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Quarterly Economic Review

October

2020

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# Economic Review

Despite some choppiness in September, the S&P 500 Index rose 8.9% in the quarter and has recovered all its losses for the year. Without the FANMAG stocks (Facebook, Amazon.com, Netflix, Microsoft, Apple, and Google/Alphabet), the S&P 500 would still be down for the year.

Underneath the surface, mega-cap growth names continue to lead the U.S. market. They now dominate the index, but their outsized past returns have come from their ascension to the top, not from owning them once they were already there. Owning the largest stocks has badly lagged owning the diversified index over time.

The U.S. mega-cap growth effect has driven the relative returns of U.S. versus foreign stocks this year. Developed international stocks gained 6.0% this quarter, almost three percentage points behind U.S. stocks, though, emerging-market stocks outperformed U.S. stocks with a return of 10.2%. Both groups still trail U.S. stocks year to date.

Bond markets were calm throughout the summer, thanks in large part to the Federal Reserve's extremely accommodative monetary policy. With Treasury yields unchanged, core investment-grade bonds gained 0.6% in the third quarter.

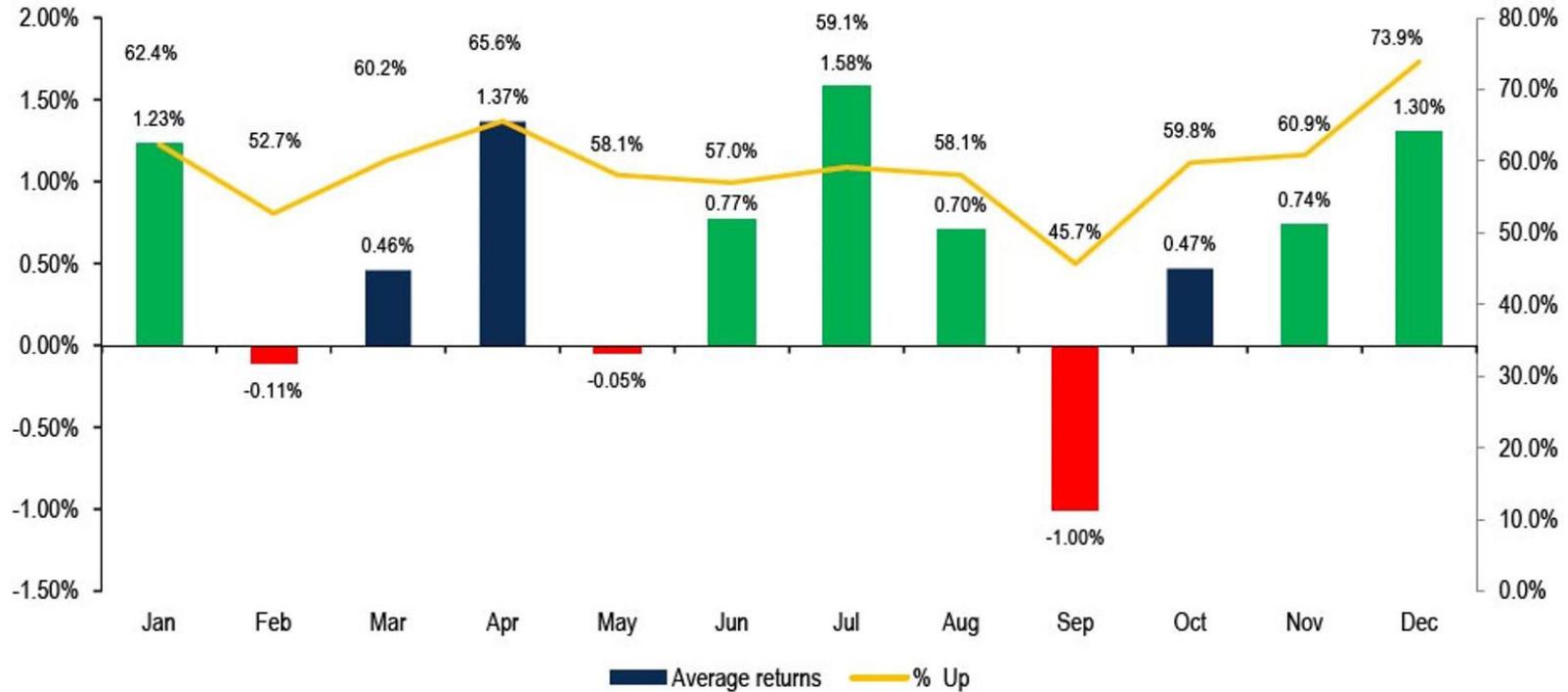
In riskier segments of the bond market, high-yield bonds and floating-rate loans were each up over 4% but remain slightly negative for the year.

Despite a shaky September, the third quarter of 2020 was a good one for most asset classes.



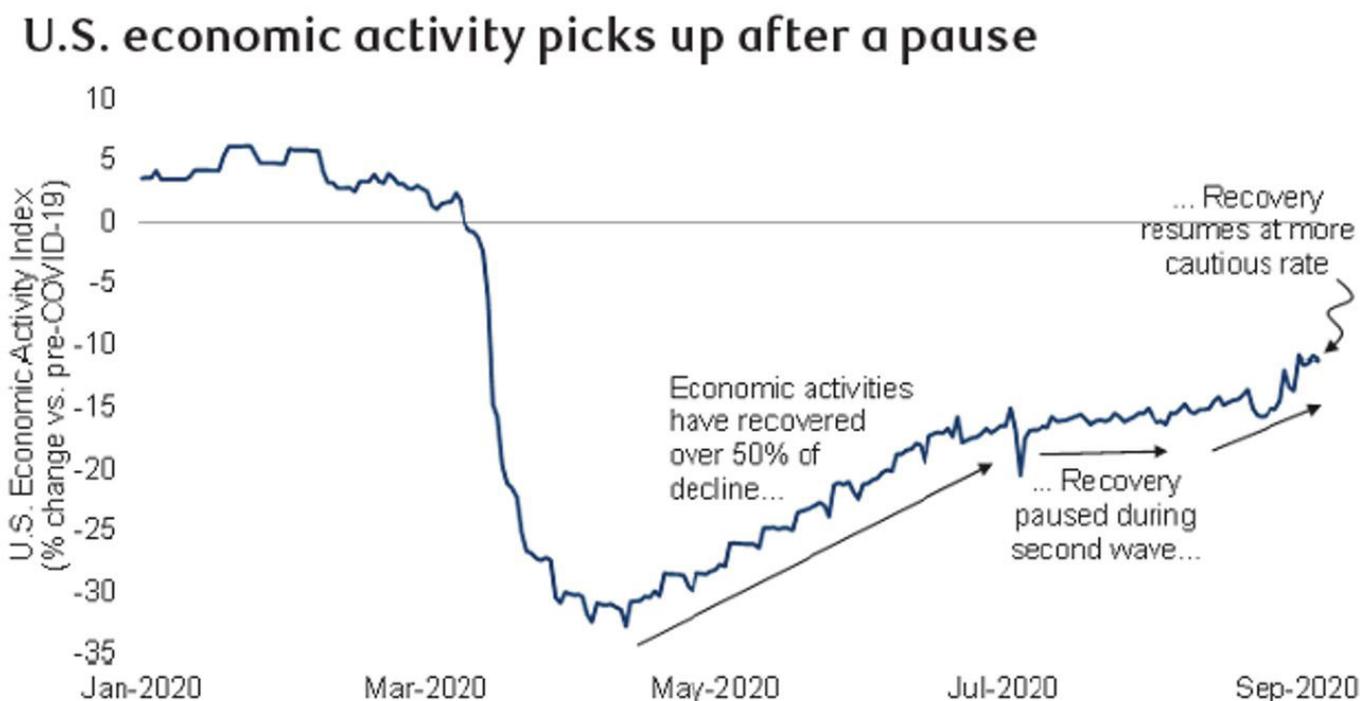
(And September is historically a weak month in the market anyways...)

**Chart 1: S&P 500 – 1-month returns & percentage of time up – 1928 to present – July is strongest month. September is weakest month.**



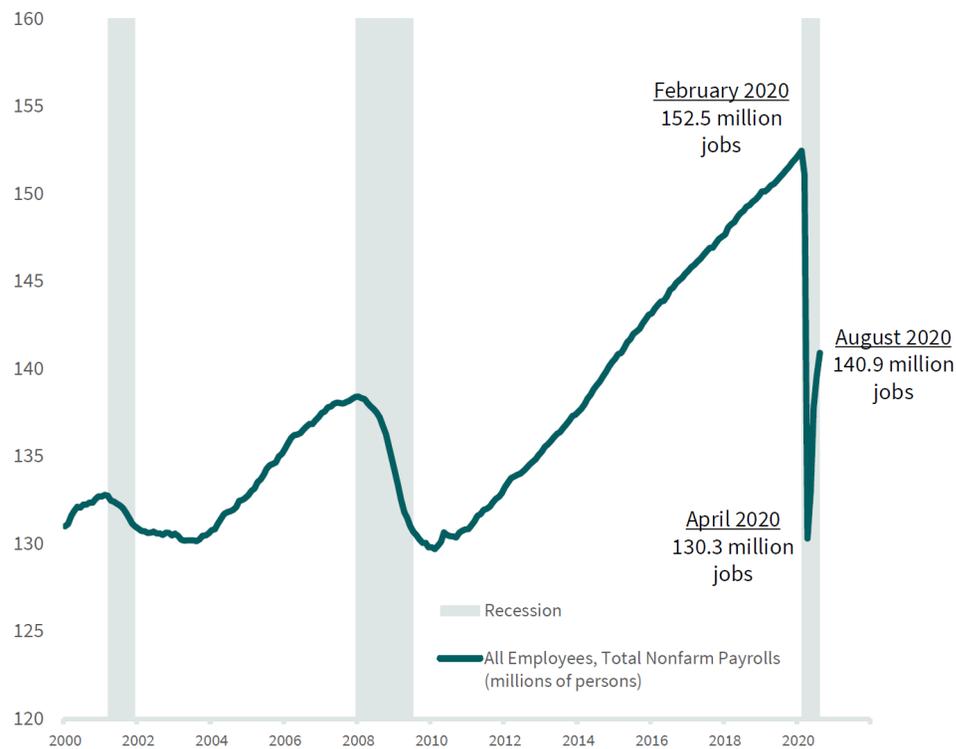
Source: BofA Global Research, Bloomberg

# In the US, economic activity picks up after a pause



*Note: As of 09/05/2020. Economic Activity Index is the average of 10 high-frequency economic data series measuring the year-over-year percentage change. Source: Bank of America, Goldman Sachs, OpenTable, Macrobond, RBC GAM*

A large portion of jobs lost in the spring have been recovered but there is still improvement needed.



- Another reason for caution is economic risk due to a resurgence of COVID-19 cases. Fed chair Jerome Powell has said “The outlook for the economy is extraordinarily uncertain and will depend in large part on our success in keeping the virus in check.”
- A resurgence in COVID-19 cases could force more economic shutdowns. The unemployment rate has fallen sharply from its April high of 14.7% to 8.4% in August, but that number could spike again in the event of another shutdown.

Source: U.S. Bureau of Labor Statistics. Data as of 8/31/2020.

# Leading economic indicators continue to improve, but the pace is moderating.

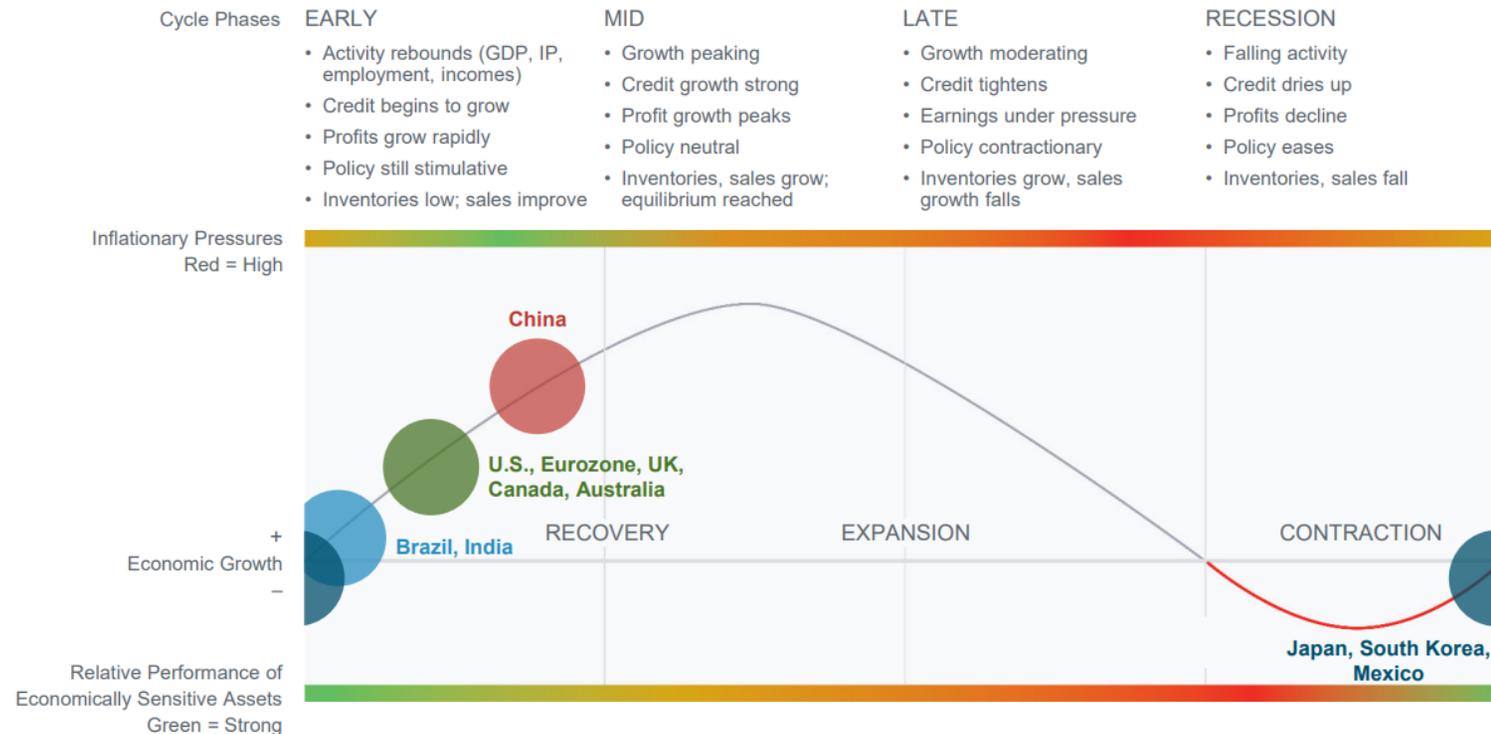
Year-over-year change in the Composite Index of Leading Indicators



Source: The Conference Board, as of 8/31/20. The Composite Index of Leading Indicators (LEI) is an index published monthly by The Conference Board, used to predict the direction of the economy's movements in the months to come. The index is made up of 10 economic components whose changes tend to precede changes in the overall economy. It is not possible to invest directly in an index. Past performance does not guarantee future results.

