

# Chat with the CIO: Implications of the Race to the White House



*In this quarter's Chat with the CIO, Eric P. Leve and Frank Marcoux, Senior Vice President, work to navigate the rocky path leading to November's elections with a focus on the potential investment implications.*

## Inside this Edition:

- 1 Chat with the CIO: Implications of the Race to the White House
- 4 Contactless Payments: The Catalyst has Arrived
- 6 The Continuing Evolution of SRI and ESG Investment Processes
- 8 Tech: A Crucial Ingredient for Economic Change
- 10 Closing Brief: Bailard's View on the Economy

**Eric P. Leve, CFA:** First off, shall we agree to keep this to the topics that best serve investors and concentrate on the *implications* of the pandemic and the upcoming election on the markets and the economy, rather than the politics?

**Frank Marcoux, CFA:** You bet. While presidents can lead the way on many areas of policy, the economy and the markets tend to work in a much broader ecosystem. And, in fact, the last 50 years have been markedly different than those before. Prior to WWII, ownership of the White House and both houses of Congress was the norm, paving the way for major legislative action like trust-busting, the pro-business 1920s, New Deal, Eisenhower infrastructure, New Frontier, and the Great Society. Now, a cohesive government is more the exception than the rule. This is particularly true over the last 20 years, where the narrower majorities in both houses have meant more gridlock.

**Eric:** But the data I've seen show that the markets are mostly indifferent to politics. The presidency has been largely shared by parties over the past 120 years. Democrats and Republicans have had 56 and 64 years in office, respectively, and it's been pretty even. Stock market returns under Democrats have been slightly better than under Republicans, but not by leaps and bounds. And the U.S. is different than most every other country... our presidents must contend with the broad powers afforded to the

states as well as the authorities of Congress and the Supreme Court.

And yet, there's been a dangerous evolution under presidents Obama and Trump to expand the use of executive orders, increasing presidential power, and—in some cases—rapidly-changing federal policy. Even though Republicans have traditionally exhibited a tighter hold on the purse strings than the Democrats, COVID changed that dynamic dramatically. These inflated spending rates are likely to continue under either political party until the economy gains firmer footing, and possibly until we have a safe, reliable vaccine and/or the mortality rate due to the virus accelerates its decline.

**Frank:** The real concern I see here is the potential for market volatility related to the election process itself. Both parties have made claims that could lead their supporters to question the election's outcome and COVID has created an incredibly-distorted dynamic. Irrespective of the eventual result, this could lead a candidate to prematurely declare victory on election night, beginning a process akin to—but likely worse than—2000. The problem is exacerbated by the variety of voting procedures across the country and the long-term underfunding that has made the U.S. Postal Service potentially ill-prepared for such a test. This may prove a greater test than the 2000 election when the Supreme Court's decision led to Al Gore's concession and resolution by the meeting of the Electoral College. In a worst-case scenario, resolution this time could extend into the new year.

**Eric:** There is nothing straightforward about the current situation within our borders. And, unfortunately, our position as a global leader is in flux as well. The dominance of the U.S. appears to be waning after 70 years.

The international system abhors vacuums and, if the U.S. continues to meaningfully withdraw from three crucial regions—including the Middle East, Europe, and East Asia—those vacuums will be filled by other players. The most likely entrants are China, Russia, and Europe; of these, only Europe is likely to play a constructive role in the international order.

**Frank:** Eric, are you suggesting that the U.S. will lose its role as global hegemon?

**Eric:** No, just that our influence might shrink around the edges. Engagement with global and regional partners like NATO and the World Health Organization is critical. Over the past several years we have seen central banks across the globe increasingly hold more euros, gold, and even the Chinese renminbi as part of their reserves. This will likely be a negative for the U.S. dollar at the margin, but most of the world's trade and financial transactions still remain dollar-denominated.

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**Frank:** Fair enough. So, let's turn to the effect on the economy. In February, the economy was already losing steam after enjoying the longest recovery in U.S. history. Unemployment was at unprecedented lows but jobs gains were weakening. Additionally, economic growth was becoming more unevenly distributed with highest growth in the Far West, Rocky Mountain, and Southwest states while the Plains and the Great Lakes regions lagged.

**Eric:** And then, as we all know now, the COVID crisis provoked one of the largest fiscal responses in history. The CARES Act enacted in late March, and the unemployment benefits from its Paycheck Protection Program, supported consumer spending through the summer. Yet, those programs have been expiring. Fulsome and appropriate follow-up measures are of grave importance not only to the economy but our citizens. Lives are truly at stake.

Going back to my earlier comment about spending and fiscal stimulus, by May, the ratio of federal debt to our country's Gross Domestic Product (GDP) had nearly reached post-WWII levels. Now, current projections show that the continued coronavirus spending, dwindling GDP, and shrinking tax-revenues will cause the federal debt held by the public to exceed 100% of GDP in the next fiscal year.

**Frank:** Interestingly, it's the government's monetary policies that have contributed positively. The Federal programs to purchase Treasuries, mortgage-backed

securities, and corporate bonds were announced on March 23rd. While the announcement occurred several days before the passage of the CARES Act, it convinced investors that the Federal Reserve (the Fed) was going to keep interest rates low for a long time, bolstering stock valuations.

