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Is the glass half-empty or half-full? The major American stock indices recorded their strongest August in 34 years, capping the best five-month run since 1938. September, however, was a risk-off month, as the American dollar had its first up-month since the March lows and virtually all asset classes ended in the red, except for government bonds which eked out small gains. The sectors that had been the strongest performers were hit the most, led by silver, which had its worst month since 2011, and the NASDAQ, which suffered a 12% correction. Still, notwithstanding September's weakness, it was a decent quarter for financial assets, albeit not as impressive as the second quarter, as 28 out of 38 core non-currency assets rose, compared to all 38 in the previous three months. Furthermore, as an indication of how well certain risky sectors have done, silver, despite being the worst performer in September, remained head and shoulders above all other contenders on a quarterly and year-to-date basis and the NASDAQ, despite its September weakness, is still up an astounding 63% from its March low.

So, was September just a well-deserved breather after a historic run or is it a harbinger of things to come? One way to shed some light on this question is to ask another question. Has the rise in equity markets since March been another leg up in the long cyclical uptrend since 2009, which would imply that the March sell-off in financial markets was just a correction, albeit a particularly nasty one, or are we a mere six months into a new cyclical advance in stock prices? While the question may seem pedantic and the answer obvious, it really is not. Over the past six months, U.S. stock prices rose by 30%. A gain of 30% or more in a six-month period has only happened eleven times in the past 100 years. Typically, it has occurred in the early stages of an advance from deeply oversold conditions and in the midst of an economic downturn (e.g. the early 1930s, 1975, 1983, and 2009). In some respects, 2020 would seem to fit the profile. The decline in the Dow Jones Industrials in 2020 was the ninth biggest of all time and it happened in the context of the biggest decline in real GDP since the 1940s. This suggests we are in a new cycle and one with room to run from a policy standpoint since governments seem happy to spend and central bankers have publicly pushed any monetary tightening far into the future. On the other hand, the stock market decline lasted only one month, which would make it the shortest bear market in history, and the eight bigger declines all lasted more than a year. Similarly, the downturn in business, linked to the pandemic, was also truncated compared to the average recession which has lasted the better part of a year. Then, too, a new cycle is usually characterized by new themes and new leadership; whereas, in the current cycle, the coronavirus downturn caused a huge acceleration in trends already in place towards technology stocks in general and the so-called FANMAG stocks in particular. The resulting valuation and other extremes in this area of the market are more consistent with the end of an old cycle than the beginning of a new one. Similarly, the many signs of speculation in the markets are typical end-of-cycle phenomena as opposed to the caution and skepticism that are normally evident in the early stages of a new cycle.

There have been two narratives that people have been using to guide them through the coronavirus era. The first was dubbed by us six months ago as “The Good, the Bad and the Ugly”. The basic idea was that we were going through a tough time (the ugly), that we would inevitably recover to whatever the new normal is going to look like (the good), but that we would be left to face the consequences of the pandemic, including, in particular, the amount of debt being incurred (the bad). The second narrative has been that “we are all in this together”. These notions were useful six months ago. They provided a sense of hope and solidarity and they were to some extent true. The entire world was hit with a pandemic - one million dead worldwide, over 200,000 in the U.S. (which the Economist Magazine judges likely to be huge undercounts. They estimate two million and 300,000 respectively). In an effort to stop the spread of the coronavirus, governments imposed a series of lockdowns that temporarily brought the world economy to its knees. In turn, in an effort to offset the lockdowns, central banks around the world injected an estimated $9 trillion of liquidity into the world financial markets even as governments undertook unprecedented borrowing and spending.

In the United States, most Americans who were receiving $600 additional weekly federal unemployment benefits under the emergency "Cares Act" ended up with more take home pay than when they were working. As the economist, David Rosenberg, notes, "The fiscal and monetary pump-priming this year has more than doubled the actual economic loss from the pandemic. If not for the gobs of fiscal stimulus, real GDP would have contracted at a 10% annual rate in the third quarter as opposed to the +30% (expectation)". Initially, the impact of all this liquidity was felt in the financial markets and, as the lockdown restrictions were lifted and people went back to work, the real economy followed. While the expected transition from "the ugly" to "the good" was, if anything, smoother than expected in the markets, events in the real economy have been more complex. Given the deep hole in the second quarter, gigantic positive economic numbers were inevitable once the economy reopened. However, as the number of coronavirus cases have reaccelerated, as government benefits expire, as the impact of monetary easing wanes, and as many of the "temporary" losses during the pandemic become permanent, the economic recovery seems to be losing momentum. This is especially evident in the labour markets. Despite a big bounce off the lows, the proportion of the U.S. population working is only back to where it was in 1976. A big drop in the labour force without a good reason is unusual, yet 700,000 Americans dropped out in September. Total hours worked in the U.S. in September were 7.6% less than a year earlier. This may not sound dramatic, but the September number was worse than any monthly number except one during the 2008-2009 Great Recession. So, the notion of a more or less linear move from ugly to good to bad no longer appears so helpful.