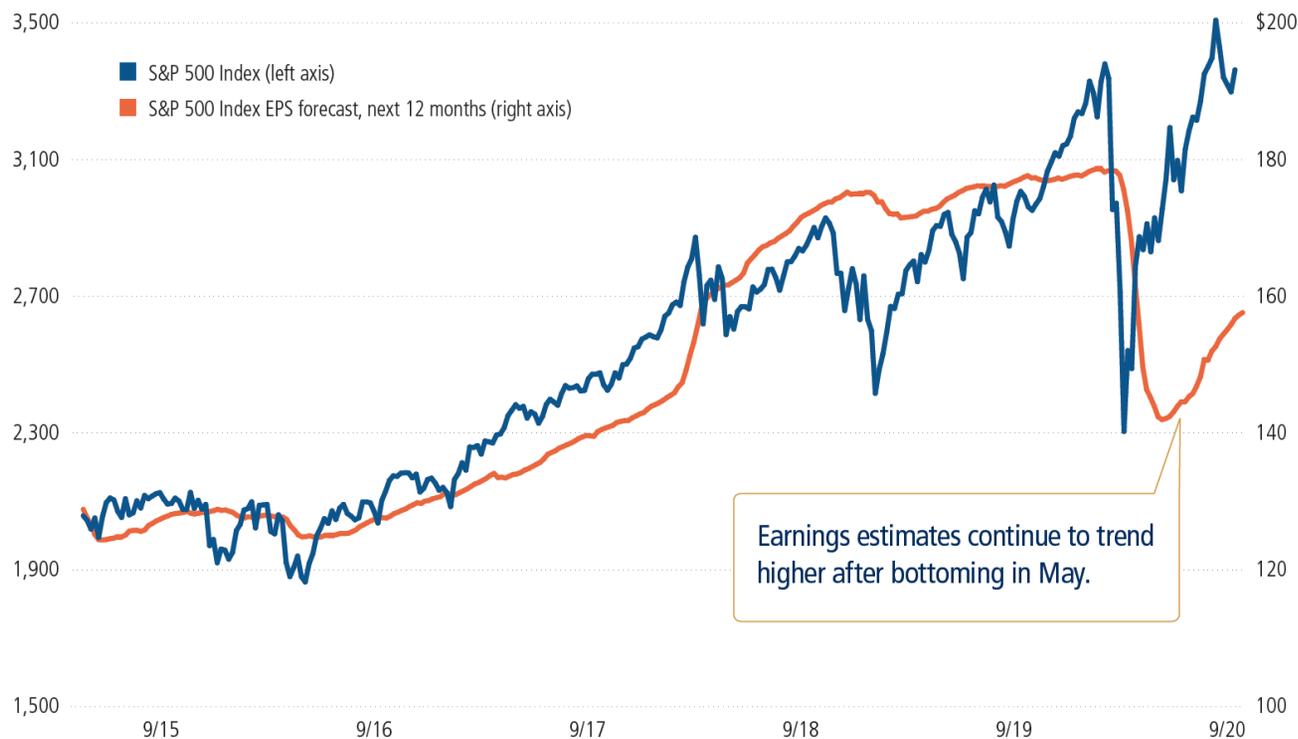
# And signs of recovery are being seen across many global economies.

## Business Cycle Framework



Note: The diagram above is a hypothetical illustration of the business cycle. There is not always a chronological, linear progression among the phases of the business cycle, and there have been cycles when the economy has skipped a phase or retraced an earlier one. Source: Fidelity Investments (AART), as of 9/30/20.

# In the US, stocks are pricing in a substantial earnings recovery.

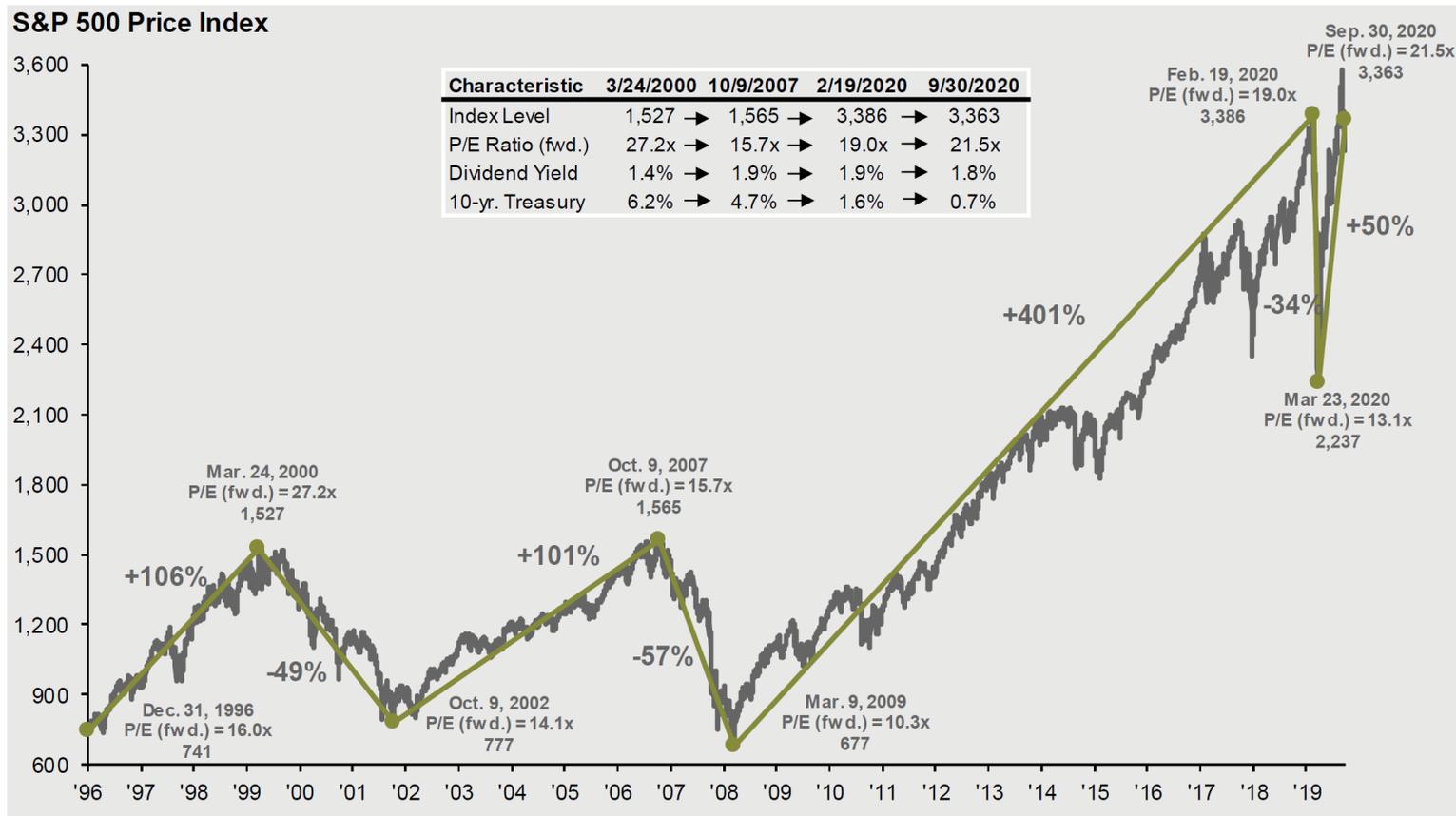


EPS growth estimates year over year (%)

	2020	2021
Healthcare	5.61	13.09
Information technology	4.26	13.75
Consumer staples	1.14	6.61
Utilities	0.90	5.48
Real estate	-5.41	6.85
Communication services	-11.06	20.00
Materials	-16.72	29.58
<b>S&amp;P 500 Index</b>	<b>-17.79</b>	<b>25.66</b>
Financials	-33.92	29.65
Consumer discretionary	-41.55	73.06
Industrials	-49.62	89.61
Energy	-105.69	—

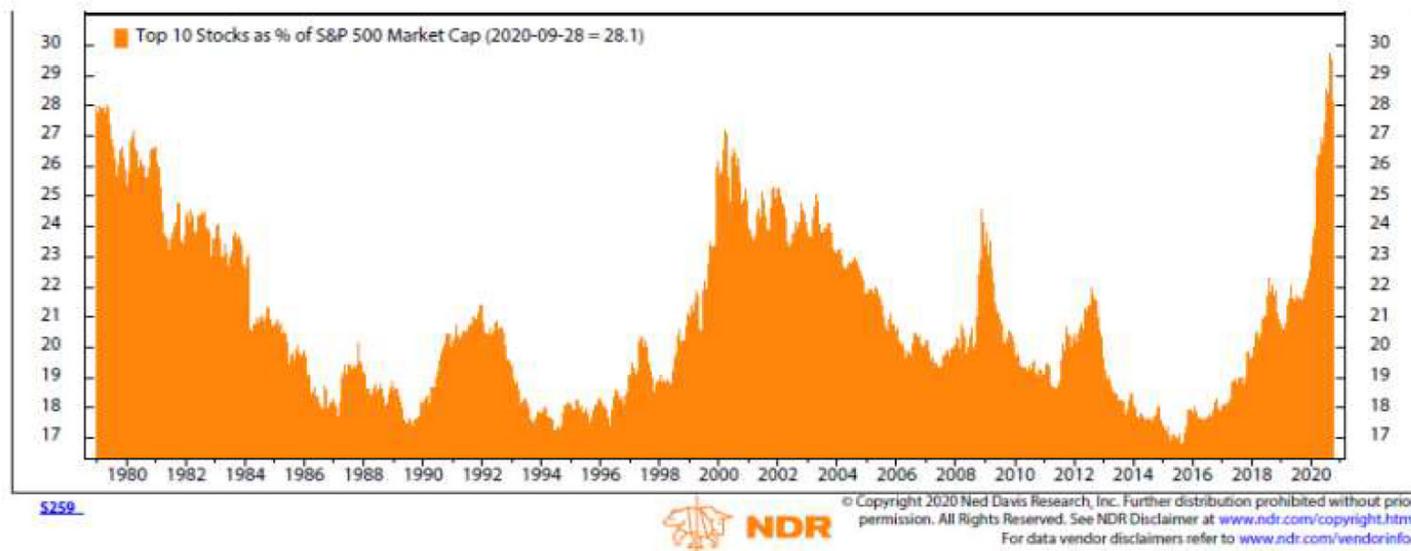
Source: FactSet, as of 9/30/20. The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. It is not possible to invest directly in an index. Earnings per share (EPS) is a measure of how much profit a company has generated calculated by dividing the company's net income by its total number of outstanding shares. Past performance does not guarantee future results.

# The S&P 500 reached all time highs in the 3rd Quarter...



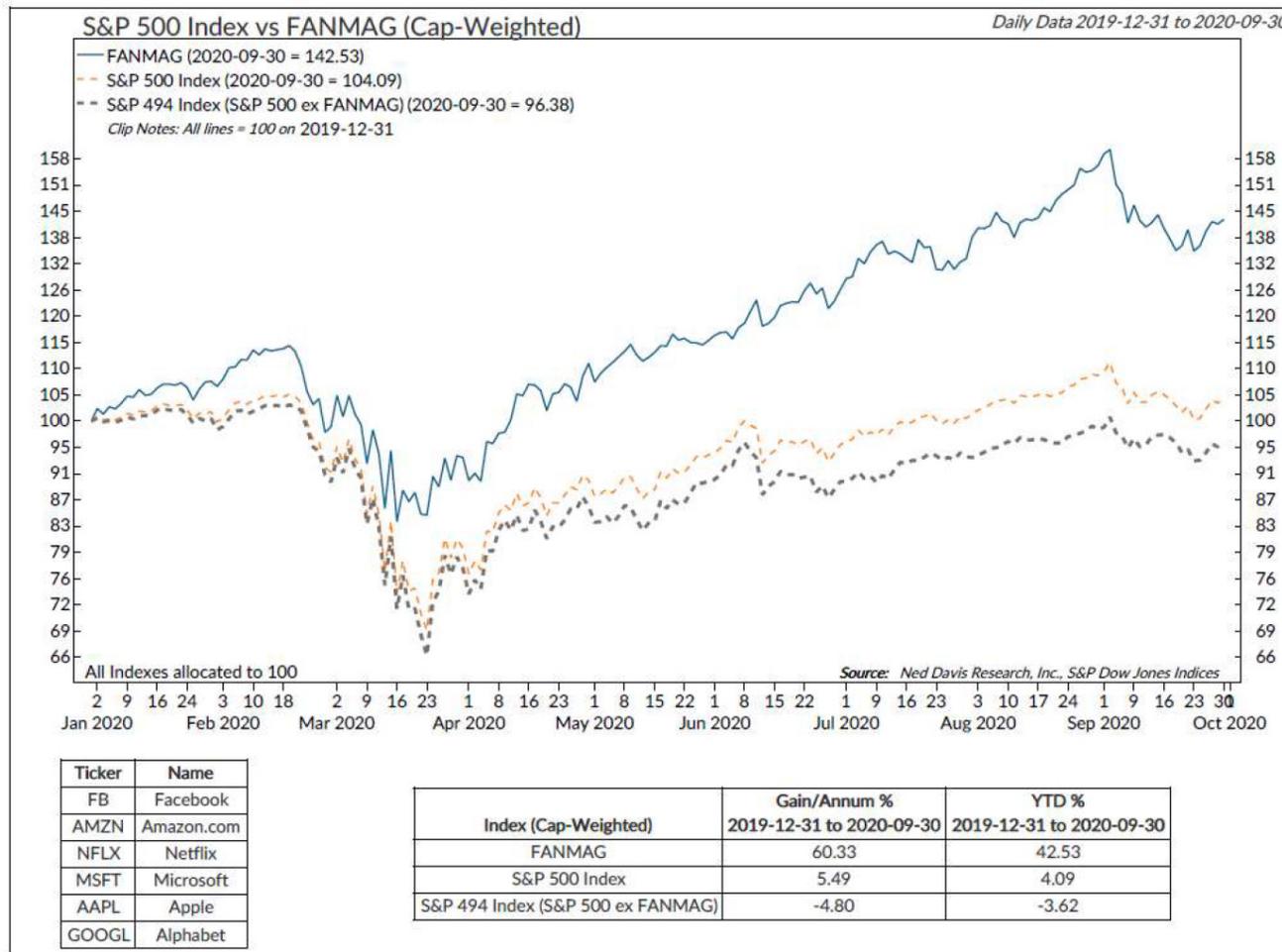
Source: Compustat, FactSet, Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management.  
 Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat.  
 Forward price to earnings ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.  
 Guide to the Markets – U.S. Data are as of September 30, 2020.

...driven by massive concentration in the top ten holdings of the S&P 500.



Top 10 S&P 500 Constituents During Other Highly Concentrated Periods		
1980	1999	2020
IBM	Microsoft	Apple
AT&T	General Electric	Microsoft
Exxon	Cisco Systems	Amazon.com
Standard Oil of Indiana	Wal-Mart Stores	Facebook
Schlumberger	Exxon Mobil	Alphabet
Shell Oil	Intel	Berkshire Hathaway
Mobil	Lucent Technologies	Johnson & Johnson
Standard Oil of California	IBM	Procter & Gamble
Atlantic Richfield	Citigroup	Visa
General Electric	America Online	NVIDIA

The top 6 companies in the S&P 500 are up 4.09% YTD. The other 494 companies in the S&P 500 are down -3.62%.

