May 15, 2020

Update: Coronavirus and the Markets - What We're Watching

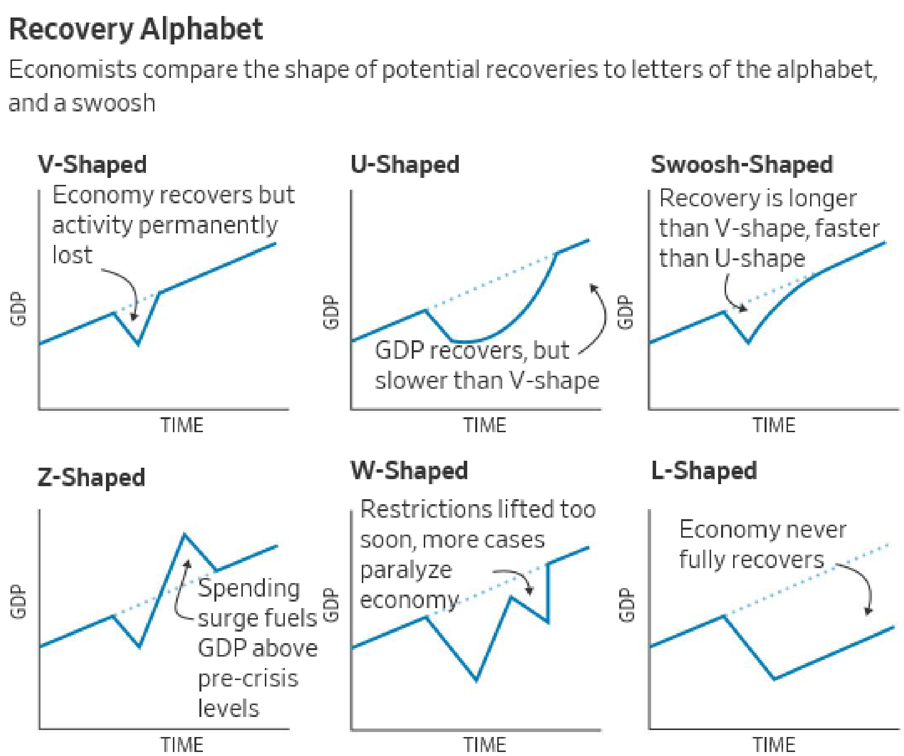
Reopening – it's all we are focused on these days and rightfully so, everyone is itching to get back to some semblance of normalcy after a few months of quarantined life. A new normal is inevitable – a new way of working, of dining, of shopping, of flying, of greeting each other – while it can be uncomfortable, in some ways it's a good thing. It will force us to be creative, to be innovative and try new ways of living. Technology is a prime example of this – what would have taken us years to adopt and trust, we've had to implement and rely heavily on in a matter of weeks. It's presented a more human side to our daily interactions as well. The virtual structure has created a more personal environment and helped us communicate differently. It took us out of the board room and into a more intimate environment with casual attire and dogs and kids in the background. Reopening may in some ways bring us back to where we were and in other ways change us permanently. Regardless of what life post COVID-19 looks like, reopening needs to be met with great caution. Scientists and government officials alike comment reopening too quickly could cause more harm than good. Dr. Anthony Fauci, Director of the National Institute of Allergy and Infectious Diseases and a member of the White House coronavirus task force testified in front of a Senate committee this week noting just that, unless states are equipped to handle a potential sudden surge in cases, they should strongly consider the speed at which they open. While there is hope a vaccine will become available, it is not likely it will in time for schools to reopen in the fall, which puts a greater emphasis on the availability of more testing. After an arduous back and forth with the White House, The Centers for Disease Control and Prevention (CDC) released new guidelines yesterday to help schools, restaurants, transit systems, and other businesses reopen. Its first draft was more rigid and specific, but was met with rejection by the White House and never released. This amended version is simple and straight forward, and also mirrors the advice health officials have already told us – social distancing, proper hygiene, and protecting those who are more vulnerable. The onus will be on individual states to keep an eye on health data and reopen judiciously, and businesses to establish new protocols that emphasizes heightened safety and testing.