In addition, if the coronavirus has shown us one thing, it is that we are not, in fact, all in this together. Take where you live, even within countries - Vermont versus Arizona in the U.S., the Maritimes versus Quebec in Canada. Different outcomes. Then there are countries. Some, like Taiwan and China, have handled the coronavirus well. Indeed, China will likely be the only major country to register growth in 2020, albeit 1%, which, by Chinese standards, is a major hit. Others have not handled it well at all. Over 50% of all COVID-19 cases are concentrated in the U.S., Brazil, and India. Of course, they have big populations, but, even relative to population, Brazil and the U.S. are in the top five. In first place is the U.K., where, to this day, the proportion of the population wearing masks is well below the rest of the world. It is not surprising that Trump, Johnson, and Bolsonaro, leaders of three countries that have mishandled the coronavirus, should have contracted it themselves. Dealing with the coronavirus medically is one thing, responding to the economic fallout fiscally is another. The economies of countries whose fiscal stimulus has been more aggressive (e.g. the U.S., Japan, and Germany) have tended to hold up better than average. Furthermore, different countries have a different exposure to industries that are especially hard-hit by the pandemic. For example, tourism is extremely important to Spain's economy, but relatively unimportant to Canada; on the other hand, the oil and gas industry is important to Canada, but not to Spain. Finally, in advanced economies, on average 40% of the jobs can be done from home, compared to less than 30% in emerging markets. Putting all these factors together, some countries, like Taiwan, have come through relatively well; others, for example, India, which will suffer its first annual decline in real GDP in 40 years, not so much.

Then there are a host of factors such as race, gender, age, education, social-economic status, and type of work that have had a huge impact on how groups and individuals have fared during the pandemic. Minorities in the United States and no doubt elsewhere have suffered doubly, both from a health point of view and economically; for example, 60% of whites who were unemployed have their jobs back in the U.S. compared to 34% of blacks. That the protests for racial equality in the U.S. are occurring during the pandemic is probably more than coincidental. Women, too, have suffered a double shock. Occupations where women are disproportionately represented have been relatively hard hit and, at the same time, women have shouldered more responsibility for the challenges to family, health, and school closures. Dads of school age children in the U.S. have recouped 70% of their job losses compared to 45% of Moms. Older people, of course, have borne the brunt of the health risk, but younger people have been disproportionately hit economically. More than 50% of 18-29-year-olds in the U.S, higher than during the Great Depression, and continuing an uptrend from 60 years ago when the percentage was less than 30%, are living with their parents. Then there is the importance of income. In the past three recessions, job losses for the top 25% of income earners and the bottom 25% were not that different. In the current period, low wage earners have been hit eight times harder than high wage earners. For many Americans, primarily those at the top of the economic heap, the recession is over if they even felt it; for many others, it feels more like a depression. More than 40% of Americans have had someone in their household lose a job or wages because of Covid and 10% of American adults say that their household sometimes or often does not have enough to eat.

One big common denominator between those doing well and those not doing well is the type of business they are in. Covid has been a huge plus for the technology sector in general and especially companies helping employees work remotely. On the other hand, retail companies are going bankrupt at the fastest pace on record. Airline flights are down by two-thirds. The Airbnb occupancy rate of 20% is scarcely off its lows and is down 50% from February. Bars, gyms, beauty salons, restaurants, and similar establishments are suffering. In an effort to survive the pandemic, restaurants have increased their debt from 25% of assets to 75%. Oil companies show massive and historic asset impairments. Offices, which represent about 40% of commercial structures, obviously face an uncertain future.

In one respect, the notion that we are not all in the same boat is also reflected in equity markets. Large capitalization U.S. growth stocks, primarily technology, and especially the FANMAG stocks or the Awesome 8 (adding in Nvidia and Tesla), have destroyed all pretenders to the performance throne. The six FANMAG stocks have a market capitalization greater than the financial, energy, industrial, and material sectors combined and trade at a price-to-earnings ratio of 44, triple the historic P/E rate for the market as a whole, and a price-to-sales ratio of 7.6 or seven times the historic norm for the market. Ten stocks account for 18% of the world market index, breaking the old record of 17% set in 2000. An index of growth stocks in the U.S. outperformed an index of value stocks by 35% in the first nine months this year, far eclipsing the second-best start for growth of 20% in 1934. Indeed, value stocks have clocked in with their worst ten-year run in history. Of course, two big value sectors are energy and financials and both have been crushed on a relative basis. Shares of energy giant British Petroleum recently closed at their lowest level in 25 years and most of the world's systemically important banks trade at prices below their book value. The U.K. market, with the highest concentration in financials and energy, has underperformed European stocks in general, which have a lesser concentration in energy and financials, and European stocks in turn have underperformed U.S. stocks, which have the least. Of course, this is not the only reason behind the outperformance of U.S. assets. Then there's size. The biggest ten companies in the S&P 500 at the end of the 2nd quarter traded at 33 times free cash flow compared to ten times for the smallest 50 companies. The big 10 companies, meanwhile, had returned 9.5% year-to-date, while the small 50 companies were off by a staggering 38.5%.

Everywhere you look - huge disparities. Some big winners, but also many losers. Not that these trends are new. For example, from 1979 - 2017 in the U.S., the earnings of the top 0.1% grew 15 times faster than the bottom 90%. The world and the markets are ripe for reversion to the mean; but what could cause it? Covid instead has accentuated everything. An inflationary boom would perhaps do the trick, but what are the odds? Even slower growth and low inflation looks more likely at the moment. Perhaps a bold, big-spending Biden fully embracing Modern Monetary Theory?