacerbated in sectors with a combination of long duration and low yields, as accrued income was insufficient to offset negative price returns.
- Delinquency rates in commercial mortgage-backed securities (CMBS) declined for the fourth consecutive month. Lodging and retail remained the most distressed sectors and pricing in the subordinated tranches of those CMBS deals overweight to these sectors remains dislocated.

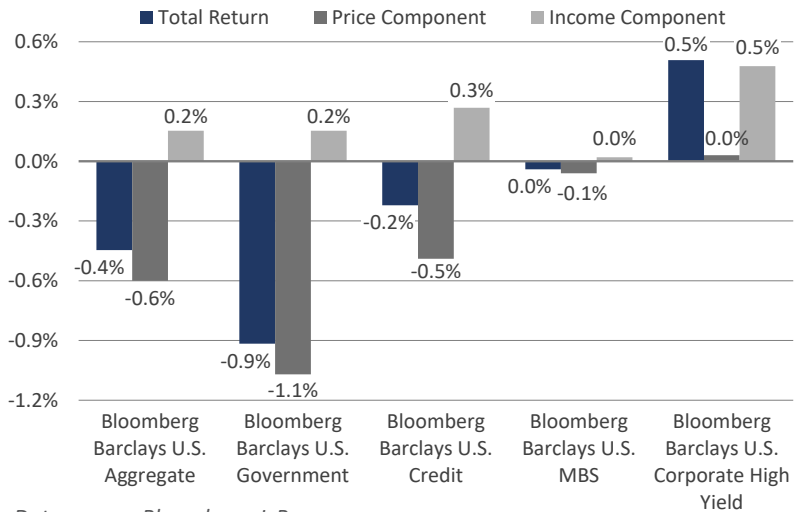
## CORPORATE CREDIT SPREADS HAVE STABILIZED

Rolling Three-Month Change in Option-Adjusted Spreads



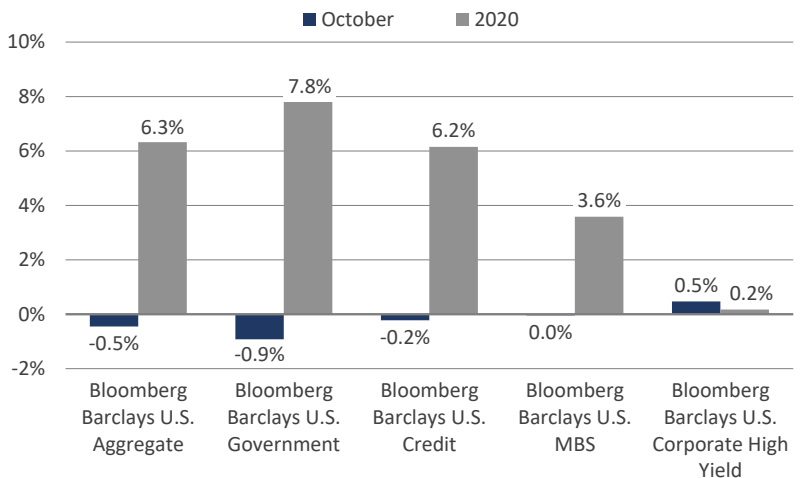
Data source: ICE Indices

## CREDIT-SENSITIVE SECTORS WERE SPARED IN OCTOBER, AS TREASURY YIELDS ROSE



Data source: Bloomberg, L.P.

## INTEREST-RATE SENSITIVE SECTORS LOST GROUND IN OCTOBER, BUT STILL LEAD YTD



Data source: Bloomberg, L.P.

- Corporate credit spreads widened early in the month but subsequently tightened during the latter half of October. Spreads across the ratings spectrum ended the month modestly tighter relative to their levels at the beginning of the month.

