

Third Quarter 2020

# Market Update

**The economy bounced back faster than expected but remains dependent on fiscal stimulus. The Federal Reserve signaled that rates would remain low, emphasizing the benefits of full employment in its policy framework update.**

## Interest rates

The Federal Reserve's new guidance indicates that rate hikes won't happen until realized inflation exceeds 2%.

**Volatility remains elevated in the run up to the election.**

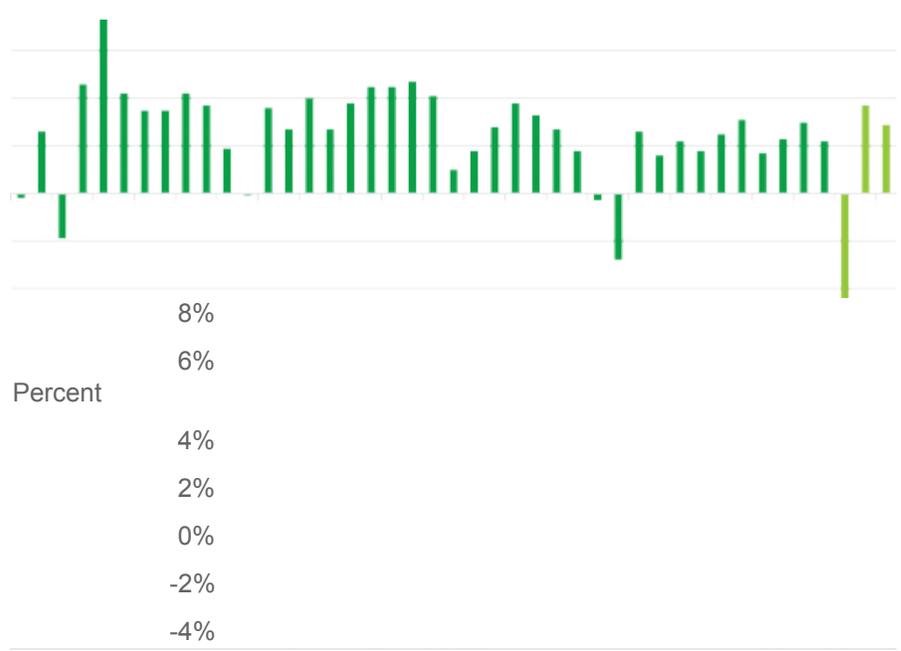
Markets ended up for the quarter despite the return of volatility and continued uncertainty around the lasting impact of COVID-19 on the economy. Many investors remain convinced that the Federal Reserve (Fed) will continue to provide a backstop to credit markets. High grade investors easily absorbed record corporate issuance totaling more than \$1.5 Trillion so far this year. High-yield and investment grade corporate bonds outperformed treasuries as spreads tightened during the quarter.

The Fed unveiled its new policy framework while reiterating its goals of maximum employment and price stability. The Fed's new guidance indicates that rate hikes won't happen until realized inflation reaches 2% and inflation is on track to moderately exceed 2% for some time. Policymakers want to see enough job growth to fully absorb labor slack, even if that means the economy runs "hot" before raising rates. The Fed's move towards a more flexible inflation target wasn't a surprise. The new policy appears to factor in a 1-2% overshoot of the 2% target to ensure the economy reaches full employment before policymakers raise rates. Real rates are likely to remain depressed in this scenario.

**The economic outlook is a good news/bad news story.**

While the early recovery has been V-shaped and faster than expected, it's questionable whether the momentum is self-sustaining at this point. The recession is likely to be the shortest on record after a 31% annualized quarterly decline in real Gross Domestic Product (GDP) in second quarter, which was the deepest quarterly downturn ever. Policy support focused on Main Street has been effective in delivering relief to battered consumers and affected businesses. While expanded unemployment benefits had been an early tailwind, without another stimulus package, a weaker consumer could quickly become a headwind. The consensus for GDP growth in the third quarter is about 25%, which still leaves the economy far below where it was in 2019. We expect economic activity to shrink by 4-5% for the full year and unemployment to remain elevated at between 7-8% at year end.

## U.S. REAL GDP GROWTH



1980  
1982  
1984  
1986  
1988  
1990  
1992  
1994  
1996  
1998  
2000  
2002  
2004  
2006  
2008  
2010  
2012  
2014  
2016  
2018  
2020  
2022

-6%  
Real GDP Growth Forecast

**Expecting a strong re-bounce, however...**  
we expect economic activity to shrink by 4-5% for the full year.

Year

Source: Bureau of Economic Analysis, Bloomberg consensus estimates. Data as of 10/01/2020. Data spans from 01/01/1980 – 12/31/2019 with forecast predictions for 2020, 2021 and 2022.

The big question on investors' minds is whether we'll see growth slow more than expected as the fiscal stimulus dwindles and the "new normal" comes into view. Another stimulus package would help hold the line until we have a vaccine. Until then, corporate earnings, particularly in travel and leisure, remain under significant pressure. As the pandemic drags on and businesses refocus on long term prospects, we expect further restructuring and less positive labor market momentum. Against a backdrop of continued uncertainty, growing corporate and government borrowing have reduced the resilience of the economy to an unexpected shock. An effective vaccine would be a game changer. However, the timing – and the public's faith in the process – are key uncertainties. Our political system seems less responsive than ever to growing imbalances that could threaten longer run growth prospects. The lack of any consensus in even defining the nation's most pressing problems has hurt the outlook for the economy and the markets. We expect continued volatility until the election is settled – potentially well past election day.

Sources: Bloomberg, The Federal Reserve, Bureau of Economic Analysis, Securian Asset Management, Inc. All sources as of 10/01/2020.

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