**Eric:** Even though some investors are still sidelining their cash, those in search of yield are finding that stocks have continued to be compelling compared to bonds. Dividend yields from stocks have remained stable, while bond yields have exhibited a secular decline. U.S. stocks' dividends offer more income relative to bonds than at any time since 1958. Following on the same theme, economic uncertainty and low real interest rates may provide a tailwind for gold.

**Frank:** Thinking further on the markets, I'd expect that a post-COVID world means a tepid, long-term recovery along with a number of new challenges and investors must be prepared to reexamine their assumptions. Large cap stocks have generally become the "safety trade," but there is a credible case that Tech and Health Care may be leaders for the long-run. Furthermore, small cap U.S. stocks are in the cheapest decile compared to large cap over past 20 years. While no one knows how or when the pricing on small and large caps will converge, I believe exposure to smaller cap stocks should be a positive.

**Eric:** And, a similar statement can be made about international stocks. Based on any of the major indicators, whether it's trailing earnings, forward earnings, or book value, international companies are also in the cheapest decile over the past 20 years.

So, let's bring these trains of thought together Frank, and highlight some of the investment themes. From elections to the markets and the economy, what can we expect based on the campaign rhetoric?

**Frank:** While there are certainly some major differences, there are several sectors that may benefit regardless of the eventual winner. One area where presidential candidates Trump and Biden agree is infrastructure. Every election features massive infrastructure spending as a campaign promise, and this may just be the time it comes to fruition. The importance of 5G wireless connectivity, electrical grids, and water cannot be denied. These necessary endeavors

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are also by definition local, and would broadly support job creation in a time where municipal finances are otherwise strained.

**Eric:** Internationally, a Biden victory would likely increase engagement with global partners, which may restore some bilateral trading arrangements. These negotiations will be critical for either winner, as a new unified political will in Europe could make it a credible challenger to the U.S. for governments' foreign reserves.

At the end of the day, massive monetary stimulus will continue regardless of the November Presidential election and the ultimate result whenever that comes. The subsequent deficits may eventually constrain any 2020 winner from further aggressive fiscal policy.

With no shortage of uncertainty, investors will be well served to remain disciplined. September reminded us that technology stocks aren't bulletproof and broad diversification among equities—especially to those areas that have underperformed in recent years—will likely serve investors well. What I do know is that I appreciate the thoughtful, disciplined wisdom of my Bailard colleagues and our collective ability to entertain passionate discourse. Until next time, Frank!

# Contactless Payments: The Catalyst has Arrived

*Eric Greco, Portfolio Associate*

Over the last decade, we have seen rapid global adoption of a superior form of digital payments. Known as “contactless payments,” “tap to pay,” or “NFC payments,” this rising digital payments technology represents a powerful tool for digitizing low-value, high-frequency cash purchases (like that daily take-away latte) as well as driving credit and debit card volume growth. Particularly with the recently-increased adoption—underpinned by technological advancements, data security enhancements, and consumer preference for convenience—we view this shift as a mechanism for further acceleration in cash displacement within the payment ecosystem.

## A Rising Trend

While contactless payments are already popular in a number of countries around the world, widespread adoption domestically has suffered from a lack of appropriate infrastructure. Nevertheless, over the past year, usage in the U.S. appears to have reached an inflection point on the continued expansion of merchant acceptance as well as increasing contactless card issuance from leading financial institutions. Further, hygienic concerns linked to COVID-19 present a unique opportunity for contactless payments to penetrate small ticket items (under \$25), where approximately 80% have heretofore been conducted in cash.<sup>1</sup> We believe the upward trajectory of adoption creates a number of considerations in the investment space.

## Remind Me: What are Contactless Payments?

Currently, consumers conduct contactless payments in two primary forms: either enabled credit and debit cards, or mobile wallets like Apple Pay and Google Pay. This functionality provides consumers with a way to pay for goods and services without physically inserting or swiping a card into a point-of-sale terminal. Instead, contactless payments exchange encrypted data from your credit/debit card or smartphone to a payment terminal or tag within close proximity, typically at a



## STAY TUNED!

This fall, Bailard's Technology & Science team will be publishing a white paper dedicated to contactless payments on [www.bailard.com](http://www.bailard.com).

distance of less than four inches. And it's Near Field Communication (NFC) technology that makes it all happen. NFC has key advantages over other wireless technologies—like Bluetooth and WiFi—tailoring its usage to payments technology. While NFC doesn't have the same range as Bluetooth, its superiority in pairing connectivity and lower-power consumption far outweigh its drawbacks.





## 2020 Driving Changes in Consumer Behavior

COVID-19 has precipitated material changes in consumer behavior including a preference for contactless payments. As the global population works to limit virus transmission between individuals, we've seen businesses limit in-store foot traffic and shift to curbside pickup, public transportation systems expand the acceptance of contactless payments solutions, and consumers eschew cash as a payment method for goods and services. A combination of better technology (described below) and consumer acceptance together point to a strong future for contactless payments.