## REAL ASSETS

### REAL ESTATE

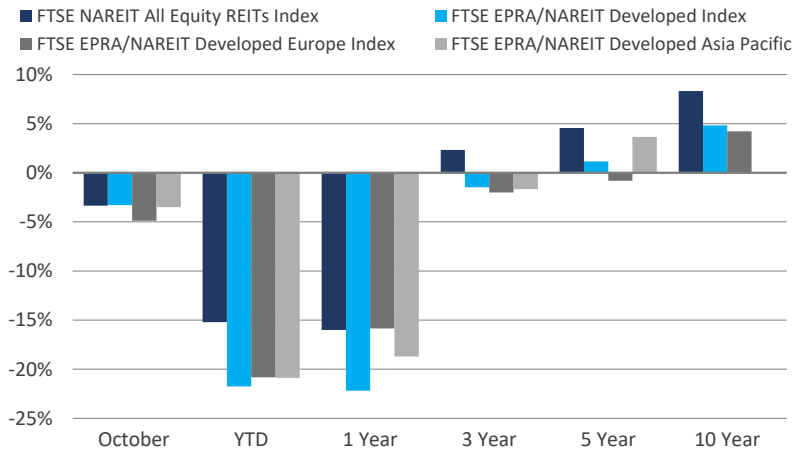
- REIT prices declined across the board in October, driven by continued weak performance in the office, shopping center, and retail sectors, in line with the trend for 2020. As COVID-19 concerns and uncertainty continue to permeate, year-to-date (YTD) performance has been most affected by underperformance in retail, lodging/resorts, and office, while property types supporting the digital economy have tended to perform well.
- As of October 31, regional malls had fallen over 54% and shopping centers were down roughly 48% YTD. Across the U.S., uncertainties persist around the viability of retail properties, which face the possibility of reintroduced shutdowns in the near future.
- Data centers and industrial REIT performance was relatively muted in October. However, YTD the defensive characteristics of these sectors in supporting the growing digital economy have positively affected performance. Self-storage has also benefited from the pandemic, as the shutdown of many activities and events led to the purchase of boats, ATVs, and recreational vehicles.
- U.S. REITs were roughly in line with international REITs in October and have outperformed through most trailing periods.

### NATURAL RESOURCES

- The average daily WTI oil spot price was ~\$39 per barrel in October, holding roughly steady from September's average pricing of ~\$40 per barrel. Average daily spot prices have stayed within a narrow band of about \$38-\$43 since June 2020. Much uncertainty remains in the market, yet peak oil contraction took place in April, when the market fell approximately 20MMBbl/d below pre-COVID-19 levels of 80MMBbl/d.

## REITS REMAIN UNDER PRESSURE

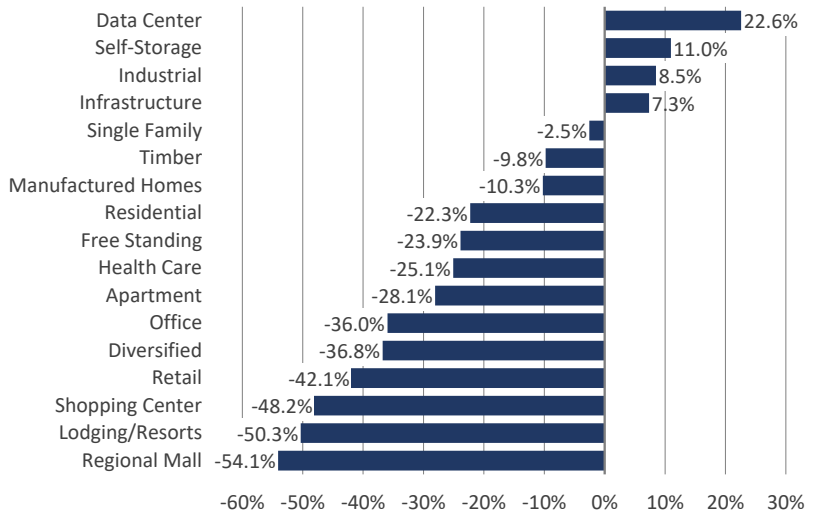
### Public Real Estate Index Trailing Returns