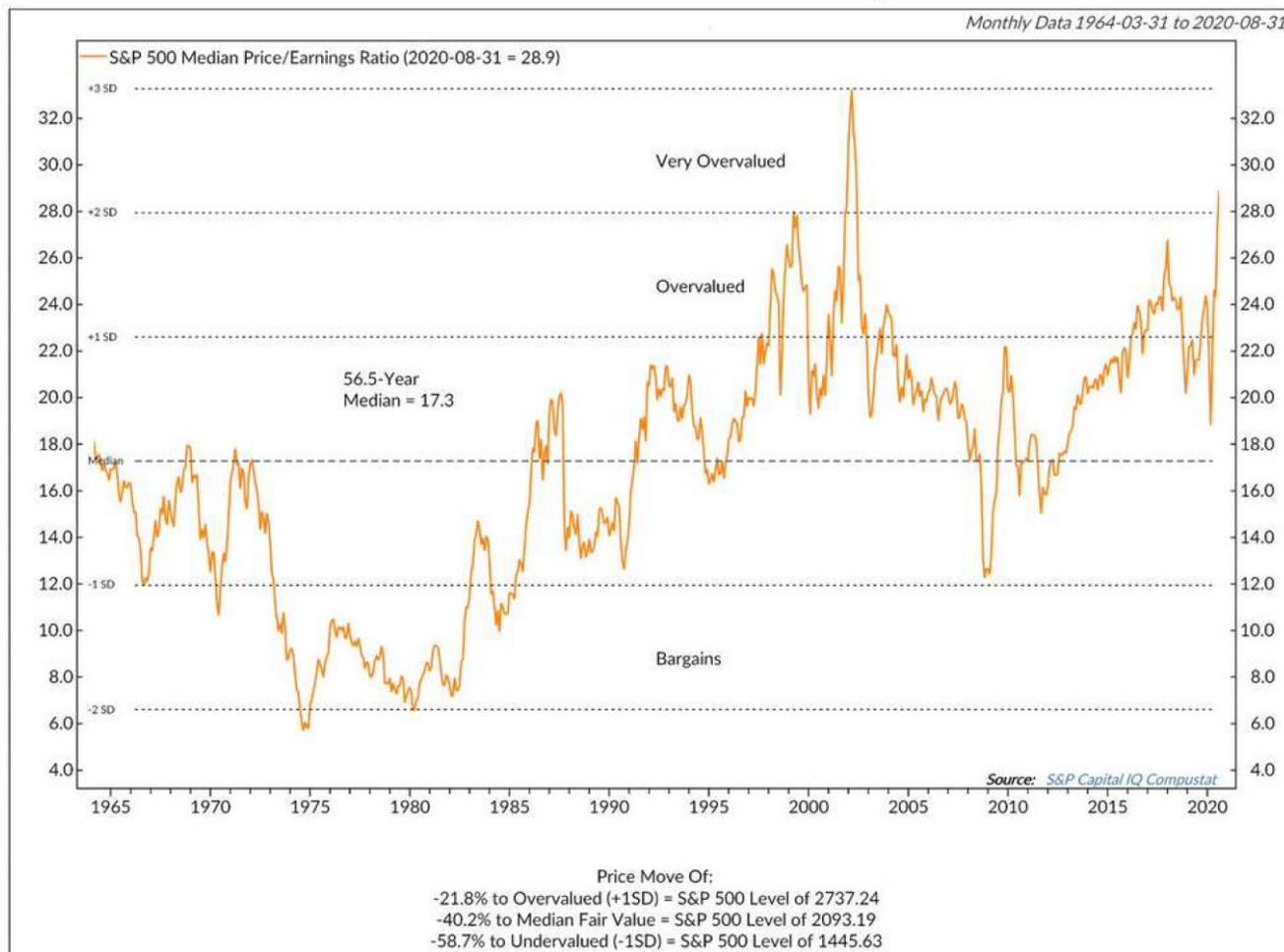


Ticker	Name
FB	Facebook
AMZN	Amazon.com
NFLX	Netflix
MSFT	Microsoft
AAPL	Apple
GOOGL	Alphabet

Index (Cap-Weighted)	Gain/Annum %	YTD %
FANMAG	60.33	42.53
S&P 500 Index	5.49	4.09
S&P 494 Index (S&P 500 ex FANMAG)	-4.80	-3.62

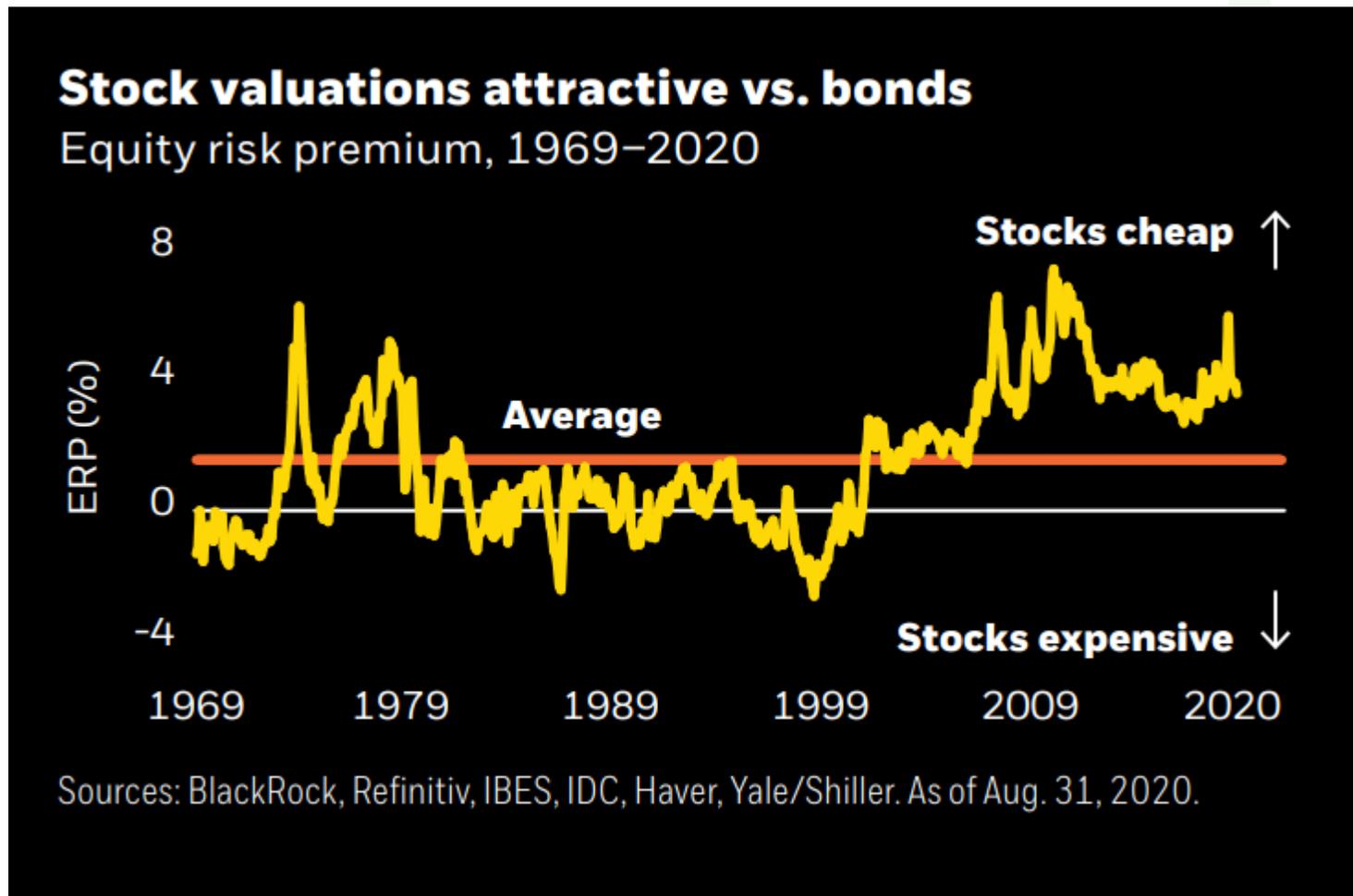
Compared to historical valuation metrics, the stock market looks expensive...

### S&P 500 Median Price/Earnings Ratio



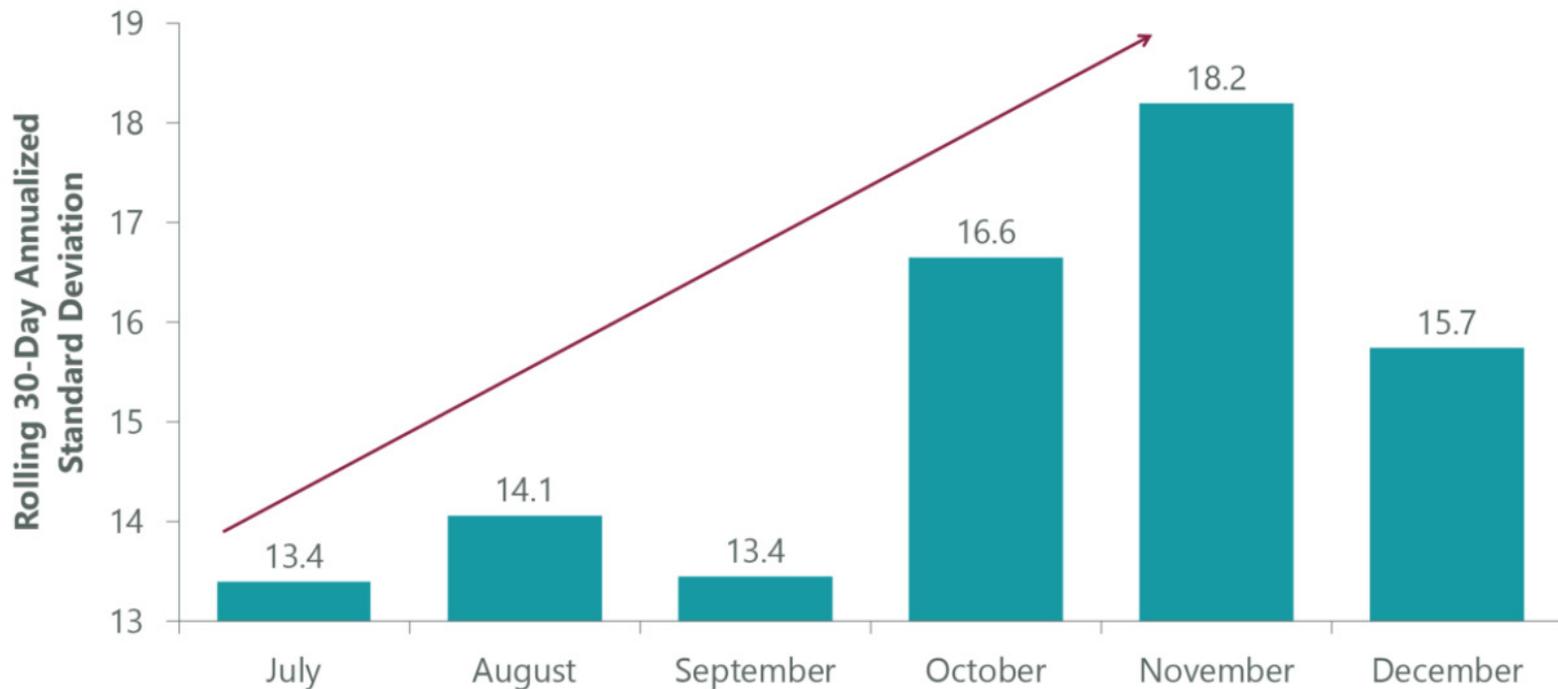
Source: S&P Capital IQ Compustat

...but compared to bond yields, the market looks fairly valued.



In election years, volatility tends to spike in the 4th quarter.

Exhibit 6: Elections Spark Higher Volatility

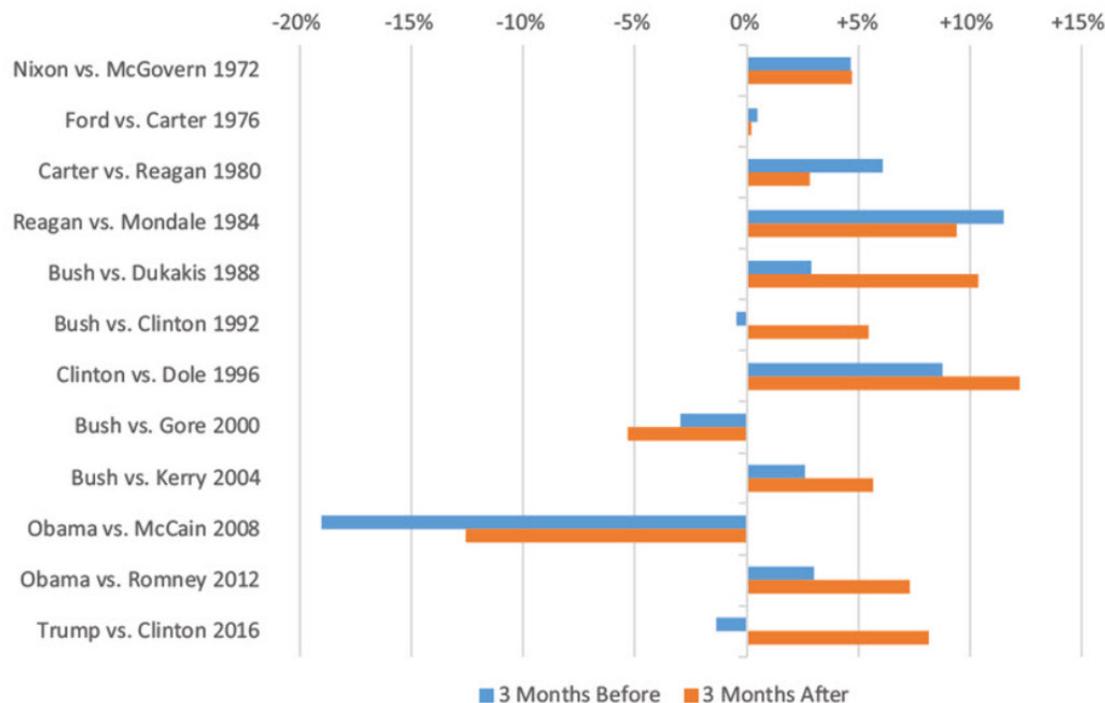


Source: FactSet.

# Historically, market performance has been positive around elections.

## Market Performance Tends to Be Positive 3 Months Before and After Presidential Elections

S&P 500 Index (% Returns)



Going back to 1972, the stock market has averaged



**1.4% GAIN**  
THREE MONTHS **BEFORE**  
ELECTION DAY

**4.0% GAIN**  
THREE MONTHS **AFTER**  
ELECTION DAY



Source: Morningstar, 9/20. **Past performance does not guarantee future results.** The Index is unmanaged and not available for direct investment. For illustrative purposes only.

However, investors dislike uncertainty, and during the 2000 recount, all risk assets declined in value...