## Infrastructure: A Chicken and the Egg Problem

The rise of new payment forms is entirely dependent on a rather complicated web of retailers, payment processors, merchant acquirers (merchant banks), issuing banks, and card networks. Together, these entities must develop the physical and digital infrastructure, security, acceptance, and frictionless experience in order to permit ease of use for consumers. Two of the most important components of the infrastructure

## Ecosystem Outlook

Participants	Outlook	The Impact
Payment Processors	 Net Gainers	Cash-to-card shift and digitization of smaller ticket transactions through contactless adoption — driving transaction throughput and payment volume growth
Mobile Wallets	 Net Gainers	Ubiquity of smartphones, growing merchant acceptance of mobile wallets, and consumer aversion of cash as a result of COVID-19
Networks	 Net Gainers	Cash-to-card shift, strong competitive moat, and digitization of smaller ticket transactions through contactless adoption — driving transaction throughput and payment volume growth
Issuing Banks	 Mixed Effect	Beneficiary of contactless card rollout and adoption, however, lack of differentiation and efforts from neobanks to disintermediate will serve as a headwind

Source: Bailard.

build-out are widespread merchant acceptance (by installing the point-of-sale terminals) and early-stage issuance of contactless cards by the issuers. Early-stage development of the aforementioned components paved the way for successful rollouts in markets including Australia, Canada, the UK, and portions of Continental Europe.

Stateside, the rollout has progressed more slowly. The reality of the situation is, up until recently, the U.S. had a serious chicken and the egg problem: that is, an imbalance of contactless acceptance by retailers and proper payment cards issued to consumers. Culpability falls at the feet of the issuing banks that were mandated to issue compliant chip cards by late 2016. Most of them chose the path of least resistance and, in order to save roughly \$0.35 per card, they issued consumers single-interface chip cards without the antenna needed for contactless technology.<sup>2</sup> Fortunately, the landscape has changed over the last year. The largest banks in the U.S. are now actively rolling out new contactless cards, with nearly 200 million in circulation as of June, 2020. Just six years ago, less than 5% of in-person card transactions were conducted at contactless-enabled terminals; that figure has now skyrocketed to nearly 65%.<sup>3</sup> The infrastructure dilemma has been meaningfully solved.

## What Makes This Important?

In addition to making it more convenient to pay for that single-origin pour-over coffee, this growing trend has investment implications, too. Holistically, the entire payments chain stands to benefit from the secular cash-to-card shift, gaining 2% per year, and pull forward growth through the adoption of contactless payments. Annual global consumer-to-business spend is estimated to be a \$33 trillion market. And 47% of that massive market transacts with credit, debit, and prepaid cards, which then generates several hundreds of billions of dollars in annual fees in the U.S. alone.<sup>3</sup> Not only do we expect a continuation of the cash-to-card trend, but we see contactless payments accelerating credit/debit card use, materially boosting card spend and the resulting fees for the entire payment ecosystem.

Contactless appears to be quite effective at converting small value payments from cash-to-card as well as increasing the frequency of use. Recent data points offer clear proof of engagement growth, with average card spend increasing 20% for customers who start using tap to pay.<sup>4</sup> From an investment standpoint, we expect the flow-through of growth materializing through two metrics: digital transaction volume and card spend.

<sup>1</sup> "Mastercard Study Shows Consumers Globally Make the Move to Contactless Payments for Everyday Purchases, Seeking Touch-Free Payment Experiences", Mastercard Data Exchange, 4/29/2020. <https://mastercardcontentexchange.com/newsroom/press-releases/2020/april/mastercard-study-shows-consumers-globally-make-the-move-to-contactless-payments-for-everyday-purchases-seeking-touch-free-payment-experiences/>

<sup>2</sup> "The Prepaid Market: Trends for 2018", 1/4/2018, <https://hi-tech.org.ua/prepaid-market-trends/>

<sup>3</sup> "Payments Primer: Navigating the value chain, powerful secular growth & intensifying disruption. Our responses to top FAQs." Harshita Rawat and Matthew McLean, Bernstein, 11/5/2019.

<sup>4</sup> "Piper Sandler Global Exchange & Brokerage conference", FactSet CallStreet, LLC, 6/4/2020. [https://s1.q4cdn.com/050606653/files/doc\\_downloads/2020/06/CORRECTED-TRANSCRIPT-Visa-Inc.\(V-US\)-Piper-Sandler-Global-Exchange-Brokerage-conference-4-June-2020-12-30-PM-ET.pdf](https://s1.q4cdn.com/050606653/files/doc_downloads/2020/06/CORRECTED-TRANSCRIPT-Visa-Inc.(V-US)-Piper-Sandler-Global-Exchange-Brokerage-conference-4-June-2020-12-30-PM-ET.pdf)



# The Continuing Evolution of SRI and ESG Investment Processes

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*Blaine Townsend, CIMC®, CIMA®, Executive Vice President and Director,  
Sustainable, Responsible and Impact Investing*

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Morris Milgram said, “Life is too short to do anything but build the kind of world one believes in.” Milgram was the founder of M-REIT, a real estate investment trust established in the 1960s to acquire residential properties with the goal of racially integrating them. Milgram’s mission landed his company on a 1972 list of “responsible stocks,” and is an early example of what we now know as socially responsible investing (SRI).

Milgram’s message in 1972 is more relevant than ever now, as our country and world face a global pandemic and a national reckoning with systemic racism. Close to home for Bailard, the recent wildfires across the West Coast are also poignant reminders of the cost of climate change on our local communities and economy. With these national events changing the way we live and think, it is understandable that a rise in socially responsible investing has come along as well, as investors realize the true impact and economic costs of inequality and climate change.