Data source: NAREIT

## RETAIL-RELATED SECTORS DOWN OVER 40% YTD

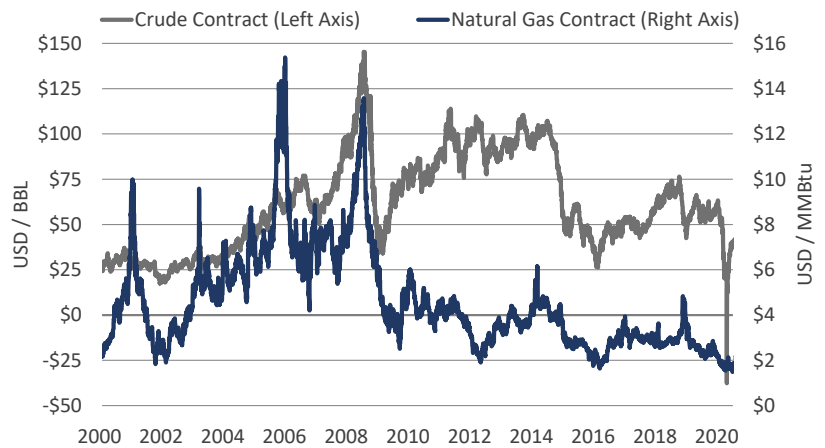
### NAREIT Sector Year-to-Date Performance



Data source: NAREIT

## OIL PRICES STABILIZE NEAR \$40

### Front Month WTI and Natural Gas Contract Price



Data source: Bloomberg, L.P.

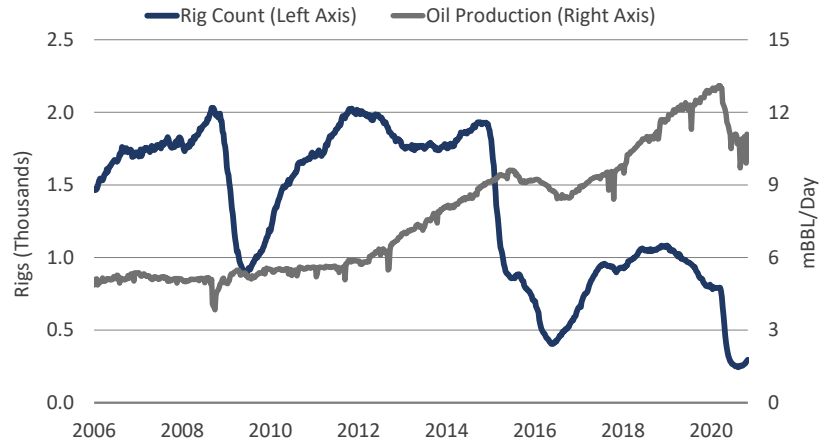
Global demand has since recovered to around 95MMBbl/d, which has helped stabilize prices.

- The U.S. EIA (Energy Information Association) expects falling production to continue to stabilize WTI oil prices into the near future, putting slight upward pressure on both crude and natural gas prices through the end of 2021. The monthly WTI spot prices are expected to remain in the ~\$40/bbl range throughout the remainder of 2020 and move slightly higher to ~\$41/bbl in 2021.
- The natural gas spot price averaged \$2.86 per MMBtu in October, a roughly 25% increase from September. With oil prices holding steady at levels below industry ideals, lower oil drilling and production activity has been a net positive for natural gas prices, as associated gas production has fallen. Similarly, the U.S. EIA forecasts that expenditures for home heating fuels—primarily natural gas—will increase by 6% compared to last winter, which has put upward pressure on pricing.
- According to Baker Hughes, the current U.S. rig count at the end of October stood at 296, up approximately 13% from the end of September and down roughly 63% from the beginning of the year. It is estimated that fewer than 11,000 wells will be drilled in 2020. From a historical perspective, this would be the lowest total of new wells drilled in the U.S. in over 100 years.
- Commodity prices, as measured by the Bloomberg Commodity Index (BCOM), were roughly flat month-over-month; however, the index has returned roughly 18% since hitting its low in April.