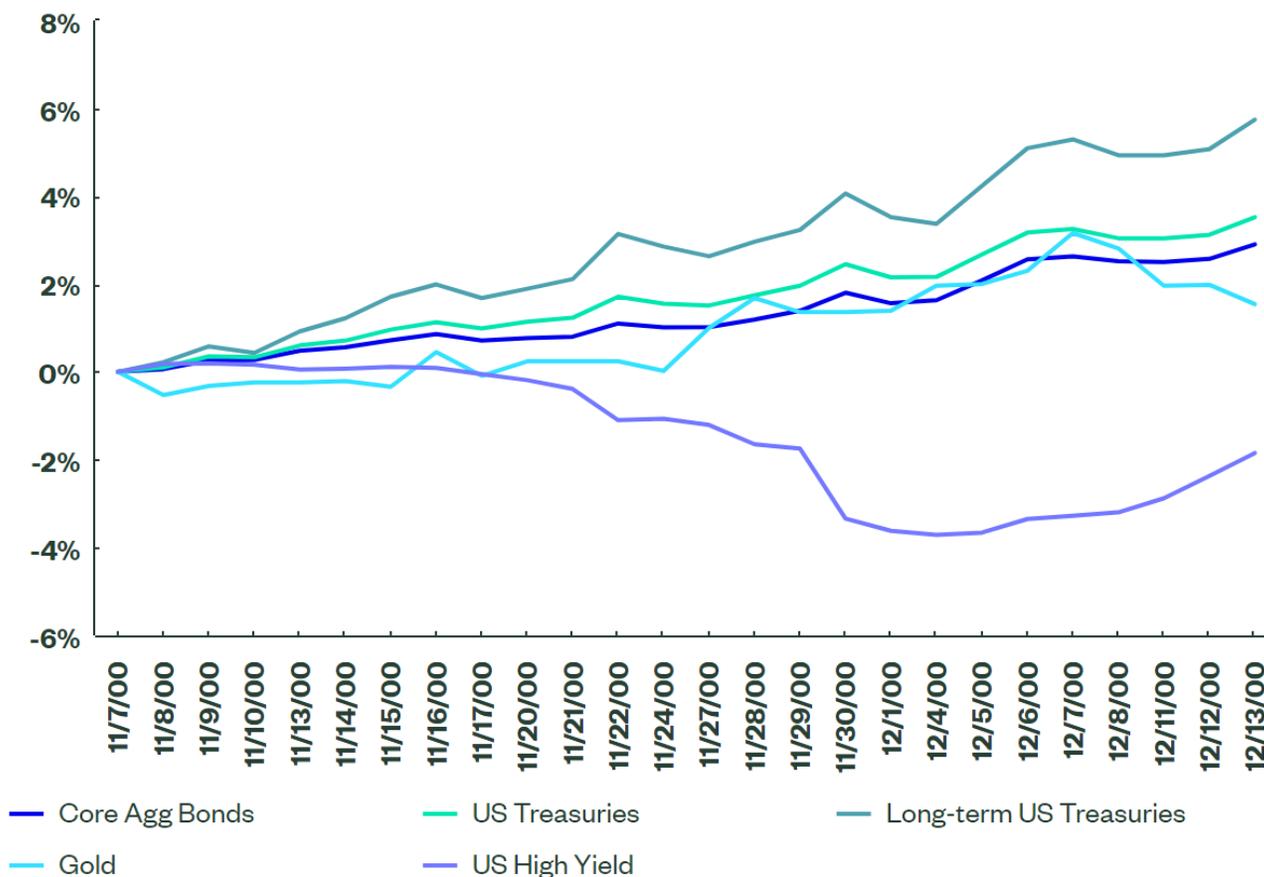
**Equity Market Performance During the 2000 Recount**



Source: Bloomberg Finance L.P. as of September 18, 2020. **Past performance is not a guarantee of future results.** Index returns are unmanaged and do not include fees.

...while 'safe' assets held their value.

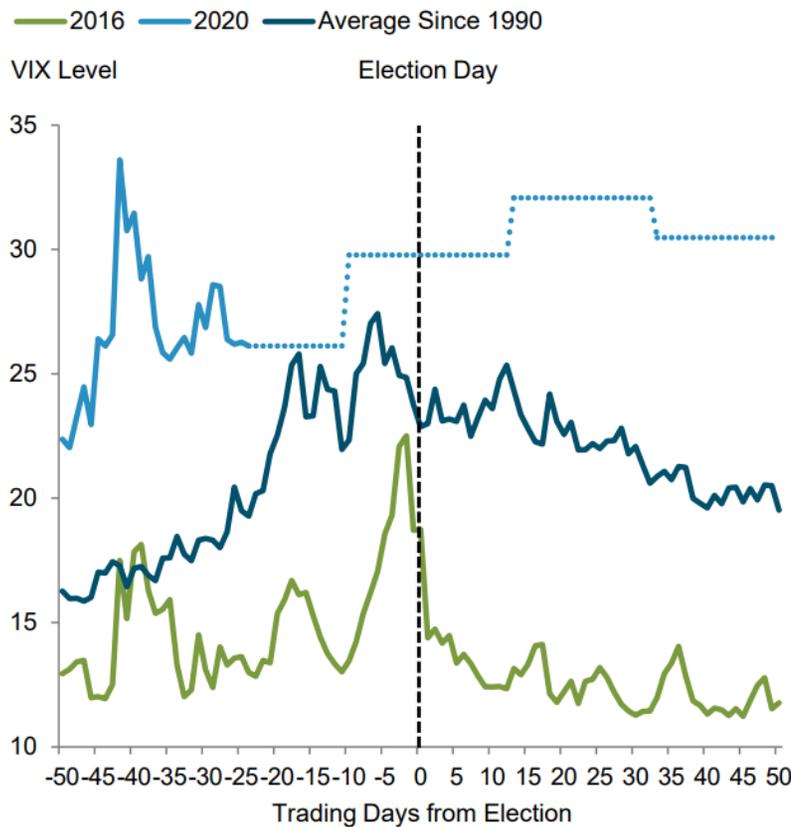
**Bond and Gold Performance During 2000 Recount**



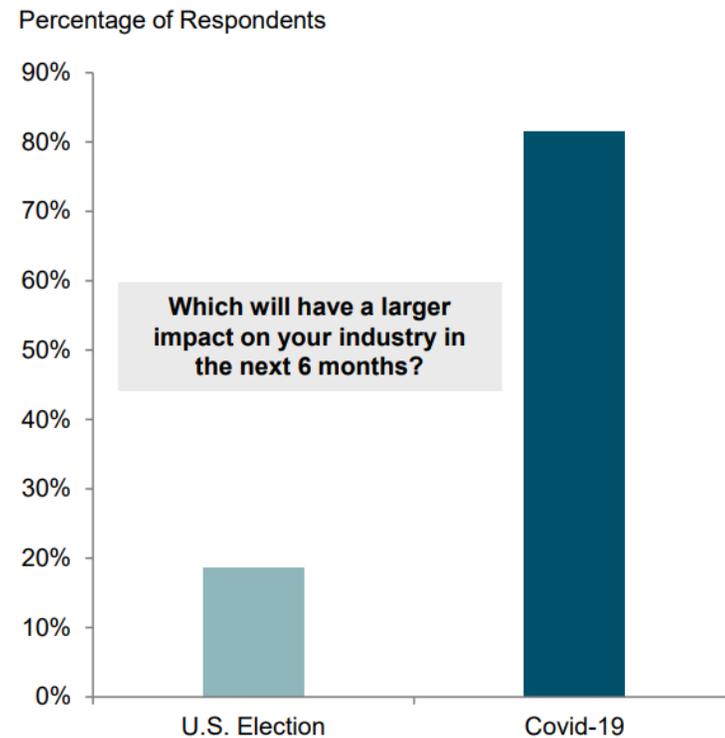
Source: Bloomberg Finance L.P. as of September 18, 2020. **Past performance is not a guarantee of future results.** Index returns are unmanaged and do not include fees. Core Agg bonds: Bloomberg Barclays US Aggregate Bond Index, US Treasuries: Bloomberg Barclays US Treasury Index, Long-term treasuries: Bloomberg Barclays US Long Treasury Index, Gold: LBMA Gold Price, US High Yield: Bloomberg Barclays US Corporate High Yield Index.

While the election uncertainty is a concern, the larger worry for US businesses is COVID-19.

### Equity Volatility Around Elections



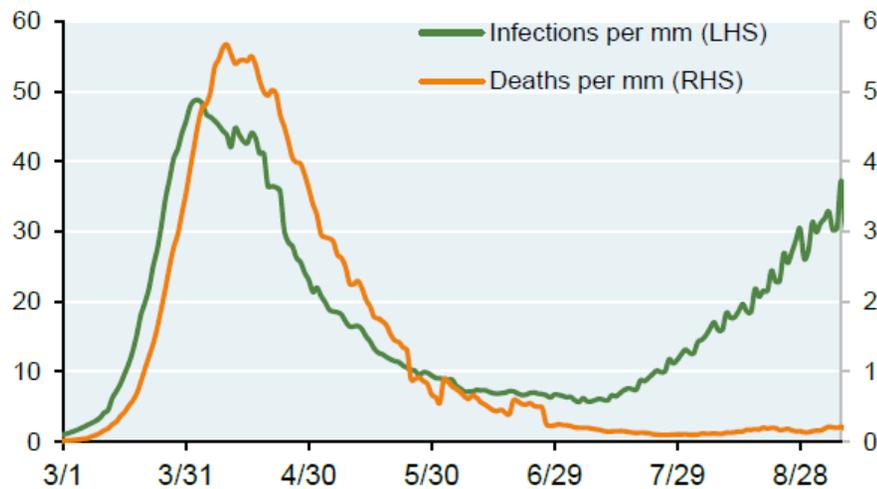
### Fidelity Company Analyst Survey



**LEFT:** VIX: Chicago Board Options Exchange Volatility Index®. Data for the 2020 line after 9/30/20 derives from VIX futures contracts until the next contract date; the rest of the 2020 line and all others show historical VIX levels. Source: Bloomberg Finance L.P., Fidelity Investments Asset Allocation Research Team (AART), as of 9/30/20. **RIGHT:** Source: Fidelity Investments Asset Allocation Research Team (AART), as of 9/30/20.

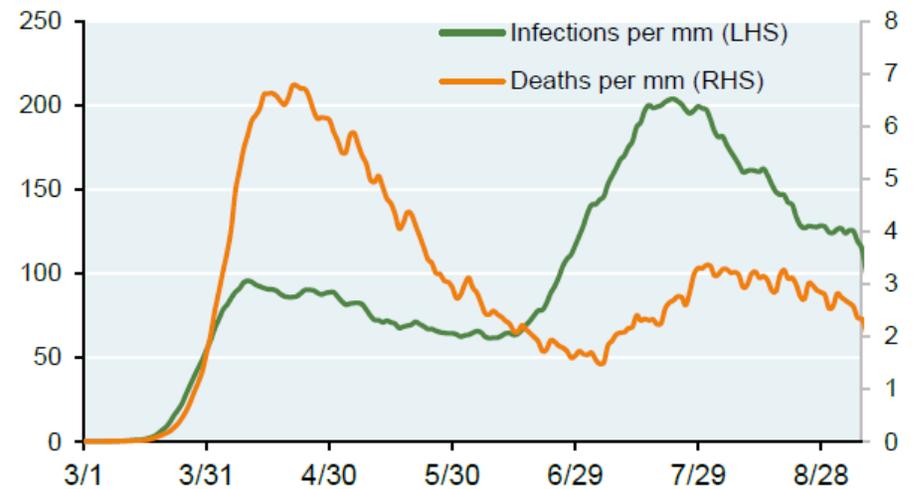
Infection rates continue to climb around the world, but the mortality rate is holding fairly steady.

**Dev World ex-US new daily infections vs mortality per**



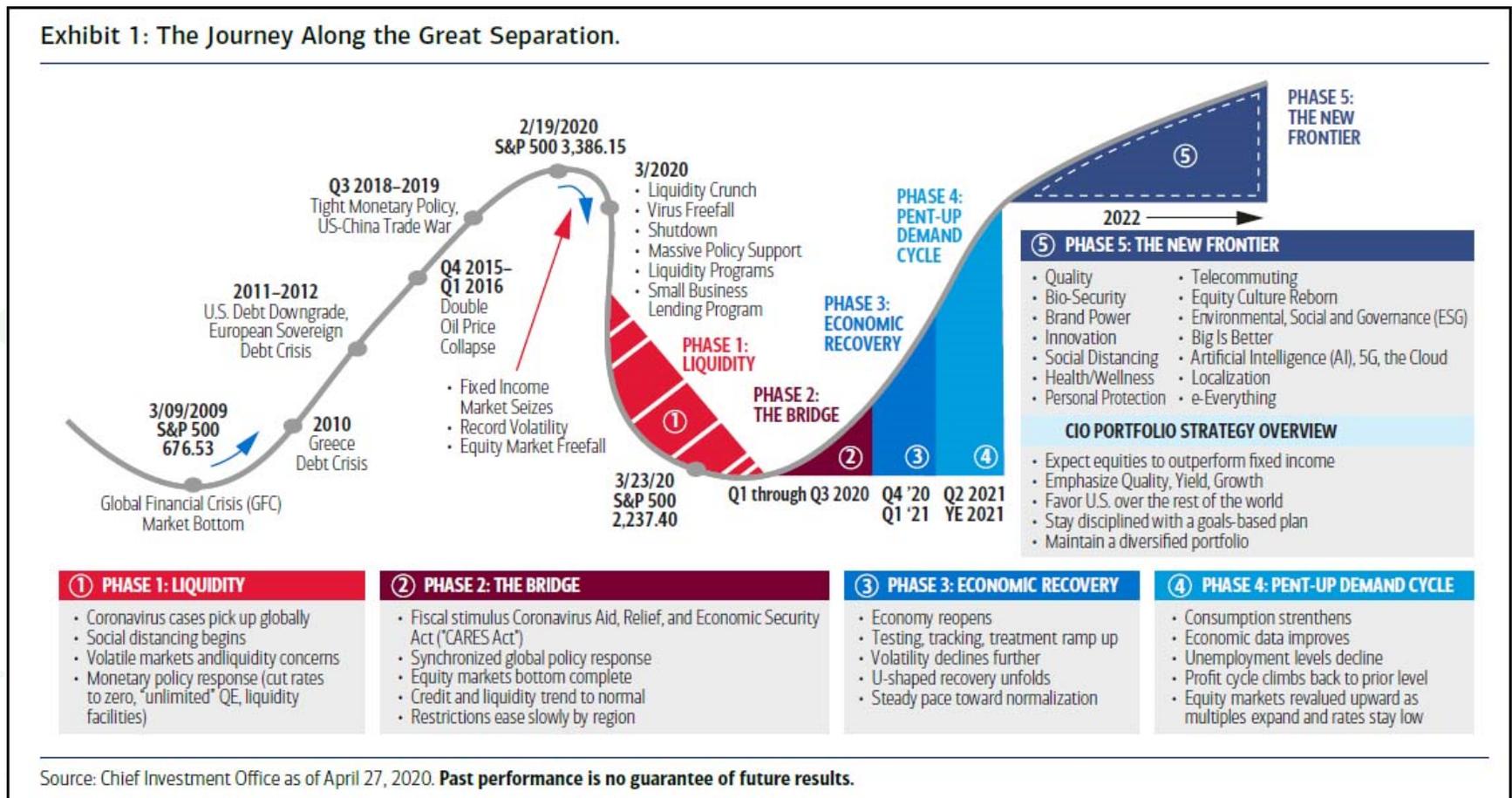
Source: JHU, Our World in Data, JPMAM. 09/07/2020.