While now is the time for investors to incorporate social impact into their portfolio, this is actually just the latest chapter of a decades-long shift towards socially responsible investing. Over the course of history, SRI evolved from avoiding “sin stocks” (such as alcohol, tobacco, gambling, and other enterprises that conflicted with certain religious morals) to encompass a wide variety of sustainable, responsible and impact investing tactics. For instance, in 1971, objections to the use of Agent Orange as a chemical weapon in the Vietnam War led to the launch of the Pax World Balanced Fund, which avoided direct investment in the supply chains for Agent Orange. During the 1980s and 90s, the environmental movement and growing interest around investing in companies that displayed “best in class” characteristics fueled the growth of the SRI industry.

Along similar lines, ESG investing rose to prominence in Europe in the mid-2000s. ESG investing employs a forward-looking analysis of environmental, social, and

governance (hence the acronym ESG) factors to determine which companies are best prepared to compete in a world with dwindling natural resources, higher regulatory burdens, a growing human population, and climate change. These factors were generally not in-

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cluded in traditional Wall Street analysis.

From social justice to the environment, the modern SRI landscape empowers investors to align their portfolios with their values, and is a legitimate influence on the capital markets and broader financial services industry. Today, investors in SRI and beyond are looking at how systemic injustice—from environmental justice to corporate governance to systemic racism in the U.S.—can be addressed in their investments.

## Climate Change

The 1989 Exxon Valdez oil spill in Prudhoe Bay Alaska prompted a coalition of institutional investors, environmental organizations, and socially responsible investors to demand greater transparency and accountability with respect to large companies’ impact on the environment. Concerns around climate change as an investment risk continued to mount in the wake of severe weather events including Hurricane Katrina in 2005 and Superstorm Sandy in 2012, particularly among investors exposed to the insurance industry. The evolving view of the materiality of climate change has been a huge driver in the credibility and demand for ESG.

## Corporate Governance

To understand why corporate governance is a critical component of SRI and ESG investing, consider the subprime mortgage crisis and the subsequent Great Recession. The 2008 crash exemplified how the evolving complexity of the capital markets, coupled with the speed at which capital flows around the planet, have raised the stakes for all investors when bad behavior hits the markets. Inadequate disclosure, lack of transparency, insufficient checks and balances, and epic ethical failures in the financial sector led to a market collapse that wrought havoc on the global economy. ESG investing takes into consideration factors such as separation of board CEO and chair, board independence, oversight committees on sustainability issues, transparency, political giving, and other governance-related issues that can be material to the ethical operation of a company as well as the long-term performance of its stock.

## Racial Justice

The murder of George Floyd in May of 2020 turned a spotlight on America's decades-long reckoning with systemic racism. Racial inequalities threaten the recovery from COVID-19, long-term economic growth, and the well-being of the nation. SRI and ESG investors will likely lead the charge to address these issues on the investment playing field by demanding greater attention to diversity and inclusion, strategies to combat income

## From SRI to ESG: The Origins of Socially Responsible and Sustainable Investing

Blaine Townsend, CIMC®, CIMA®  
EVP, Director of Sustainable,  
Responsible and Impact Investing



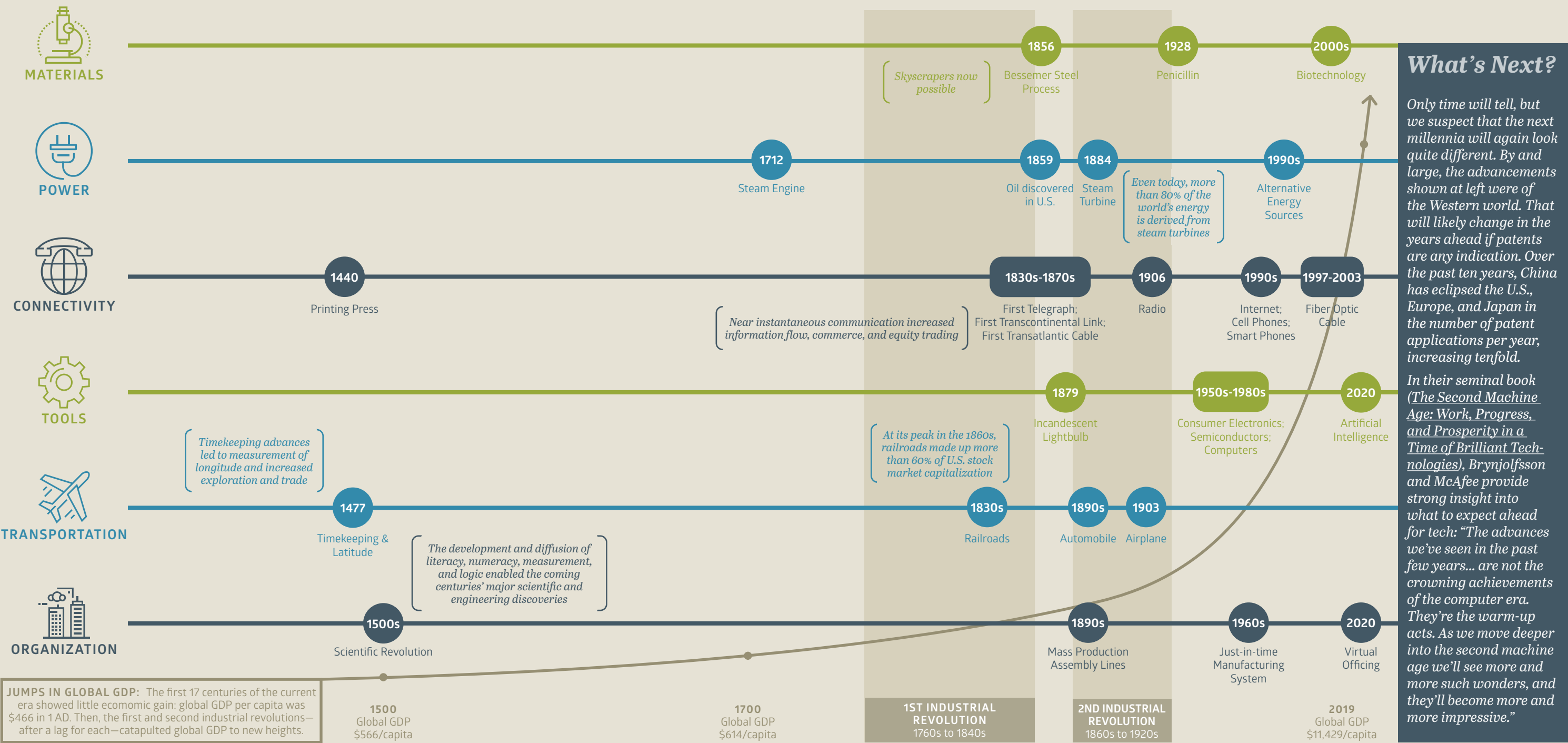
inequality, and commitments from the technology sector to crack down on biased algorithms and the spread of racist disinformation. One of ESG investing's most compelling ideas is to "future proof" portfolios for the world into which we are heading. Hopefully, that world looks very different for Black Americans.

