Economic & Investment Strategy Outlook
Autumn 2020

Economic Outlook

Prominent Pennsylvania businessman and politician Robert G. Allen once said "How many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case". Allen died in 1963 and didn't live to see the savings account rate of 10.5% in 1980! His thinking was more cerebral of course and relevant for his time. We realize he was encouraging investors to look to other asset classes or investment endeavors to grow one's wealth. From a literal perspective, Allen's words certainly ring true today, as we invest in a world where The Federal Reserve expects to maintain its target interest rate range at 0 to ¼ percent until 2023, assuming the Fed can achieve its inflation target at that time.

This zero-bound interest rate environment, where money market funds and other fixed income assets are paying historically low rates, requires investors to maximize investment dollars. To do so, they must evaluate their risk tolerance, asset allocation, and stay the course with an investment strategy designed to help attain their financial goals and maintain their standard of living. Our goal in writing this quarterly outlook is to explore factors which will drive relevant investment strategies in this, the Pandemic Era.

Pandemic

First and foremost, the pandemic influences and in some instances governs the short, medium and long-term aspects of investment strategies. Home and business lifestyles have changed. Travel and socialization have changed. Urbanization and population migration have changed. Seismologists at the Royal Observatory of Belgium report that the Earth is suddenly stiller as human and economic activity has slowed. Product cycles have accelerated, products have become obsolete, and industries have morphed to accommodate our attempts to slow the spread of Covid-19 until a vaccine is developed. This is especially true in the digital arena. A reporter from the Wall St. Journal chronicled "With respect to telemedicine, more was accomplished in two weeks than five years." What we realize is that a return to normal activities similar to what we knew in January, will not happen as long as Covid-19 poses a material threat to health and life. All these changes have provided new investment challenges and opportunities, some that are moderate in nature, and some that have reached what are considering historical extremes.

Vaccine

Worldwide, there are at least 53 Covid-19 vaccines in clinical trials. Four of the largest trials have reached the final Phase III stage. Health and Human Services Secretary Alex Azar spoke

on 10/21/20 regarding availability. He stated that by the end of January 2021, there should be enough vaccine for the most vulnerable individuals, seniors, health care workers and first responders. By the end of March to early April, there should be vaccine for all Americans who want to be immunized. The implications of announcing, implementing, and distributing a vaccine are important to markets that move on every news update. In the past, periods of disease-driven austerity generally were followed by periods of copious spending as seen after the Great Plague and the Roaring Twenties after the Spanish Flu.

Government Intervention

The response to the pandemic from the US government has been immediate and aggressive. The Federal Reserve first dropped interest rates to near zero and then outlined plans to lend billions of dollars across markets. This was followed by a new Fed interest rate policy, which will preserve low rates for the foreseeable future. Congress acted to deliver a multi-trillion dollar fiscal package to assist individuals, companies and state and local governments. While these efforts did not prevent a recession, they bought time to preserve the economy until a vaccine is deployed. Similar actions were taken by governments worldwide. We now debate the appropriate value of markets as supported by the Fed and Congress. As Marty Zweig said in his book "Winning on Wall Street" - "Don't fight the Fed," indicating that Fed policy is the dominant factor in determining the stock market's direction.