**US new daily infections vs mortality per mm**

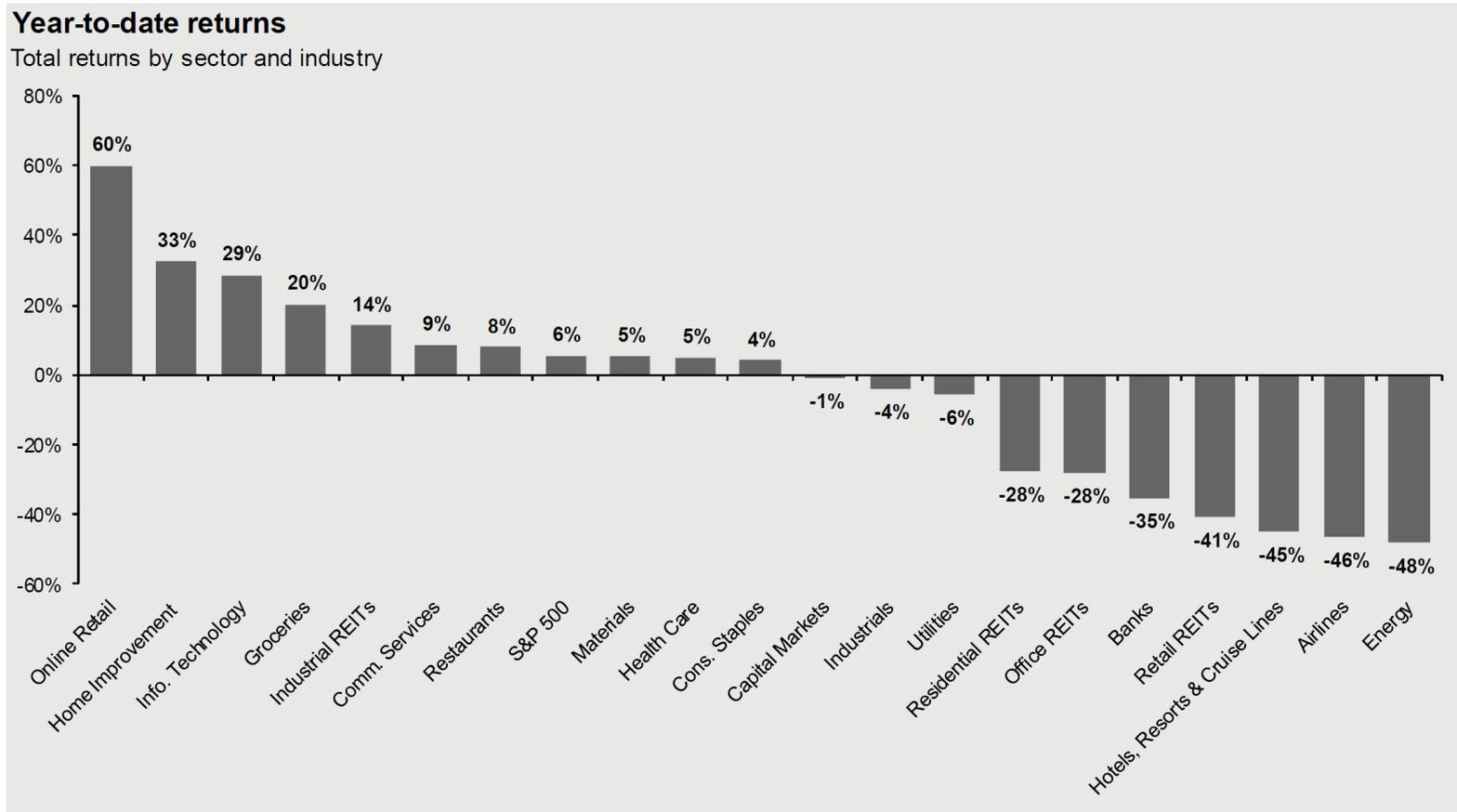


Source: JHU, Our World in Data, JPMAM. 09/07/2020.

An interesting chart published by Bank of America in April 2020 about the probable next phases forward...



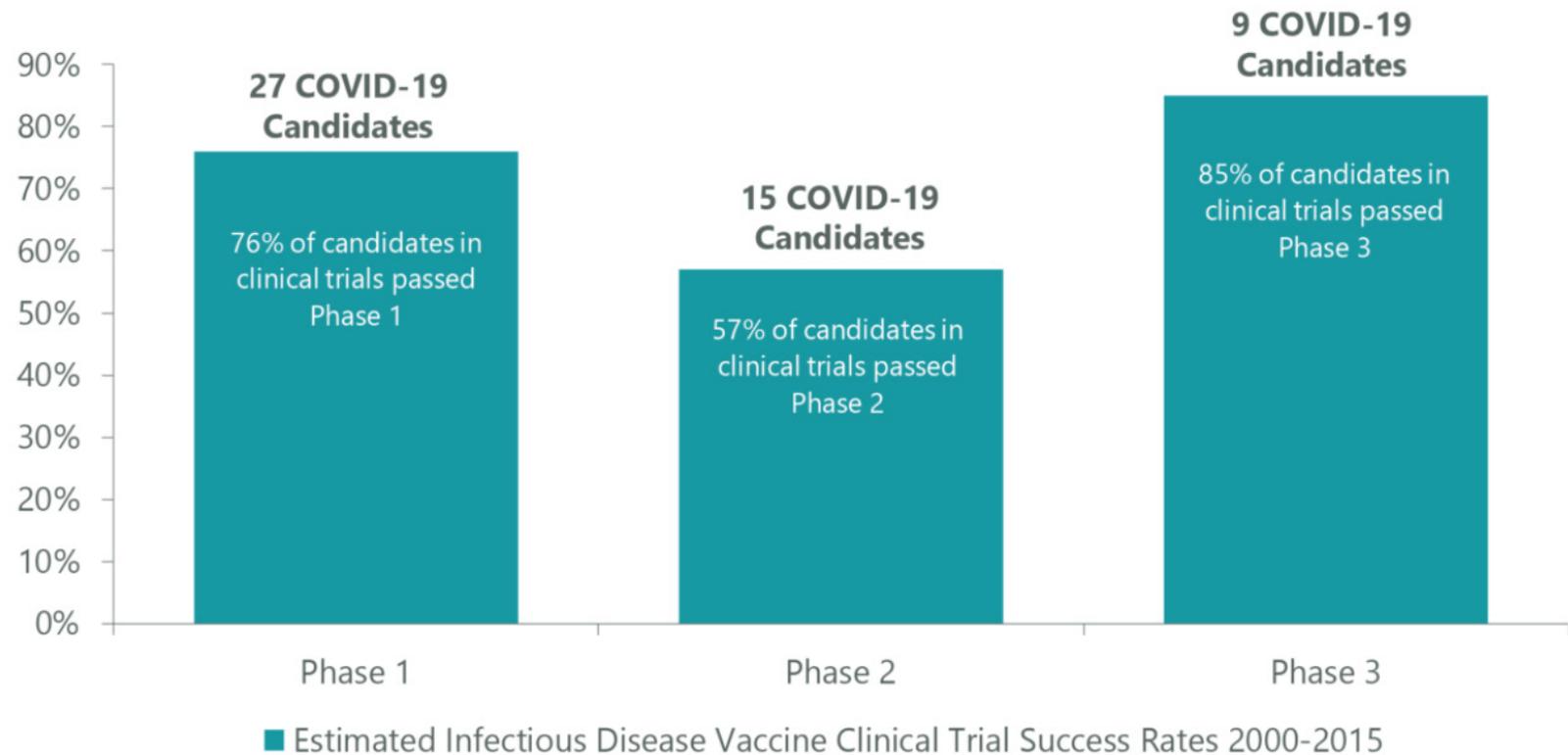
The pandemic has weighed heavily on certain industries, which will most likely have a difficult recovery path until a vaccine is approved.



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.  
Guide to the Markets – U.S. Data are as of September 30, 2020.

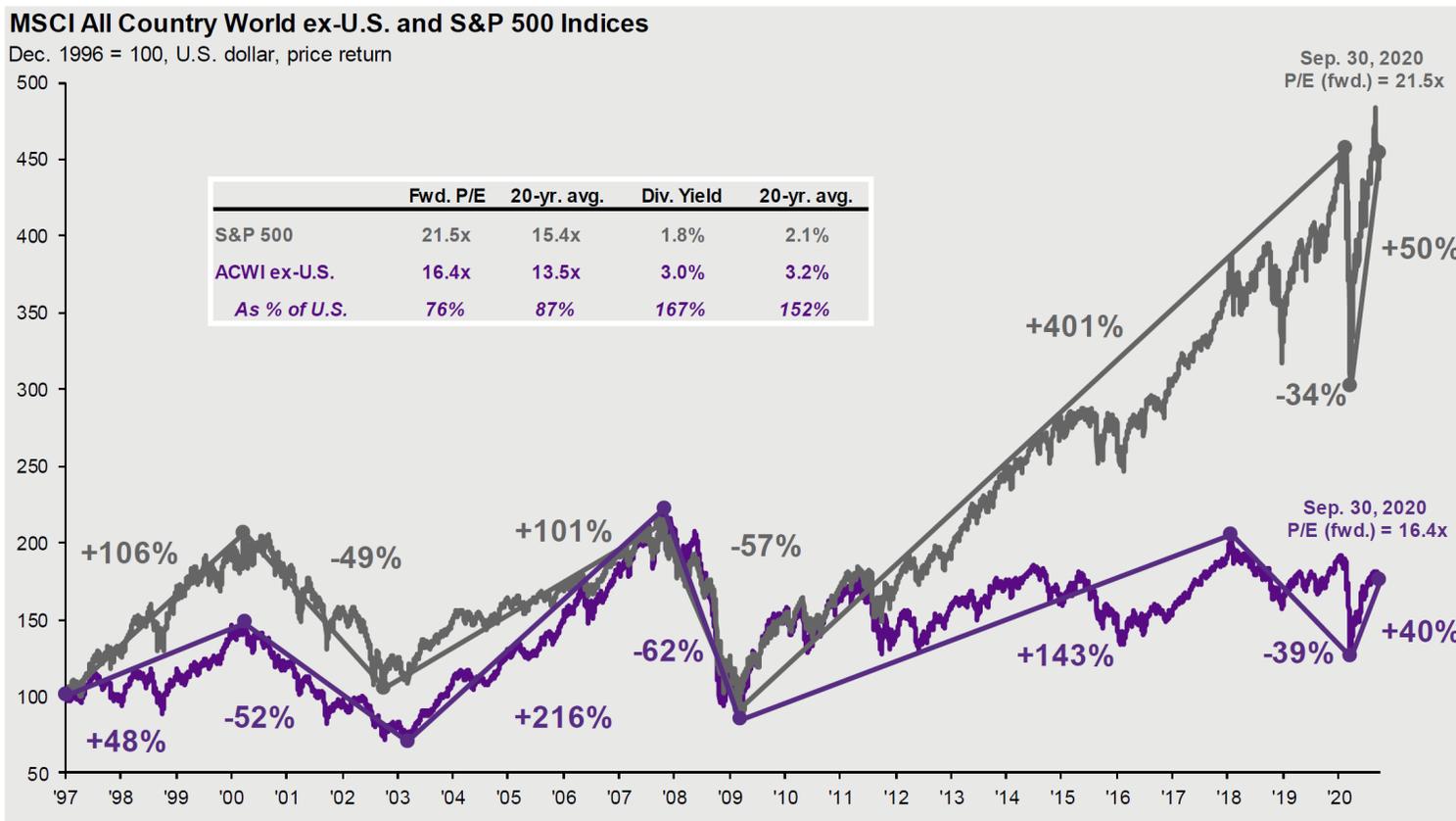
# And a massive number of vaccine trials are under way...

Exhibit 7: Lots of Shots on Vaccine Goal



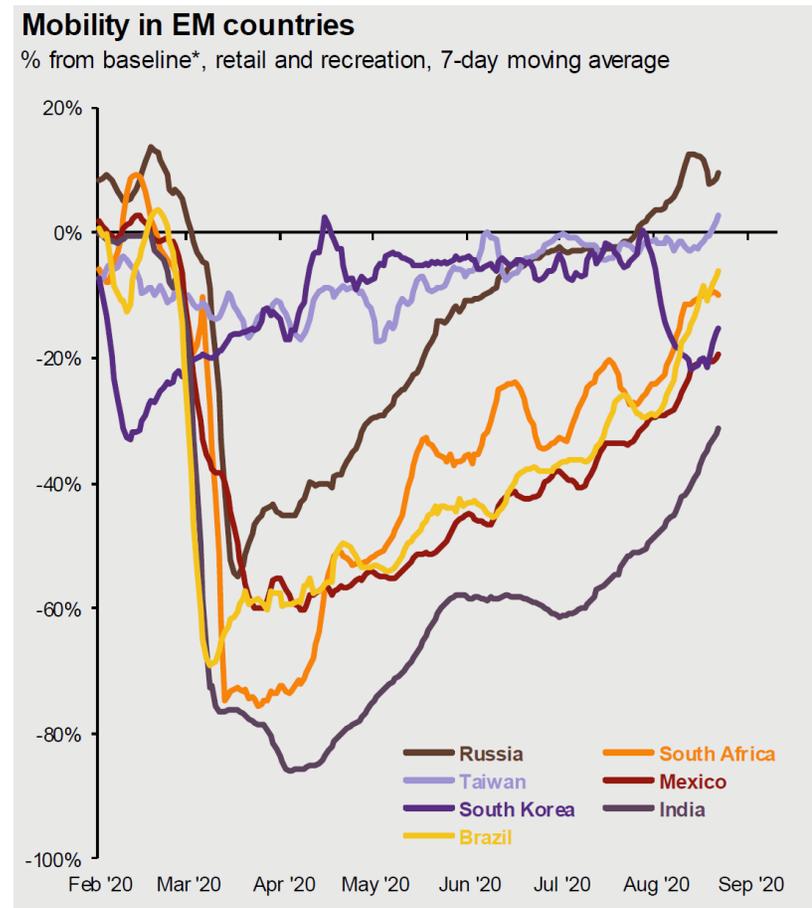
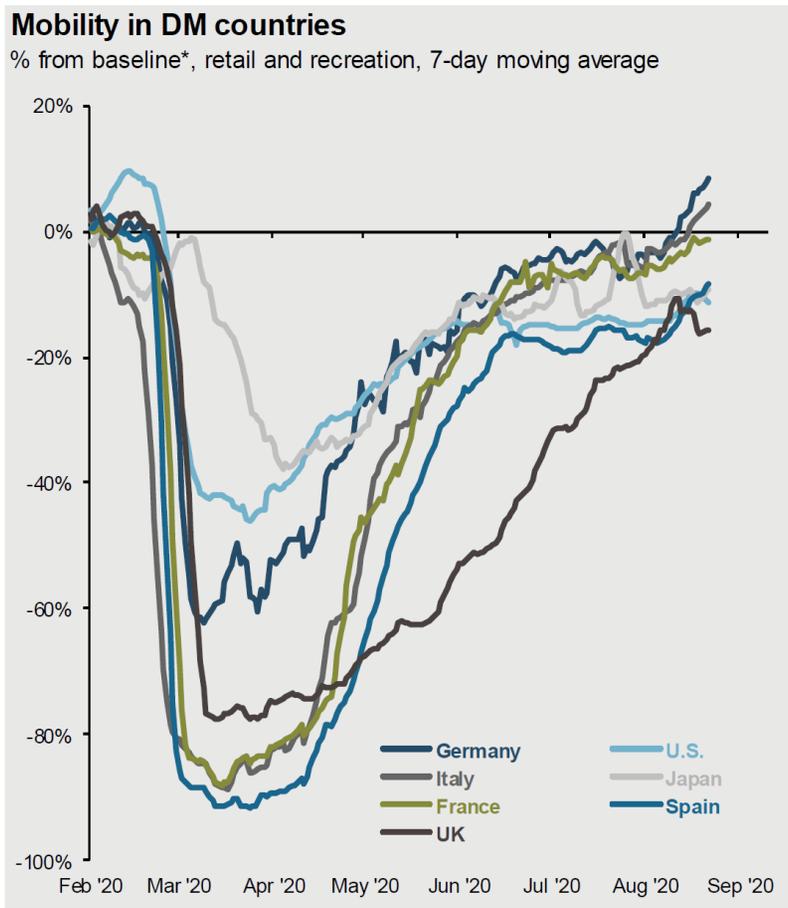
Source: "Estimation of clinical trial success rates and related parameters," Biostatistics, Volume 20, Issue 2, April 2019, Pages 273-286; WHO, New York Times.