It is no surprise this pandemic has hurt our global economy in many ways and impacted business and consumer confidence. From the status of unemployment (US economy lost over 20 million jobs in April with the unemployment rate spiking to 14.7%, the worst since the Great Depression[1]) and manufacturing, to consumer spending all reinforce the economic pain from our health lockdowns. While almost all the data has been grim, activity is starting to slowly pick up and we anticipate finding "green shoots" as the economy reopens and additional fiscal policy responses move from relief to stimulus. In that pursuit, we look to data points such as weekly jobless claims, restaurant bookings, mortgage applications, and transit choices for positive responses. Companies such as McDonalds and Chipotle are helping us measure consumers' ability and willingness to reengage, as well as spending levels from MasterCard to decipher any changes in consumer behavior and patterns. Each piece of the puzzle will help us characterize the pace and pervasiveness of the economic recovery.

Speaking of recovery, through Thursday the stock market is up 24% from the March 23rd low. However, other metrics fair differently - last Friday's jobs report showed a one month increase in the

[1] Forbes

unemployment rate from 4.4% to 14.7%. A large portion of the job losses is in restaurants and retail and retail sales plunged today, the biggest decline since the government started tracking the figures. One bright spot in retail however, was non-store sales jumped pointing to the acceleration of online sales with companies who have strong online channels. Q2 2020 earnings are now expected to fall 42% from a year ago, and full year 2020 earnings are on track to fall 21%[2]. There are fears of a major economic contraction, but the US Treasury yield curve is signaling a less than 20% chance of a recession within the next 12-months. As we've reported previously, volatility is a normal occurrence in the stock market. We saw a bit of that this week as some of its rebound faded as investors scaled back their optimism for a "v" shaped recovery and questioned whether markets have moved "too far too fast" in light of the health and economic challenges that still lie ahead. A "v" shaped recovery involves a sharp decline followed by a quick and sustained recovery. Economists are now contemplating the likelihood of other potential "recession shapes" on their recovery chart.



Note: Recoveries are using sample data
Source: Brookings Institution

It's often said the economy is not the market and the market is not the economy. Reinforcing that belief has been the clear disconnect in the data between Main Street and Wall Street. In April, the S&P 500 posted its best month in 33 years, while on Main Street a 20.5MM jobs were lost. In addition, there is a disconnect between rising stock prices and falling earnings which calls into question whether the market has become too expensive.

[2] Fidelity May 13, 2020

With the likelihood of a longer economic downturn, the market is questioning whether the Fed has enough ammunition to keep financial markets running smoothly. Federal Reserve Chairman Powell spoke Wednesday, acknowledging more needs to be done to combat the coronavirus-induced economic downturn. Chairman Powell acknowledged "The scope and speed of this downturn are without modern precedent, significantly worse than any recession since World War II". Acknowledging the challenges ahead, Powell asserted the Fed has enough tools in their tool kit to provide liquidity to the market before the need to consider negative interest rates. He urged the White House and Congress to focus their attention on spending more money to battle the downturn, citing the "Reversal of economic fortune has caused a level of pain that is hard to capture in word." and "There is a growing sense that the recovery may come more slowly than we would like…and that may mean that it's necessary for us to do more." The House is scheduled to approve today their latest coronavirus response bill, aiming to continue providing relief to families and businesses. The HEROES Act would provide another $3 trillion in additional funding with the majority going towards "closing the digital divide" among schools and families.

A level of uncertainty remains around the economic impact amid the reopening of several states and the potential resurgence of new cases in the fall. As such, we expect elevated volatility to remain through May. With the Q1 earnings season nearing an end, the markets near term path will be heavily influenced by new developments, positive or negative, which reinforces why staying invested and riding out the effects of these movements is important. It wasn't long ago we saw declines in the market only to be quickly followed by upswings. The short-term view of the market and our economy can be uncomfortable. Instead, try to focus on the progress you've made towards your long-term goals. Those goals may be negatively impacted if you react to short-term moves. Stay the course – investing is a long-term game and history shows us, the market's long-term trend has always been higher.