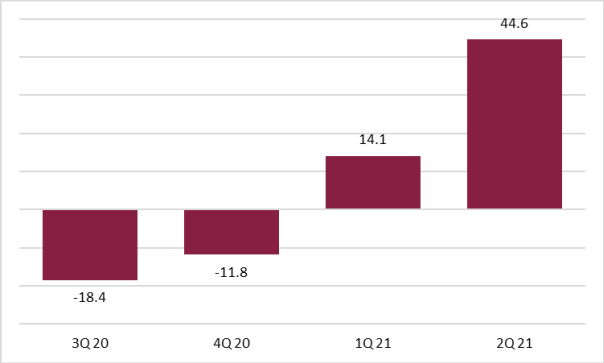
Election

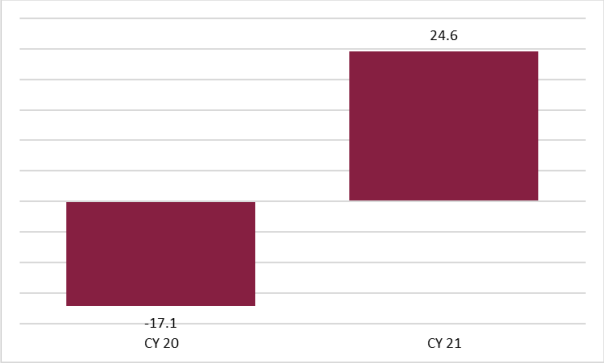
The outcome of the election portends to have repercussions for corporate earnings. The Democratic platform is built upon higher taxes for corporations and wealthy taxpayers and increased program spending, while the Republican platform focuses on new tax cuts. In either case, what is enacted will depend on the congressional election outcome. Each regime has its own set of risks and opportunities. There are also implications for the next round of stimulus, if not passed or partially passed before the election. Historically, markets and the economy have experienced positive returns and growth under all executive and legislative configurations of government. From 1929 to 2019, one party held the presidency and controlled both legislative branches in 45 of those years. During those years, the S&P 500 rose 7.45%. For the other 46 years in which there was a split government, the S&P rose 7.26%.

Corporate Earnings

The stock market is a forward-looking discounting mechanism that values corporate earnings. Earnings so far this quarter are robust with the percentage of S&P 500 companies beating earnings per share estimates for the quarter with the magnitude of the improvements at near or exceeding record levels. Although earnings growth will remain negative through the end of the year, expectations are for a sharp rebound in 2021 that will surpass pre-pandemic levels. We note that next year's earnings may appear high given the unusually deep recession. The rationale for increased earnings is multifaceted, but primarily twofold. First, would be optimism about the timing and efficacy of vaccine and therapeutics and the prosperity of a post Covid-19 future. Second, economic consequences of the pandemic are being inflicted primarily on individual and small businesses and to a much lesser extent, on publicly traded companies.

Projected Earnings Growth for S&P 500 Companies



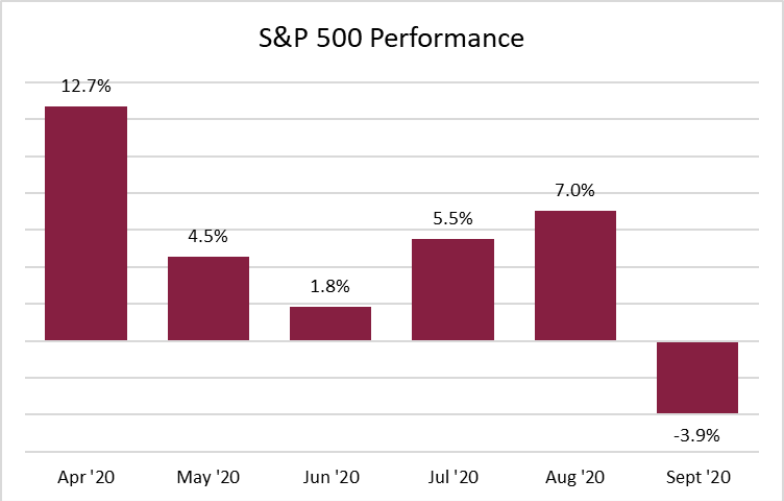


Source FactSet; PeoplesBank Wealth Management

Investment Strategy

Since our last report to you in August, the Investment Strategy Committee made no asset allocation changes nor added or deleted any allocation positions. We see the potential upside and downside risks in equity markets as balanced, maintaining our equity and fixed income allocations at neutral. The Pandemic Era factors we considered in our decision making are accompanied by many other pros and cons. For example, we see strong housing, auto sales, consumer spending, manufacturing and inventory replenishment offset against the attainment of sustained economic growth, a stock market that seems disconnected from the economy and ballooning worldwide government debt.

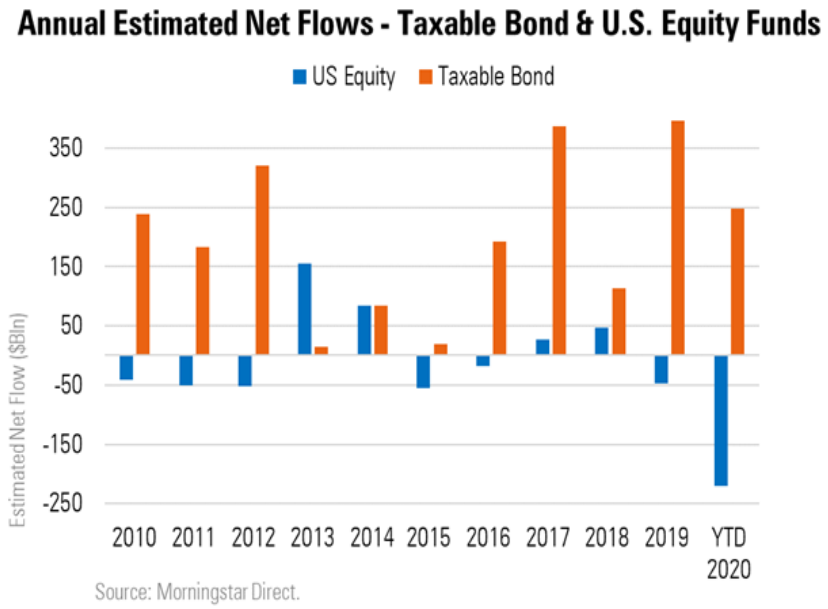
We have written before about the risk of market timing and being out of the market. Instead, we continue to advocate a proper positioning between equities and bonds that reflects portfolio goals and risk tolerances. We have experienced record volatility in February and March followed by strong equity returns in April through August of 2020:



Source: Market Watch, YCHARTS, Peoples Bank

In September, the S&P 500 dropped 3.9%. The NASDAQ 100 dropped more than 10% during the month, ending down 5.7%. This downturn in the S&P was triggered by a variety of events – disagreement among lawmakers on size and timing of additional stimulus, increasing rate of Covid-19 cases and a pullback from richly valued technology stocks.

This market performance reinforces the need to avoid emotional reactions and stay invested. Above average volatility may be with us for some time. We must remember, markets rely on fundamentals and investment time horizons that extend beyond short term events. In the Summer Outlook, we wrote about how 401(k) investors stayed the course through February and March. That same fortitude was not shared by the broader community of investors, as at the end of September, year-to-date equity fund outflows were $220.6 billion – on track for the worst year of outflows on record.



Our View on Gold

We have had inquiries from clients about investing in gold. Gold has gained celebrity status in 2020 given its run up in price and as a safe haven investment in the early months of the pandemic. There are several reasons investors consider adding gold to portfolios:

- First and foremost – as a form of catastrophe insurance and store of value in volatile times
- Low rates make gold appealing relative to interest paying investments
- Gold is priced in U.S. dollars and can be a hedge against a falling dollar
- Gold can be a hedge against inflation

Setting aside owning gold for catastrophe insurance or emotional reasons, we have weighed the investment criteria for owning gold. Here are our current thoughts:

- While gold may be attractive in a low rate environment, there is really no way to perform fundamental analysis to evaluate its potential. Gold does not pay interest or dividends. In fact, there is an annual carrying cost to owning a gold ETF or in physical form in an investment portfolio.
- Unhedged international stock funds will benefit in the same manner as gold to a devaluation of the U.S. dollar. We currently have a position in client portfolios in international stock funds.
- While generally accepted as a hedge against inflation, there is some debate about its effectiveness versus other assets. We currently have an allocation to inflation protected securities (where there is fixed income exposure) and real estate, as an inflation hedge, in our investment strategies.

We will continue to monitor gold as a potential investment as we do with other assets, but at this time, we are not making an allocation to gold in our investment strategies. We would be happy to discuss gold investments with clients case by case, based on their individual circumstances.

Please see our overall recommendation on the next page.

The Investment Strategy Committee

PeoplesBank Wealth Management
Relative Asset Class Recommendations
As of 10/28/20

	Unattractive	Slightly Unattractive	Neutral	Slightly Attractive	Attractive
Stocks			X		
US Large Cap				X	
US Mid/Small Cap				X	
International Developed		X			
Emerging Markets		X			
Bonds			X		
US Investment Grade			X		
Inflation Protected Securities (TIPS)				X	
High-Yield	X				
International Bonds	X				
Municipal Bonds				X	
Preferred Stocks	X				
Real Assets					
Real Estate		X			

As of 10/28/20. Recommendations subject to change at any time without notice.

Investment Process

PeoplesBank Wealth Management's asset allocation process develops both long-term (strategic) and shorter-term (tactical) recommendations. The strategic recommendations are based upon how the Investment Strategy Committee believes investment portfolios should be positioned in a generally neutral market environment over the next ten years. The tactical recommendations are meant to highlight opportunities over the next one to two years where the Committee sees either increased opportunity or risk.

The Wealth Management Investment Strategy Committee (ISC) is responsible for establishing and updating both the strategic (long-term) and tactical (short-term) asset allocation for Wealth Management's investment management and trust relationships. The committee is comprised of the senior members of the Wealth Management team. The committee is also responsible for monitoring and updating strategies, managers, and funds within client portfolios. The ISC meets monthly. If you have any questions or would like to discuss PeoplesBank Wealth Management's outlook further, please call or send an email to your relationship or investment officer.