# Globally, recovery has been strong but muted compared to US recovery.



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.  
 Forward price to earnings ratio is a bottom-up calculation based on the most recent index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on price movement only, and do not include the reinvestment of dividends. Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by FactSet Market Aggregates. Past performance is not a reliable indicator of current and future results.  
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Most global economies have regained full mobility, which should help continued economic growth.



Source: Google Mobility Reports, J.P. Morgan Asset Management.  
 \*The baseline is the median for the corresponding day of the week, during the 5-week period between January 3 and February 6 of 2020.  
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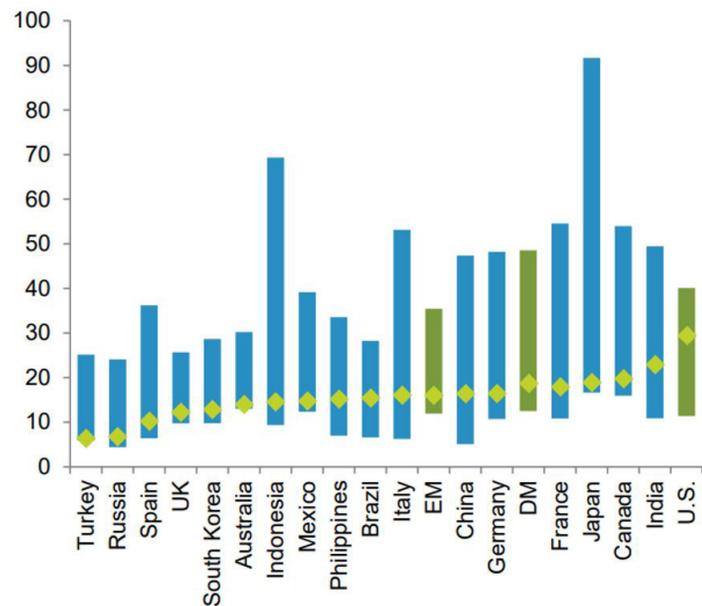
# Non-US equity valuations are relatively attractive.

Cyclically adjusted P/E (CAPE) ratios for international developed-market and emerging-market equities remained below U.S. valuations, providing a relatively favorable long-term backdrop for non-U.S. stocks. Despite depreciating for the second quarter in a row, the U.S. dollar remained relatively expensive against most major currencies.

## Cyclically Adjusted P/Es

◆ 8/31/20    ■ 20-Year Range

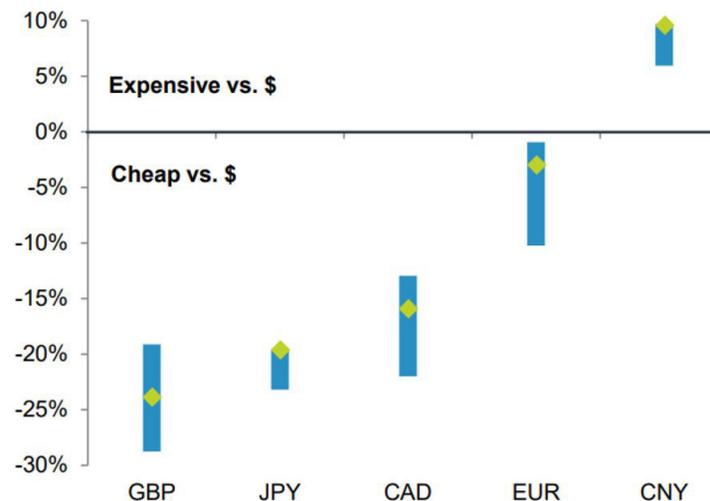
Shiller CAPE



## Valuation of Major Currencies vs. USD

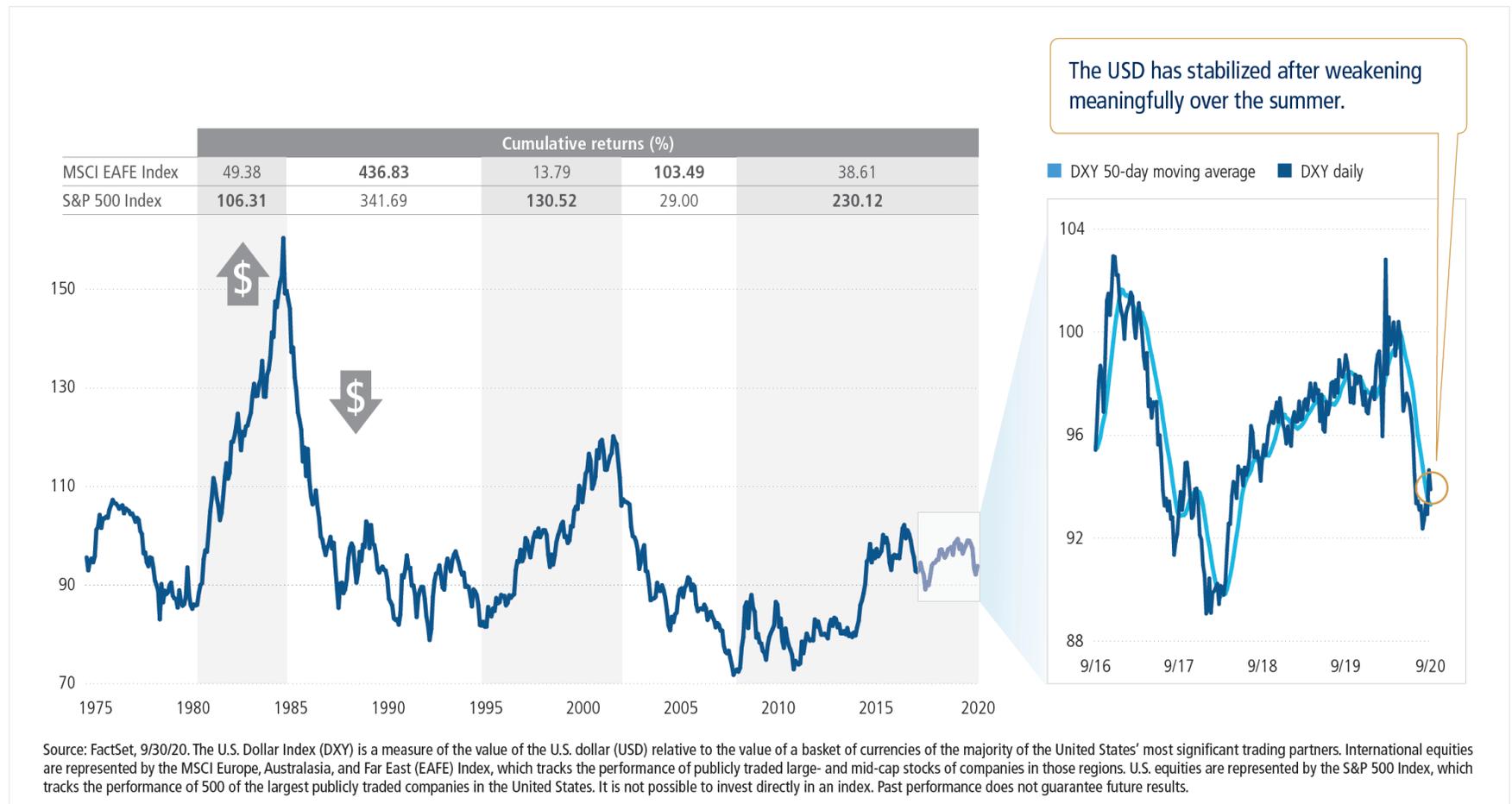
■ Last 12-Month Range    ◆ 9/30/20

Valuation of Real Exchange Rates



DM: Developed Markets. EM: Emerging Markets. Past performance is no guarantee of future results. It is not possible to invest directly in an index. All indexes are unmanaged. See Appendix for important index information. **LEFT:** Price-to-earnings (P/E) ratio (or multiple): stock price divided by earnings per share, which indicates how much investors are paying for a company's earnings power. Cyclically adjusted earnings are 10-year averages adjusted for inflation. Source: FactSet, countries' statistical organizations, Haver Analytics, Fidelity Investments (AART), as of 8/31/20. **RIGHT:** GBP—British pound; JPY—Japanese yen; CAD—Canadian dollar; EUR—euro; CNY—Chinese yuan. Source: Federal Reserve Board, Haver Analytics, Fidelity Investments (AART), as of 9/30/20.

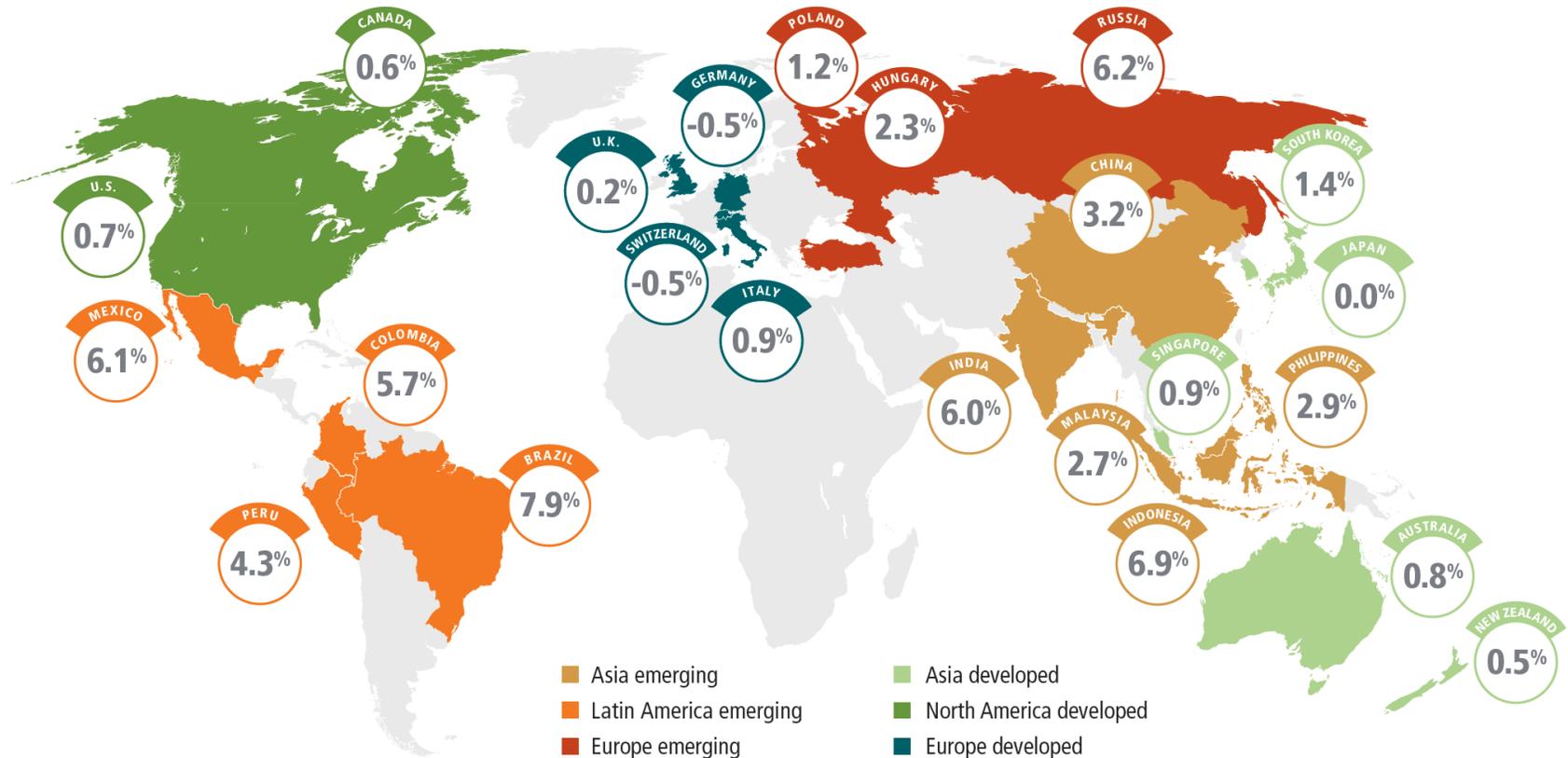
International stocks have been comparatively weak when the dollar rises - and comparatively strong when it falls.



Source: FactSet, 9/30/20. The U.S. Dollar Index (DXY) is a measure of the value of the U.S. dollar (USD) relative to the value of a basket of currencies of the majority of the United States' most significant trading partners. International equities are represented by the MSCI Europe, Australasia, and Far East (EAFE) Index, which tracks the performance of publicly traded large- and mid-cap stocks of companies in those regions. U.S. equities are represented by the S&P 500 Index, which tracks the performance of 500 of the largest publicly traded companies in the United States. It is not possible to invest directly in an index. Past performance does not guarantee future results.

# Across the world, fixed income yields remain low...

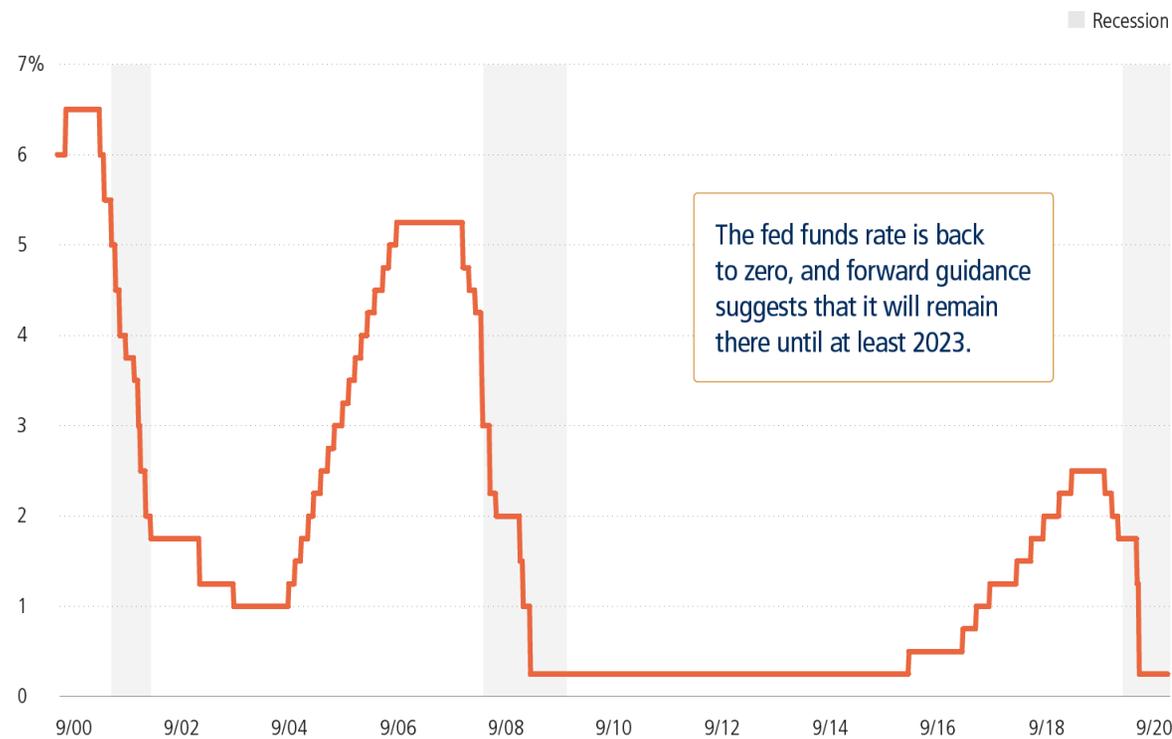
10-year government bond yields



Source: FactSet, as of 9/30/20. Foreign investing, especially in emerging markets, has additional risks, such as currency and market volatility and political and social instability. Past performance does not guarantee future results.

