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ECONOMIC OUTLOOK

Summary

As anticipated, GDP growth in the third quarter registered its highest reading (33.1%) since the government started providing the data on a quarterly basis back in 1947. This record increase was only made possible by a rebound in economic activity from the stunted growth (-31.4%) experienced during the second quarter amid the pandemic related lockdowns. Although the increase for the third quarter was numerically higher than the decrease in the second quarter, it's important to note that because of the different starting values the actual dollar value remains lower. GDP is down 2.9%, compared to a year ago, and 3.5% below its pre-pandemic peak level earlier this year.

The bulk of the growth this quarter came from consumer spending, which contributed 25.3% to GDP, its highest levels since WWII. This was split between both goods (9.3%) and services (16.0%). In fact, it's likely that the main detractor from GDP, net exports (-3.09%), was only negative because of surging U.S. consumer demand. With a weaker recovery outside of the U.S., it appears that there was not enough international demand for our exports to offset the robust increase in imports.

What does this mean? For starters, in order to get back to peak GDP levels, we still need a fourth quarter growth rate of at least 15.1%. This is an unlikely outcome as many restaurants, bars, gyms and other close-contact businesses are still not fully participating in the recovery. We are only one month into the quarter but the most current estimate from the Federal Reserve Bank of Atlanta (via GDPNow) is targeting 3.4% growth. Even so, the post-lockdown economy seems to have found solid footing, even without full participation. Absent any future

lockdowns, the worst appears to be behind us, though the massive third quarter increase suggests future growth is likely to be much more modest.

Of course that doesn't mean the economic growth can't continue. The amount of individuals continuing to receive unemployment benefits has been steadily decreasing but there are still nearly eight million people without jobs. As those individuals are able to find or return to work, they will also be able to contribute to our future economic growth.

Positives

Continuing unemployment claims have declined from a high of about 25MM, to currently 7.7MM

Retail sales have remained in positive territory for the past five months

The trade deficit narrowed for the first time in three months (although remains significantly negative)

Negatives

GDP is still 3.5% below its peak level

Initial unemployment claims still regularly tally more than 700,000 per week (well in excess of pre-pandemic levels)

The U.S. had a \$3.1 trillion budget deficit for fiscal year 2020

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EQUITY OUTLOOK

Summary

Equity market performance was a mixed bag in October highlighting the uncertainty headed into a heated election. Large U.S. indexes were generally lower with the S&P 500 down 2.7% for the month. The Russell 1000 Growth Index fell 3.4% while the Russell 1000 Value Index declined 1.3%.

Indexes of large U.S. companies had been outperforming their small company peers year-to-date but the month saw a reversal of that trend. The Russell Midcap Index rose 0.6% and the Russell 2000 Index (small cap) climbed 2.1%.

The performance of international markets offered no particular trend or insight. The developed MSCI EAFE Index fell 4.0% in October. Over the same period, the MSCI Emerging Markets Index gained 2.1%.

From a sector standpoint, the relative performance was mixed. The best performing sectors were utilities up 5.0% and communication services returning 0.8%. The worst two performing sectors were information technology which declined 5.1% and energy which dropped 4.4%.

While complete results are still somewhat unknown, the conclusion of the election should ultimately bring some relief to equity markets and investor sentiment. It has been a challengingly partisan cycle that we will appreciate having in the rearview mirror. As we have stated in past writings,

corporate America is very flexible and can adapt to just about any tax or regulatory environment. It is for that reason, in part, we continue to believe stocks are in a favorable position relative to other asset classes over the intermediate and longer-term time periods. A divided government, which seems likely, may limit policy change and create a fertile backdrop for equity markets moving forward.

Positives

Health care and pharmaceutical industries continue to make medical breakthroughs concerning COVID-19 treatments and vaccines

Many retail investors have been on the sidelines throughout the rally – the pain trade is higher

Accommodative Federal Reserve and global central bank policy

Negatives

Stock valuations, by some traditional measures, look relatively stretched

COVID-19 cases are rising in Europe and several U.S. states

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FIXED INCOME OUTLOOK

Summary

The yield curve steepened in October as election polling increased the likelihood of a “blue wave”, where control of the senate is turned over to the Democrats along with the presidency. The prevailing thought was that a larger aid package will be approved with unobstructed control of the government purse strings. A bigger stimulus package will further increase the budget deficit and require funding in the Treasury market. The 10-year Treasury yield increased 19 basis points (bps) to end the month at 0.87%. While far from a route for bond holders, this was very near the high yields seen in early June which were the highest in the past six months.

With the Fed’s overnight lending rate anchored for years to come, the 2-year Treasury yield increased by a mere 2 bps to end the month at 0.15%. The rate stayed comfortably near the middle of the fed funds target range of 0.00% to 0.25%. Overall, Treasury notes delivered a negative return of 94 bps for the month, with intermediate maturity (1 year to 10 year) returns declining by 38 bps. Credit spreads dropped by 12 bps before bouncing twice off the same 122 bps bottom seen in August and September. Investment-grade corporate bonds performed better than Treasury debt as credit spreads ended at about 127 bps. While the full maturity spectrum of corporate bonds declined 18 bps for the month, intermediate maturity (1 year to 10 year) corporates actually had a positive return of +0.04%. With a steeper yield curve, financial company debt performed better than industrial company bonds which were also hurt by declining oil prices.

We have been of the belief that longer-term yields could increase as the economic recovery continues, another stimulus bill is passed and the development of a successful vaccine approaches. With the fed funds anchored for years to come and inflation failing to rise to the Fed’s long-term

target, we also believe that increases in longer maturity yields will be limited. The 10-year yield has found and should continue to find buyers in the area of 0.90%. As uncertainty subsides and a vaccine comes to fruition, we could see that rate increase to slightly more than 1% in the early months of 2021. The Fed remains committed to the efficient flow of credit to households and corporations. As such, we expect their open market purchases to continue at the current rate of \$120 billion per month and their emergency lending programs to be extended into next year as well. Corporate bond credit spreads could decline further in this environment leading to their continued outperformance of Treasury debt.

Positives

Years of ZIRP (Zero interest rate policy)

Elevated equity prices could lead to rebalancing and bond purchases

Negatives

Additional aid/stimulus package will need to be financed

Treasury bond yields are less than the targeted inflation rate

Unknowns

Incremental waves of the coronavirus may lead to another lockdown

Election litigation challenges