**MASTER LIMITED PARTNERSHIPS (MLPs)**

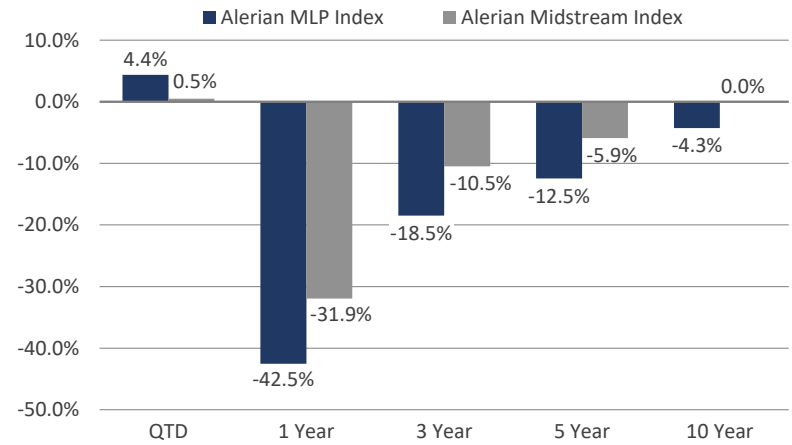
- MLPs, as measured by the Alerian MLP Total Return Index, were roughly flat in October compared to September. Performance for the index has been volatile throughout 2020, with a 47.6% return in the second quarter and a -16% return for the third quarter.
- Midstream—more broadly Alerian Midstream Energy Index (AMNA)—was also relatively flat for the month. Strength from large corporations in the U.S. and Canada has helped buoy the AMNA past the MLP index on a YTD basis.

**RIG COUNT AND PRODUCTION SHOW STABILIZATION**  
U.S. Rig Count and Daily Oil Production



Data source: Baker Hughes

**ENERGY INFRASTRUCTURE HAS A POSITIVE MONTH**  
Midstream Index Trailing Returns



Data source: Alerian

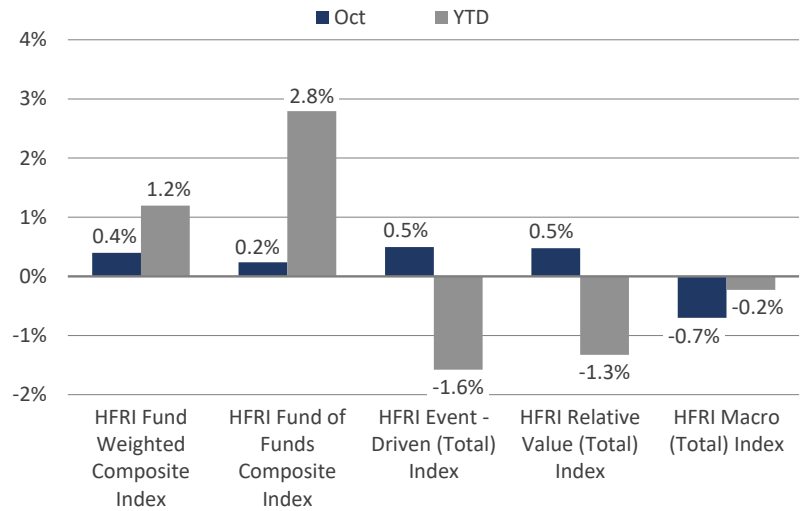
- The current yield on MLPs stands at 14.7% as of the end of September. In contrast to the prior midstream business model, emphasizing a growth-at-any-cost mentality in both capital expenditures and dividends, midstream has been shifting to a more sustainable model that is less capital market dependent, which could alter distributions moving forward.

## DIVERSIFYING STRATEGIES

- Broad hedge fund performance bounced back in October after a weak September. Outside of global macro, all major strategies produced modest returns. Equity hedge led all strategies, with exposure to the healthcare sector contributing substantially.
- The robust performance of convertible arbitrage strategies continued in October. Record issuance and attractive valuations led to additional gains for the highly cyclical strategy. The broad index rose by over 1.1%.
- Systematic macro strategies generated mixed performance during the month. Losses were concentrated in long-term trend following exposure to long equities. Short-term systematic and value tilts also resulted in negative performance.