...and in the US, the Federal Reserve intends to keep them low for a long time.

Fed funds target (upper bound)



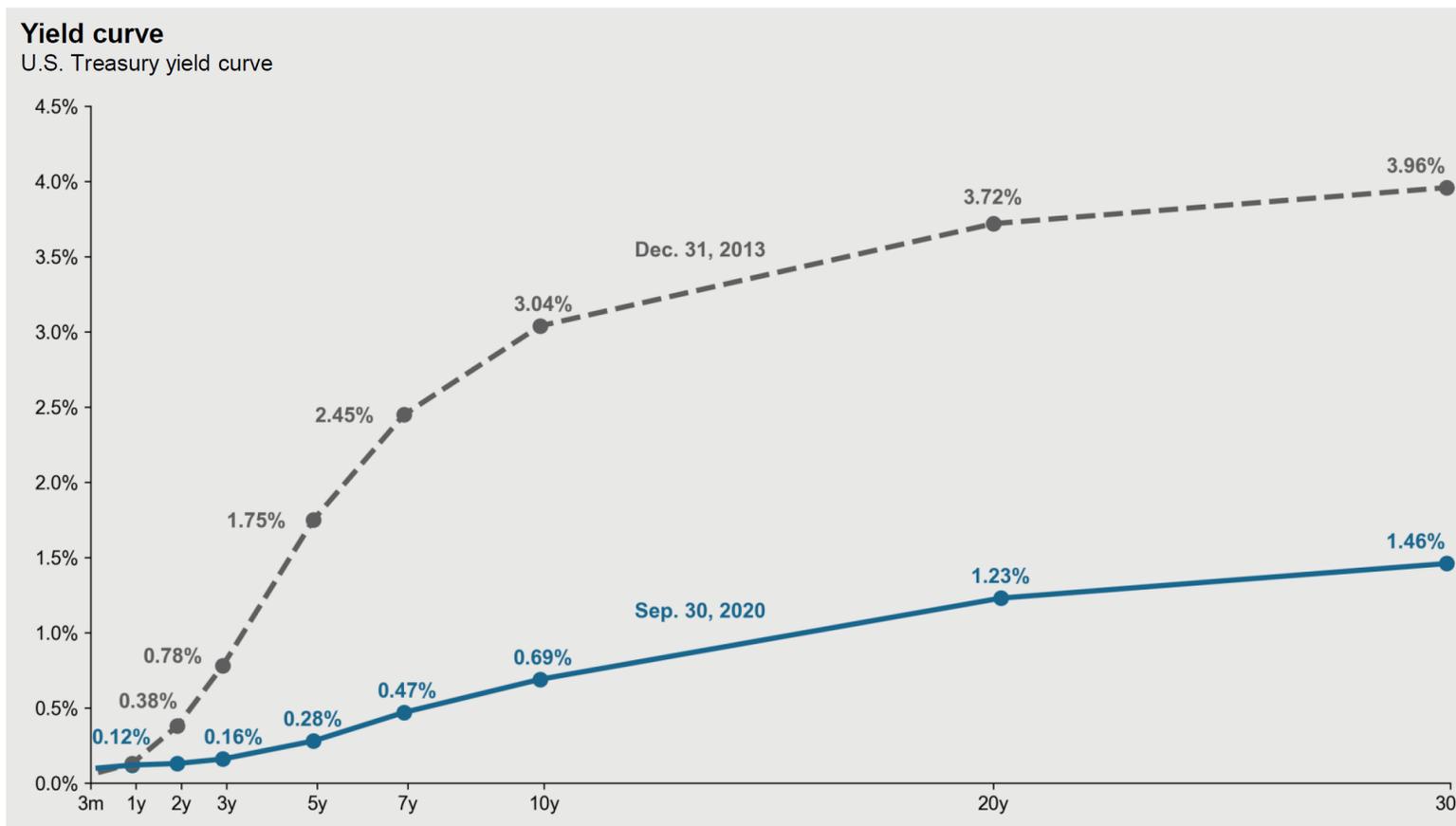
The fed funds rate is back to zero, and forward guidance suggests that it will remain there until at least 2023.

U.S. Treasury yield curve (%)

1 month	0.08
2 month	0.08
3 month	0.10
6 month	0.11
1 year	0.12
2 year	0.13
3 year	0.15
5 year	0.28
7 year	0.47
10 year	0.69
20 year	1.23
30 year	1.46

Source: U.S. Federal Reserve (Fed), Chicago Fed, as of 9/30/20. Interest-rate projections are based on the median for the federal funds rate projections of the Federal Open Market Committee (FOMC), the body responsible for setting the federal funds rate, which meets eight times a year. FOMC members anonymously report interest-rate projections four times a year, in March, June, September, and December. Past performance does not guarantee future results.

The yield curve is extremely flat, with very little reward for long term bond holders.



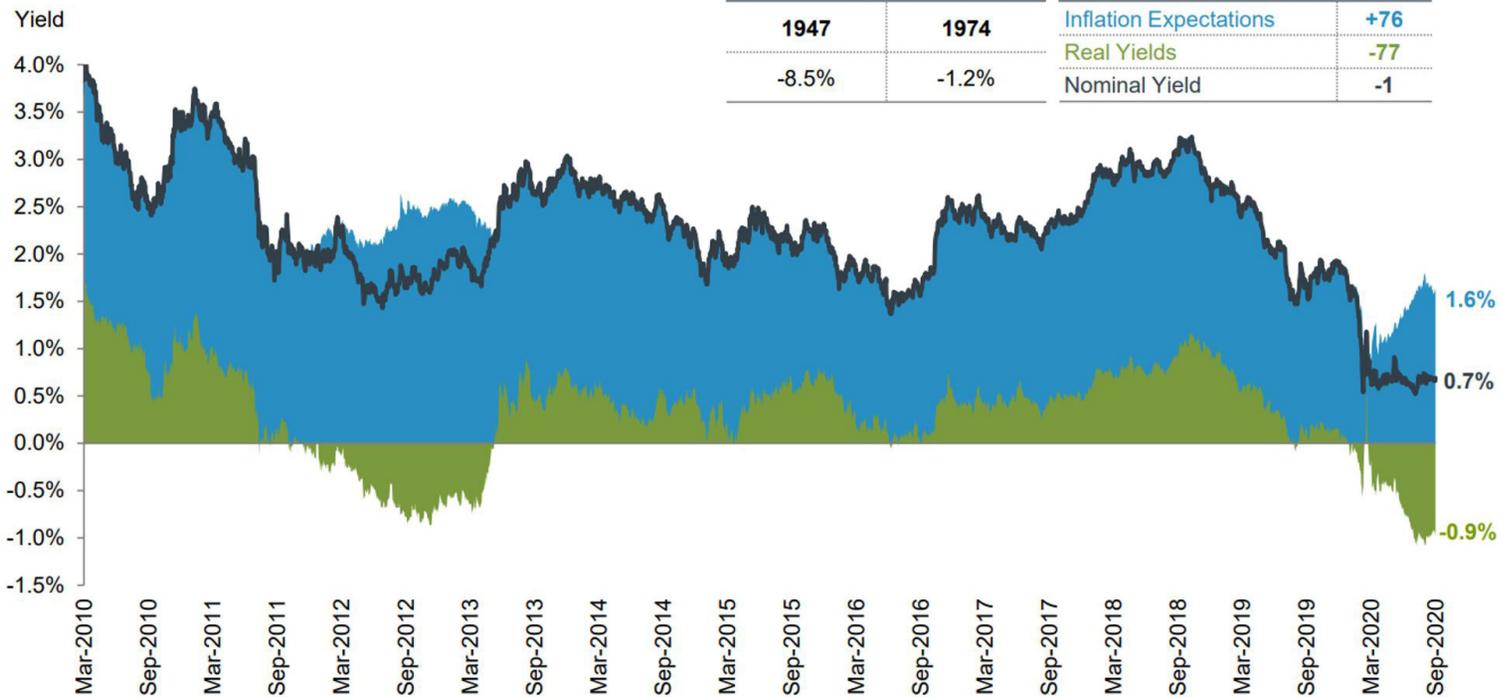
Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.  
Guide to the Markets – U.S. Data are as of September 30, 2020.

# After inflation, real bond yields are deeply negative.

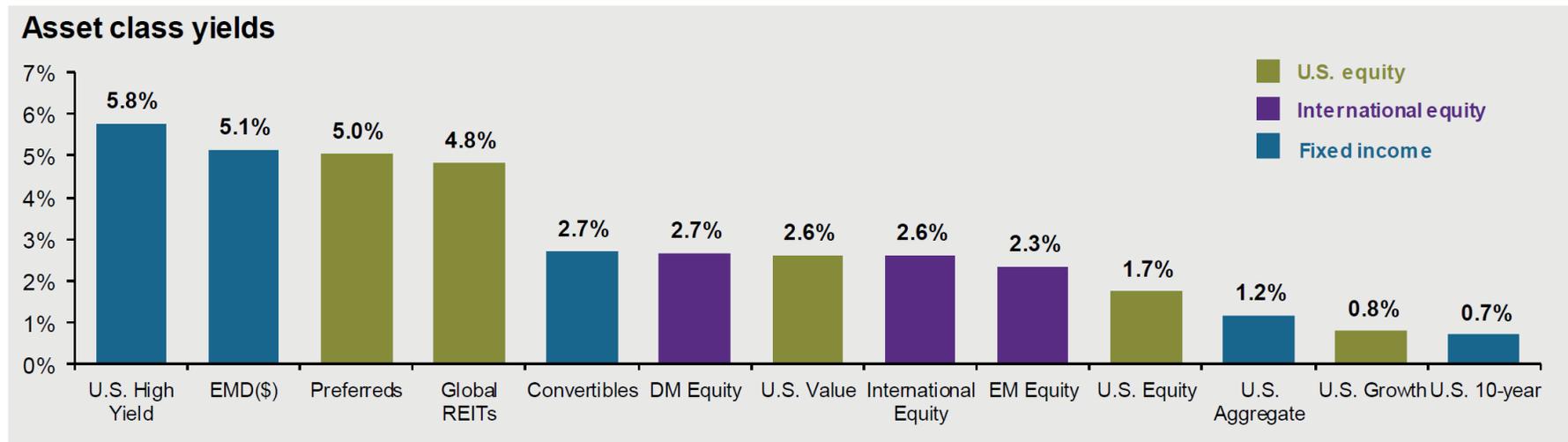
U.S. 10-year Treasury yields remained near record lows, held stable by weak economic activity, quantitative easing, and a global low-yield environment. The real cost of borrowing fell deeper into the negative during Q3, due to a rise in inflation expectations from depressed levels. The most negative real yields in U.S. history occurred during periods of monetary accommodation and higher inflation in the late 1940s and the mid-1970s.

## 10-Year U.S. Government Bond Yields

■ Inflation Expectations ■ Real Yields — Nominal Yield

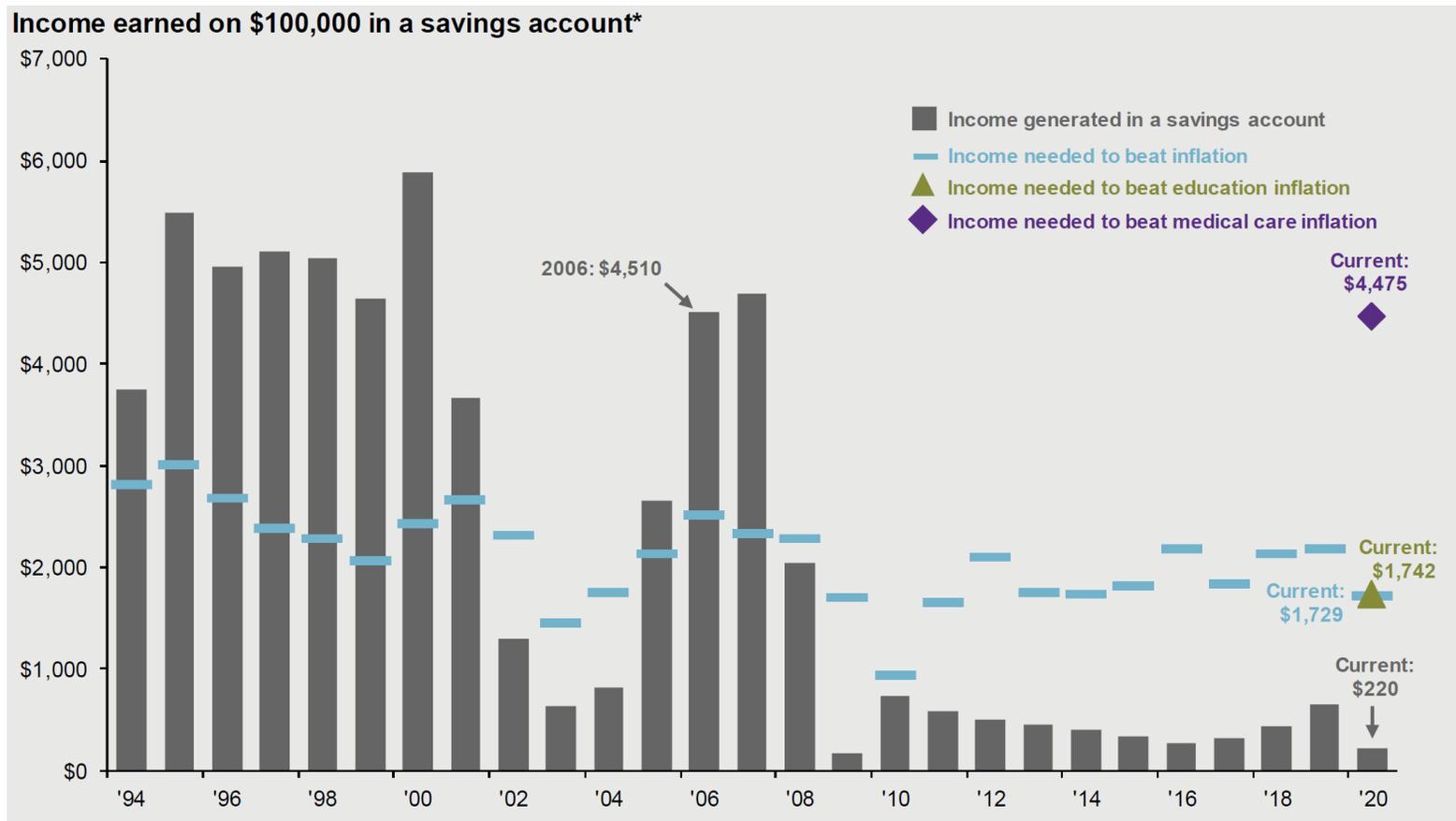


# Most asset yields barely clear inflation assumptions of 2% annually...



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Top) Ibbotson; (Bottom) BAML, Barclays, Bloomberg, Federal Reserve, FTSE, J.P. Morgan, MSCI, NCREIF, Russell. Dividend vs. capital appreciation returns are through 12/31/19. Yields are most current. Preferreds: BAML Hybrid Preferred Securities; U.S. High Yield: Bloomberg US Corporate High Yield; Global REITs: FTSE NAREIT Global REITs; U.S. Aggregate: Bloomberg Barclays US Aggregate; EMD(\$): J.P. Morgan EMBIG Diversified; Convertibles: Bloomberg Barclays U.S. Convertibles Composite; International Equity: MSCI AC World ex-U.S.; EM Equity: MSCI Emerging Markets; DM Equity: MSCI EAFE; U.S. Equity: S&P 500; U.S. Growth: Russell 1000 Growth; U.S. Value: Russell 1000 Value; U.S. 10-year: Tullett Prebon.  
*Guide to the Markets – U.S.* Data are as of September 30, 2020.