SRI and ESG investment processes are continuously evolving to reflect the growing interest (and investment volume) from the investing community. Within the scope of Bailard's quarterly newsletter, I offer this brief introduction to these frameworks and how the landscape is addressing the issues facing our world today. But, for more insights on the history, details, and performance of SRI and ESG investing, please visit the Bailard website to view the more fulsome report titled, "[From SRI to ESG: The Origins of Socially Responsible and Sustainable Investing](#)."

# TECH

a crucial ingredient for economic change

Throughout history, technology has always been the key to growth. While it looks different each time, technology generates an increase in productivity for a given set of inputs and leads to the evolution of superior inputs: think of oil as a catalyst for the second industrial revolution. Yet, noticeably, innovation often creates a large lag between the invention itself and the resulting societal and economic benefits due to speed and breadth of adoption and the associated “creative destruction.” Below, we invite you to take a walk through the technological innovations of the last two millennia in the current era.





# Closing Brief: Bailard's View on the Economy

*Jon Manchester, CFA, CFP®, Senior Vice President and Portfolio Manager -  
Sustainable, Responsible and Impact Investing*

It seems safe to say that 2020 has been a fairly monumental test of our nation's collective optimism. A bright-eyed view of the world, long seen as an inherently American trait, has faced a torrent of negative news flow this year. The buoyancy meter has mostly ebbed and flowed with the daily COVID case count, amidst a host of other related challenges including high levels of unemployment, social isolation, and—for many—bouts of anxiety. For those in California, another outbreak of wildfires and the resulting poor air quality have cast a sometimes eerie backdrop to the doom-and-gloom delivered via other airwaves.

## Dissonance

As November approaches, the presidential election threatens to overshadow all else, a politically fractious, fast-moving current that has stranded many on opposite banks. The passing of Supreme Court Justice Ruth Bader Ginsburg only added to the turmoil. With seemingly everything politicized, and every issue polarizing, it has been difficult to look forward with much of a shared hopefulness.

That is, unless, you happen to invest in stocks. Optimism is readily apparent on Wall Street, and particularly evident in the tech-heavy NASDAQ Composite Index, which posted a cool +25% for the first three quarters of 2020. We know that Wall Street is not Main Street, and that stocks tend to discount the future. Still, the near-relentless rise from the March depths for equities must give even the half-full crowd pause.

Elsewhere, too, are signs that investors are looking past the 2020 wreckage. The U.S. dollar high yield (junk) bond market is expected to set a new annual record for issuance volumes, boosted in part by “fallen angels” or corporate issuers that were investment-grade rated previously. The flood of junk bonds has been met with steady demand, indicating no significant risk aversion. In August, metal packaging company Ball Corp. issued \$1.3 billion worth of 10-year bonds at 2.875%, a record-low yield for a junk bond

with a maturity of at least five years. Ball originally hoped to borrow (only) \$1 billion, but added \$300 million to the deal upon receiving strong interest.

Animal spirits are alive and well on the IPO (initial public offering) front as well. September marked the busiest month for IPOs in the New York Stock Exchange's history, and year-to-date U.S.-listed IPOs

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have raised nearly \$95 billion. That's not far off from the boom years of 1999 and 2000, with three months to go in 2020. According to *The Wall Street Journal*, more than 80% of the money raised this year has fallen into three buckets: healthcare, technology, and Special-Purpose Acquisition Companies (shell firms set up to acquire private entities and take them public, otherwise known as SPACs or blank-check companies).<sup>1</sup> North of 235 corporations have gone public in the U.S. thus far, on track for the most since 2000.

