August 3 2020

CALENDAR CONCERNS AND GOLD GAINS

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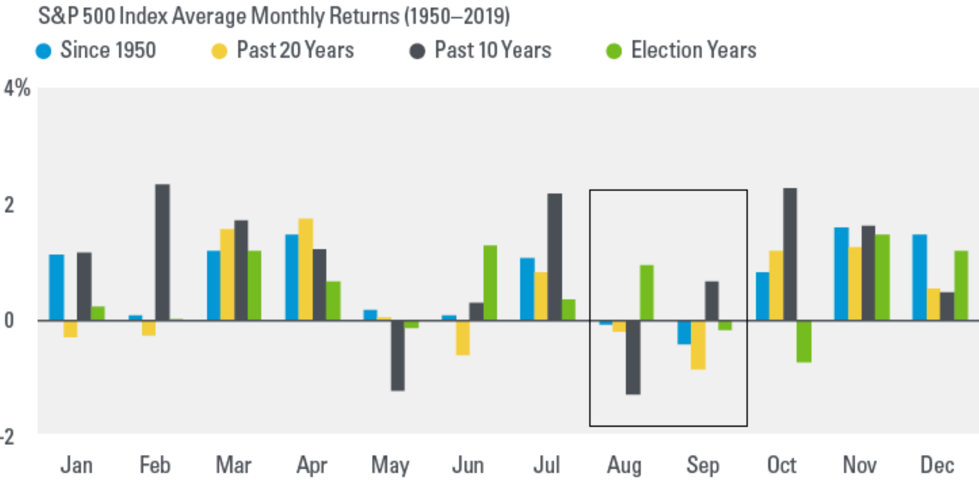
Real-time economic data continues to show a slowdown, at the same time we're entering two months of the year that historically have been troublesome for stocks. Meanwhile, gold is breaking out to new all-time highs, confusing many as to what it all means. Stocks are likely due for a breather, but it isn't out of the ordinary to see both gold and stocks trend higher together.

CALENDAR DOING NO FAVORS

Last week, we discussed why the stalling economic recovery could slow the stock market rally. This week, the calendar has our attention, as August and September historically have been troublesome months for stocks.

August and September have tended to be quite weak for stocks, with August ranking as the worst month of the year over the past decade **[FIGURE 1]**. August has been quite strong during election years previously, but after the best July for stocks since 2010, a little more caution may make sense.

1 AUGUST AND SEPTEMBER HISTORICALLY HAVE BEEN TROUBLE



Source: LPL Research, FactSet 07/30/20

All Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

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The calendar is only one part of it, though. We're seeing many signs of froth, as investors are feeling pretty good after the record stock rally. From a contrarian point of view, however, this is a worry. For instance, options traders are the most optimistic they've been since earlier this year, while sentiment surveys like the National Association of Individual Investors (NAAIM) Exposure Index and Investors Intelligence Weekly Advisor Sentiment are both flashing warning signs similar to what we've seen at previous market peaks.

In the bigger picture, we remain constructive on stocks, as we discussed in our *Midyear Outlook 2020*, but the path to future gains may be volatile. With the election discussions heating up, COVID-19 uncertainty still here, and real-time data softening, the next few months are tough to call. We remain confident that stocks may provide better returns than bonds in the second half of the year, and over the next 12 and 24 months.

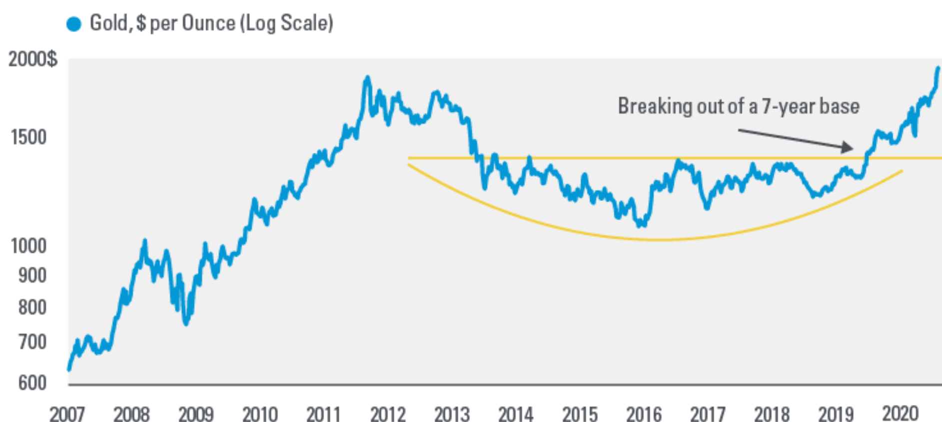
Obviously, 2020 has been unlike any other year we've seen before, but after the best four-month rally for the S&P 500 Index in more than 20 years, combined with the calendar concerns and bullish sentiment, a possible late summer lull may be perfectly normal.

GOLD MAKES NEW HIGHS, WITH MORE TO COME

The Federal Reserve (Fed), as expected, left interest rates at 0%, and likely will keep them there at least for the remainder of 2020 and through 2021, as the economic recovery remains fragile and will take time. This has led to negative real interest rates (inflation adjusted), which is one of the reasons gold is back up to new all-time highs, eclipsing its September 2011 peak. Many are worried that gold at new highs may be sending a major warning sign for stocks, but that doesn't appear to be the case to us.

So far, 2020 is the first year since 1979 when both gold and the S&P 500 have made new highs during the same calendar year. What happened the last time? In 1980, gold added another 17% and the S&P 500 was up 26%. It is widely believed that higher gold prices possibly could mean something is wrong in the stock markets and investors are more defensive; however, it isn't always that simple, and the two indeed can trend higher together.

2 GOLD BREAKS OUT TO ALL-TIME HIGHS



Source: LPL Research, Bloomberg 07/30/20

Past performance is no guarantee of future results.

The economic forecasts may not develop as predicted.

We see 10 reasons gold is at new highs and potentially could continue to move higher:

- The US dollar at its lowest level in more than two years. Historically, gold and the US dollar have traded inversely. We continue to expect a lower trending US dollar as we discussed in our July 23 LPL Research blog, Dollar Weakness May Continue.
- Growing concerns over US-China relations
- COVID-19 uncertainty and potential economic weakness
- European data quickly improving. Europe is doing a great job containing COVID-19, thus potentially strengthening the euro—which may pressure the US dollar lower.
- Record monetary stimulus. The Fed balance sheet exploded to $7 trillion recently, from $4 trillion before COVID-19.
- Nearly $15 billion worth of negative sovereign debt globally
- Record trade and budget deficits
- The 0% interest rate policy probably here to stay
- Negative real-rates. This makes gold's 0% interest look pretty good on a relative basis.
- Huge government spending programs may eventually spur inflation.

Gold based for nearly seven years before the major breakout late in 2019 **[FIGURE 2]**. There's an old technical saying that "the longer the base, the further in space," which played out quite well this time, as gold based for years before the current surge higher. Technically, gold still looks like it will continue to perform well, while fundamentally there are many tailwinds. We have been bullish on gold since late 2019, and we remain bullish in this environment.

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Investing in gold is subject to risks including loss of value. The price swings in commodities and currencies can result in significant volatility in an investor's holdings.

The Standard & Poor's 500 Index (S&P500) is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

All index data from FactSet.

Please read the full Midyear Outlook 2020: The Trail to Recovery publication for additional description and disclosure.

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