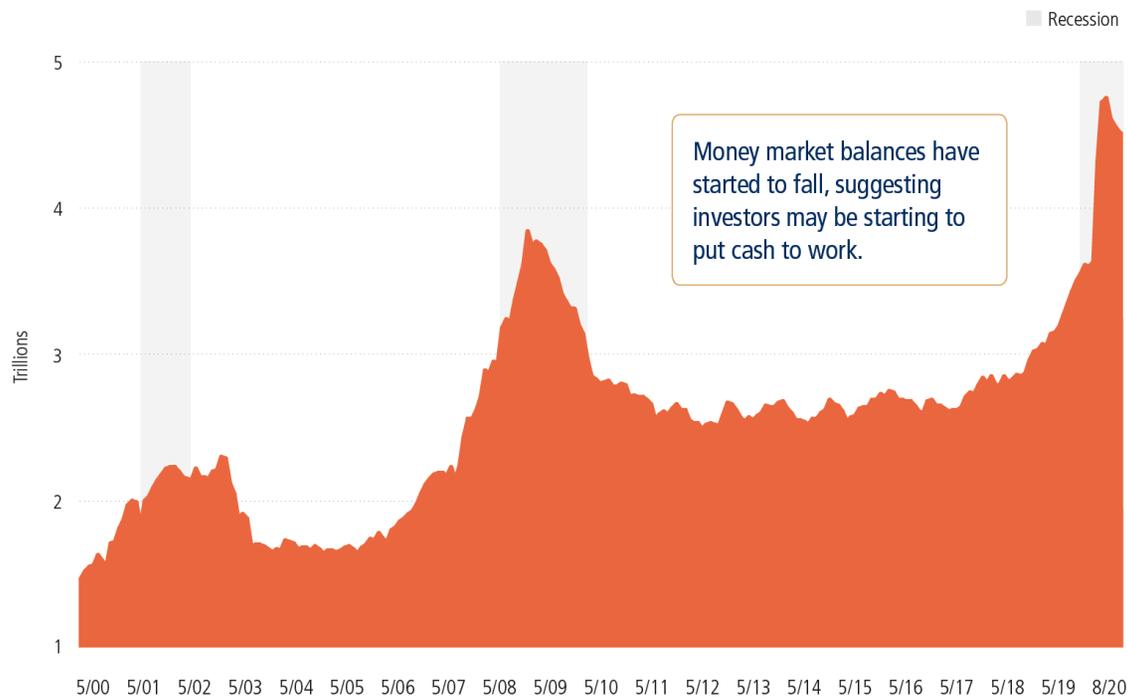
...making it difficult for savers to keep up with rising costs of living.



Source: Bankrate.com, BLS, FactSet, Federal Reserve System, J.P. Morgan Asset Management.  
 \*Savings account is based on the national average annual percentage rate (APR) on money-market accounts from Bankrate.com from 2010 onward. Prior to 2010, money market yield is based on taxable money market funds return data from the Federal Reserve. Annual income is for illustrative purposes and is calculated based on the average money market yield during each year and \$100,000 invested. Current inflation is based on August 2020 Core CPI, education inflation and medical care inflation. Current savings account is based on the September 2020 national average annual percentage rate (APR) on money-market accounts. Past performance is not indicative of comparable future results.  
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# A balanced portfolio has helped to provide long term returns with lower on average risks.

Money market assets have soared in the pandemic

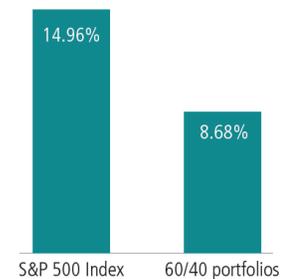


A 60/40 portfolio has provided long-term investors with a similar return to stocks, but with less risk

20-year returns

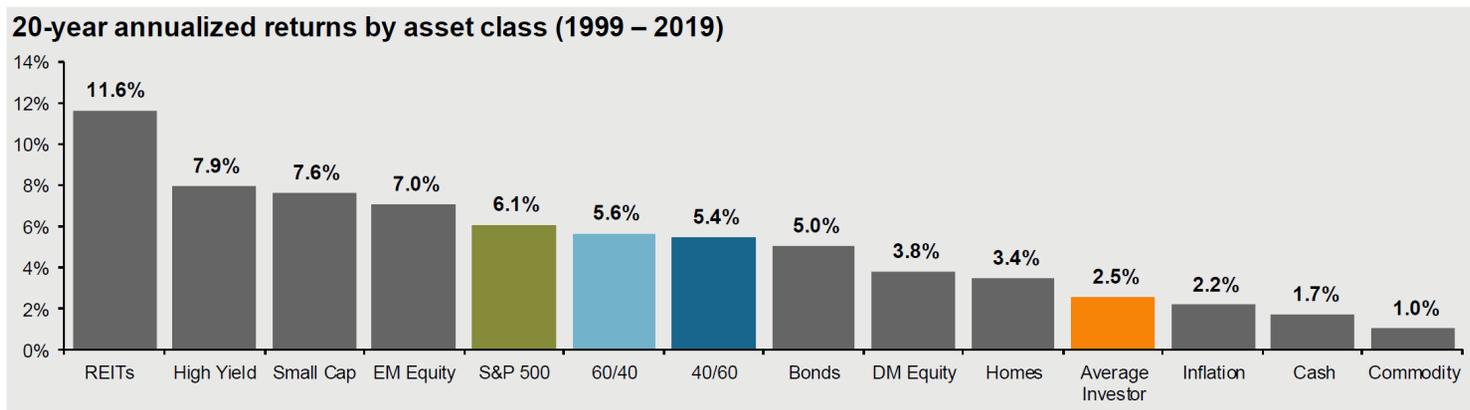
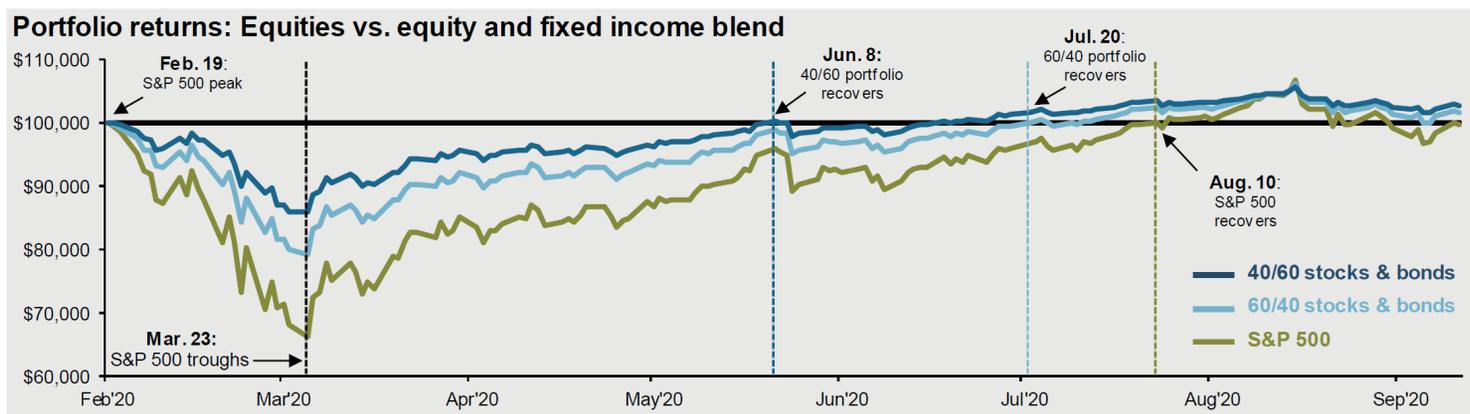


20-year standard deviation



Source: FactSet, as of 9/30/20. The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. It is not possible to invest directly in an index. Standard deviation is a statistical measure of the historic volatility of a portfolio. It measures the fluctuation of a fund's periodic returns from the mean or average. The larger the deviation, the larger the standard deviation and the higher the risk. Past performance does not guarantee future results.

A balanced portfolio was able to recover quicker after large decline in March as it had fallen less than the market.



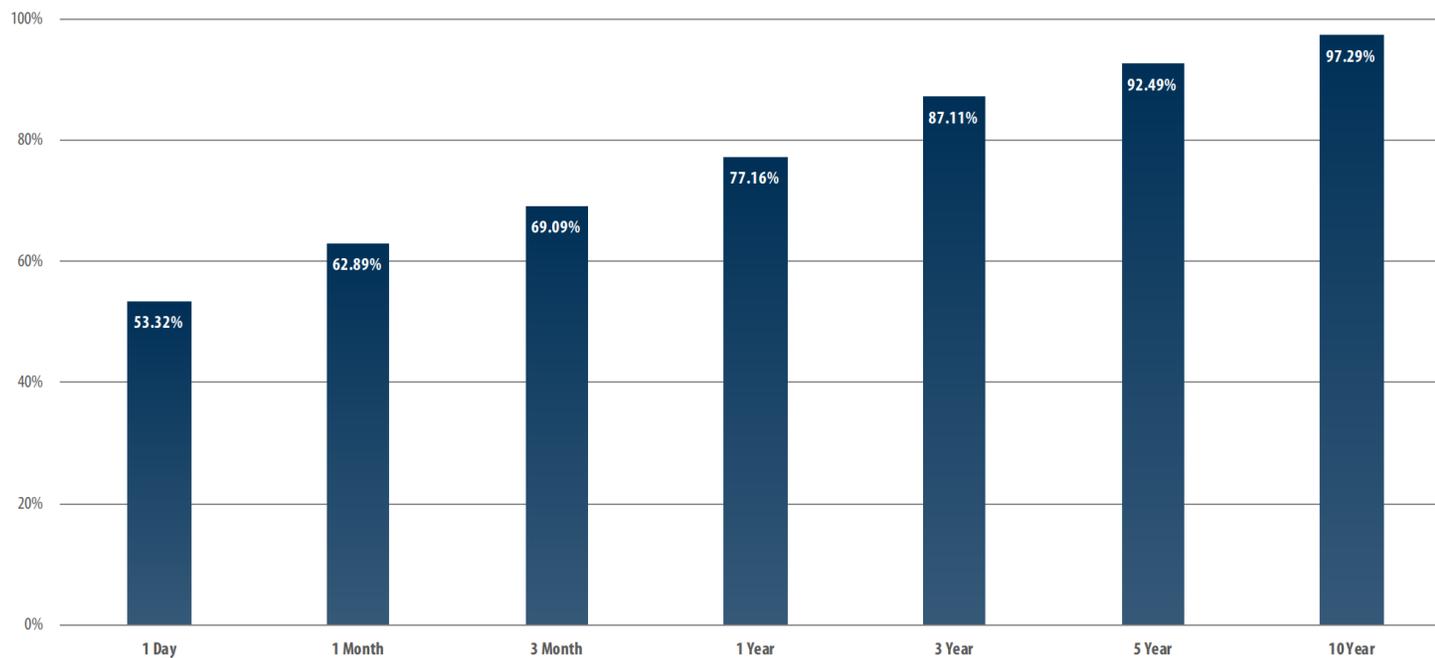
Source: Barclays, Bloomberg, FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Bottom) Dalbar Inc, MSCI, NAREIT, Russell. Indices used are as follows: REITs: NAREIT Equity REIT Index, Small cap: Russell 2000, EM Equity: MSCI EM, DM Equity: MSCI EAFE, Commodity: Bloomberg Commodity Index, High Yield: Bloomberg Barclays Global HY Index, Bonds: Bloomberg Barclays U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Cash: Bloomberg Barclays 1-3m Treasury, Inflation: CPI. 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high-quality U.S. fixed income, represented by the Bloomberg Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/19 to match Dalbar's most recent analysis. *Guide to the Markets – U.S.* Data are as of September 30, 2020.

# Patience continues to be an asset to all investors.

## Probability of Positive Returns

S&P 500 Index: 1937 – September 30, 2020

Investing in the stock market can be volatile. For this reason, we believe it is important to keep proper perspective when stocks rise or fall over short periods of time. History has shown that the odds of achieving a positive return are dramatically increased the longer the investment horizon.



Source: Bloomberg, 1937 through 9/30/2020. **Past performance is no guarantee of future results.** This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. These returns were the result of certain market factors and events which may not be repeated in the future. This chart is based on the total returns of the S&P 500 Index. The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance. The index cannot be purchased directly by investors.

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# Portfolio Implications

Going into the final quarter of 2020, multiple crosscurrents and uncertainties are presenting both investment opportunities and risks.

There are reasons to be cautiously optimistic: An economic recovery is underway. A vaccine is likely in 2021. Monetary policy is extremely supportive. And U.S. stocks are cheap relative to bonds.

There are also reasons for caution: Election uncertainty could cause financial market volatility. A disputed result or ballot-counting delays could mean greater volatility than usual. The pandemic remains a significant societal, economic, and financial market risk. U.S. stocks are expensive relative to history. And there is always the potential for a geopolitical or other unknown shock.

Our watchwords for portfolio construction and positioning remain balance and resilience. Our portfolios are balanced and diversified across multiple dimensions. And we believe they can provide strong returns in our base-case and more optimistic economic scenarios, while still maintaining resilience should a more challenging scenario play out.

Investing in a way that accounts for the wide range of plausible outcomes requires discipline, patience, and a willingness to stand away from the herd at times. It can feel uncomfortable to stay the course, or add to equities, when markets are plunging or to care about valuation and not chase markets higher when they are soaring. But in the end, this is the best approach we've found to achieving one's long-term investment goals.

# Disclosures

Please remember that past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance of any specific investment, investment strategy (including the investments and/or investment strategies recommended by the adviser), will be profitable or equal to past performance levels.

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