### HEDGE FUNDS POST GAINS

HFRI Indices Performance Returns



Data source: HedgeFund Research



## INDICES

The Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships that provides investors with an unbiased, comprehensive benchmark for this emerging asset class.

Barclays Capital Fixed Income Indices is an index family comprised of the Barclays Capital Aggregate Index, Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index, Municipal Index, High-Yield Index, and others designed to represent the broad fixed income markets and sectors within constraints of maturity and minimum outstanding par value. See <https://ecommerce.barcap.com/indices/index.dxml> for more information.

The CBOE Volatility Index (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index. FTSE Real Estate Indices (NAREIT Index and EPRA/NAREIT Index) includes only those companies that meet minimum size, liquidity and free float criteria as set forth by FTSE and is meant as a broad representation of publicly traded real estate securities. Relevant real estate activities are defined as the ownership, disposal, and development of income-producing real estate. See [www.ftse.com/Indices](http://www.ftse.com/Indices) for more information.

HFRI Monthly Indices (HFRI) are equally weighted performance indexes, compiled by Hedge Fund Research Inc. (HFX), and are used by numerous hedge fund managers as a benchmark for their own hedge funds. The HFRI are broken down into 37 different categories by strategy, including the HFRI Fund Weighted Composite, which accounts for over 2000 funds listed on the internal HFR Database. The HFRI Fund of Funds Composite Index is an equal weighted, net of fee, index composed of approximately 800 fund-of-funds which report to HFR. See [www.hedgefundresearch.com](http://www.hedgefundresearch.com) for more information on index construction.

J.P. Morgan's Global Index Research group produces proprietary index products that track emerging markets, government debt, and corporate debt asset classes. Some of these indices include the JPMorgan Emerging Market Bond Plus Index, JPMorgan Emerging Market Local Plus Index, JPMorgan Global Bond Non-U.S. Index and JPMorgan Global Bond Non-U.S. Index. See [www.jpmorgan.com](http://www.jpmorgan.com) for more information.

Merrill Lynch high yield indices measure the performance of securities that pay interest in cash and have a credit rating of below investment grade. Merrill Lynch uses a composite of Fitch Ratings, Moody's and Standard and Poor's credit ratings in selecting bonds for these indices. These ratings measure the risk that the bond issuer will fail to pay interest or to repay principal in full. See [www.ml.com](http://www.ml.com) for more information.

Morgan Stanley Capital International – MSCI is a series of indices constructed by Morgan Stanley to help institutional investors benchmark their returns. There are a wide range of indices created by Morgan Stanley covering a multitude of developed and emerging economies and economic sectors. See [www.morganstanley.com](http://www.morganstanley.com) for more information.

The FTSE Nareit All Equity REITs Index is a free-float adjusted, market capitalization-weighted index of U.S. equity REITs.

Russell Investments rank U.S. common stocks from largest to smallest market capitalization at each annual reconstitution period (May 31). The primary Russell Indices are defined as follows: 1) the top 3,000 stocks become the Russell 3000 Index, 2) the largest 1,000 stocks become the Russell 1000 Index, 3) the smallest 800 stocks in the Russell 1000 Index become the Russell Midcap index, 4) the next 2,000 stocks become the Russell 2000 Index, 5) the smallest 1,000 in the Russell 2000 Index plus the next smallest 1,000 comprise the Russell Microcap Index, and 6) U.S. Equity REITs comprise the FTSE Nareit All Equity REIT Index. See [www.russell.com](http://www.russell.com) for more information.

S&P 500 Index consists of 500 stocks chosen for market size, liquidity and industry group representation, among other factors by the S&P Index Committee, which is a team of analysts and economists at Standard and Poor's. The S&P 500 is a market-value weighted index, which means each stock's weight in the index is proportionate to its market value and is designed to be a leading indicator of U.S. equities, and meant to reflect the risk/return characteristics of the large cap universe. See [www.standardandpoors.com](http://www.standardandpoors.com) for more information.

Information on any indices mentioned can be obtained either through your consultant or by written request to [information@feg.com](mailto:information@feg.com)

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All data is as of October 31, 2020 unless otherwise noted.

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Research and Investments Team as of date of publication.