## The Tie that Binds

With money pouring into growth stocks, junk bonds, and blank-check companies, we might wonder where all the cash is coming from. It seems clear that monetary policy has played a big role in all this risk seeking. The Federal Reserve's (the Fed's) latest projections indicate they expect to keep the overnight Fed Funds rate near 0% through at least 2023. In August, the Fed announced a landmark shift in its philosophy regarding inflation. The new policy—average inflation targeting—will effectively allow the Fed to let

inflation run above its 2% goal for longer stretches, instead of feeling obligated to raise rates. In making the announcement, Fed Chairman Jerome Powell noted “inflation that is persistently too low can pose serious risks to the economy.”

The intent is clear. Within its dual mandate, the Fed will favor maximum employment over price stability for the foreseeable future. This pro-growth stance sends a message to investors, and a long-dated one at that. Further, the Fed’s open-market operations continue, with the tab for their purchases of U.S. securities on the open market currently at \$80 billion per month in Treasury securities, plus \$40 billion in Agency mortgage-backed securities. As a result, the money supply continues to rise. Per data from the St. Louis Federal Reserve, M2 money stock (a broad measure of ready cash that includes currency in circulation plus checking, savings, money market funds, and small CDs) was up to nearly \$19 trillion after starting the year just above \$15 trillion. Inflation may follow, although the bond market is not yet convinced. After an initial pop following the Fed’s August policy shift, the 10-year U.S. Treasury breakeven rate (a reflection of the market’s expectation for inflation) retraced back to ~1.6% as of September 30, approximately the same level as prior to the policy change.

### Brussels to Beijing

Across the pond, although not in the same category, the European Union (EU) also made waves this summer. In July, the EU agreed on a €750 billion stimulus package, with the debt backed by the EU instead of its individual member countries. It marked the first instance the EU itself issued debt, and prompted some to call it the EU’s “Hamiltonian moment.” Whether this is the start of a new era or simply a one-off response to the COVID crisis remains to be seen. Lehigh University International Relations professor Mary Anne Madeira seemed to indicate the former: “Symbolically, it marks a critical shift in Germany’s willingness to allow the EU to jointly borrow money.”<sup>2</sup>

A late summer surge in COVID cases has put Europe on its heels again, threatening the region’s fragile economic recovery. Weekly cases topped the prior peak level from March, with Spain and France particularly hard hit. This has prompted Spain and some other countries to re-impose restrictions on movement and

gathering, albeit of a more targeted and localized nature than the broad lockdowns from earlier this year. In July, citing the economic impacts of lockdown, the EU reduced its Global Domestic Product (GDP) growth estimates for 2020 and 2021, now expecting -8.3% and +5.8%, respectively.

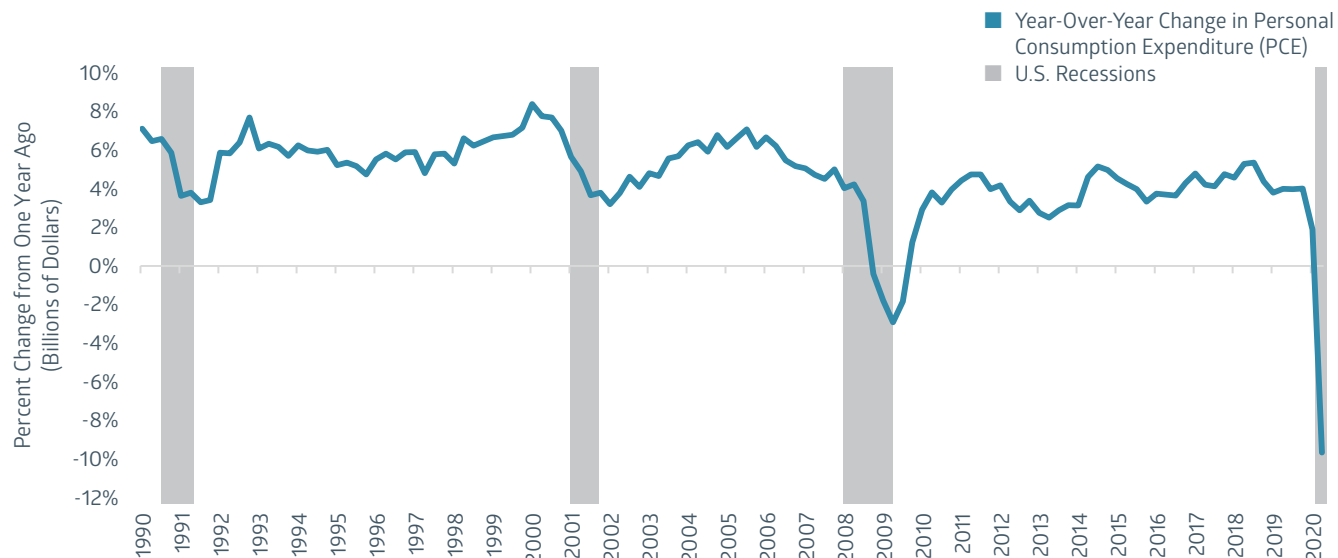
One piece of good news for the EU is the relative health of its second-largest export market: China. Farther along on the COVID recovery curve, China grew its Gross Domestic Product (GDP) by 3.2% in the second quarter. The International Monetary Fund expects China’s real GDP to grow 1% for 2020, versus -4.9% globally. Retail sales returned to pre-coronavirus levels in August, and were up on a year-over-year basis for the first time this year.<sup>3</sup> These positive data points have helped the MSCI China U.S. Dollar Index to a +14.5% price-only return thus far in 2020.

### A Digital Divide

Much has been made of the unevenness of the U.S. economic recovery, with some calling it “K-shaped” in which certain sectors or population segments (like Tech or the 1%, respectively) have thrived, while others have lagged including the travel industry and the have-nots to name a precious few. Setting aside the socioeconomic aspects, the pandemic economy has certainly been unsparing to businesses that rely on foot traffic. We might instead refer to the recovery as Amazon-shaped, with that A-to-Z arrow pointing up for e-commerce at the expense of brick-and-mortar retailers.



## Evaluating Consumer Spending Ahead of Recessions



Note: Shading indicates U.S. recessions; the most recent one is ongoing.

Source: U.S. Bureau of Economic Analysis, Personal Consumption Expenditures [PCE], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/PCE>, October 6, 2020.

Following a strong recovery in May and June, consumer spending has slowed, advancing +1.5% in July and +1.0% in August. Continued growth is encouraging, although sustained spending is in question with the unemployment rate still elevated at 7.9% in September and additional fiscal stimulus measures in limbo. Recent layoff announcements—such as Walt Disney’s decision to slash 28,000 employees—won’t help. If the economic foundation is to hold and prove the stock market’s optimism correct, U.S. consumers will likely need to play their historic role as savior, not saver.

Online, the good times largely continue. The Commerce Department reported that non-store retailers (a rough proxy for e-commerce) grew August sales 22% versus the year prior. Companies that combine physical locations with a robust online presence appear to be benefiting as well. Best Buy said their second quarter online revenues soared 242% domestically, while Target reported digital comparable sales growth of 195% for the same period. Even Costco Wholesale, a somewhat reluctant e-commerce participant, noted 91% adjusted growth in that category during their most recent quarter.

### The Big Picture

The way we spend is less important in the big picture than simply whether we keep dollars circulating throughout the economy. For those fortunate enough to own a house and have a stock portfolio—key inputs of the wealth effect—spending power should be strong. Equities have regained their mojo, and more time at home has spurred a considerable amount of residential expenditures. The S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index rose at a +4.8% year-over-year rate in July, and the Commerce Department recently reported that August new home sales were at their highest monthly level since September 2006.

October marks, at a minimum, the eighth month in the U.S. living with this pandemic. Another flu season approaches and economic activity will continue to depend heavily upon progress in the COVID fight. With great uncertainty and political upheaval ahead, we may need to draw on our optimism reserves. Faith in the future is not our only tool. The adaptability and ingenuity of humans can see us through this challenge, and hopefully, to some greater degree of normalcy.

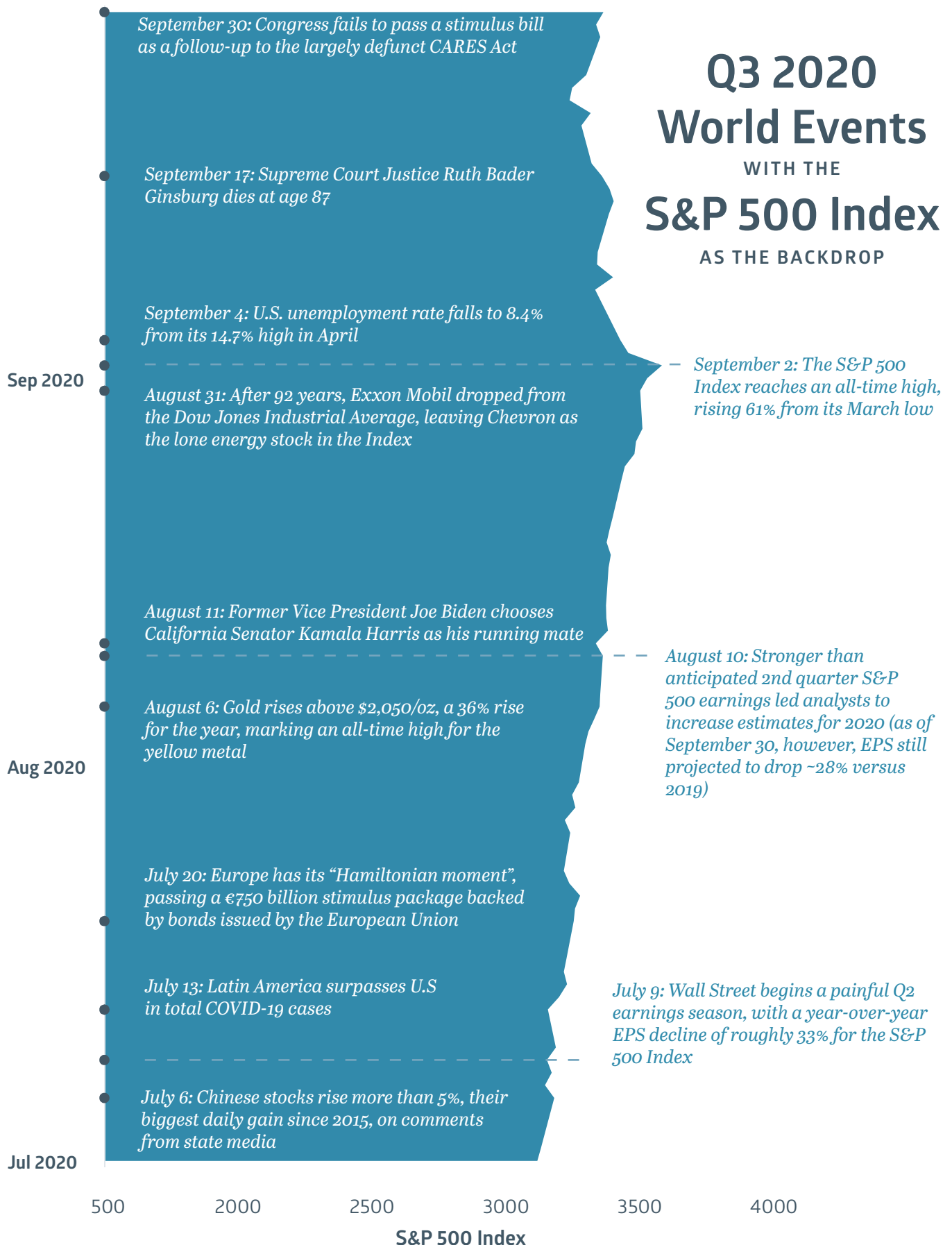
<sup>1</sup> “IPO Market Parties Like It’s 1999,” *wsj.com*, 9/25/2020.

<sup>2</sup> “What Alexander Hamilton has to do with the EU’s \$850 billion coronavirus stimulus plan,” *vox.com*, 7/21/2020.

<sup>3</sup> “China’s Economic Recovery Helps Drive Its Stocks Higher,” *wsj.com*, 10/4/2020.

# Q3 2020 World Events

WITH THE  
**S&P 500 Index**  
AS THE BACKDROP



Source: Bloomberg, Bailard. Past performance is no indication of future results. All investments involve the risk of loss.



# Market Performance

## As of September 30, 2020

U.S. Interest Rates	12/31/2019	3/31/2020	6/30/2020	9/30/2020
<b>Cash Equivalents</b>				
90-Day Treasury Bills	1.55%	0.09%	0.14%	0.10%
Federal Funds Target	1.75%	0.25%	0.25%	0.25%
Bank Prime Rate	4.75%	3.25%	3.25%	3.25%
Money Market Funds	1.71%	1.08%	0.19%	0.01%
<b>Bonds</b>				
10-Year U.S. Treasury	1.92%	0.67%	0.66%	0.69%
10-Year AA Municipal	1.85%	2.40%	1.25%	1.13%

Source: Bloomberg, L.P.

U.S. Bond Market Total Returns (US\$) through 9/30/2020	QUARTER	SIX MONTHS	YEAR TO DATE	ONE YEAR
<b>U.S. Bonds</b>				
Bloomberg Barclays U.S. Treasury Index	0.17%	0.65%	8.90%	8.04%
Bloomberg Barclays U.S. Corporate Index	1.54%	10.66%	6.64%	7.90%
Bloomberg Barclays U.S. Aggregate Index	0.62%	3.53%	6.79%	6.98%
Bloomberg Barclays U.S. 1-15 Municipal Blend Index	1.15%	3.87%	3.35%	4.19%

Source: Bloomberg, L.P.

Global Stock Market Total Returns (US\$) through 9/30/2020	QUARTER	SIX MONTHS	YEAR TO DATE	ONE YEAR
<b>U.S. Stocks</b>				
S&P 500 Index	8.93%	31.31%	5.57%	15.14%
Morningstar U.S. Small Value Index	3.43%	26.50%	-23.34%	-16.61%
Morningstar U.S. Small Growth Index	7.35%	42.60%	12.02%	22.23%
Morningstar U.S. Large Growth Index	13.83%	44.12%	27.52%	40.45%
Morningstar U.S. Large Value Index	3.39%	16.85%	-12.07%	-5.45%
<b>International Stocks</b>				
MSCI EAFE (Europe, Australasia, Far East) Index, net dividends	4.80%	20.39%	-7.09%	0.49%
MSCI Emerging Markets, net dividends	9.56%	29.37%	-1.16%	10.54%

Sources: Bloomberg, L.P. and Morningstar Direct

Alternatives (US\$) through 9/30/2020	QUARTER	SIX MONTHS	YEAR TO DATE	ONE YEAR
NFI-ODCE Index*	-1.56%	-3.10%	-2.15%	-0.67%
Gold Spot	5.89%	19.57%	24.29%	27.49%
WTI (West Texas Intermediate) Crude Oil	2.42%	96.39%	-34.13%	-25.61%

Sources: Bloomberg, the National Council of Real Estate Investment Fiduciaries

\*Q3 data not yet released. The third quarter return assumed to be same as second quarter 2020 return.

Past performance is no indication of future results. All investments have the risk of loss.

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*the 9:05* is published four times a year by Bailard, Inc., 950 Tower Lane, Suite 1900, Foster City, California 94404-2131. (650) 571-5800. [www.bailard.com](http://www.bailard.com). Publication dates vary depending upon the availability of critical data, but usually fall in the first month of each new quarter.

## ABOUT THE 9:05

Since 1978, we've held a weekly company-wide meeting during which we talk about the prior week's activities and those anticipated in the week to come. We refer to this meeting, which begins just after nine each Monday morning, as "the 9:05." Just as the 9:05 enables us to share our knowledge and insights with each other, this newsletter provides us with a valuable means of communicating with our clients. Hence its title: *the 9:05*.

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