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MID-APRIL 2020

Market Update

"THE PACE OF THE SELL-OFF CAN BE TRACED TO THE ENORMOUS AMOUNT OF UNCERTAINTY TIED TO SHUTTING DOWN MAJOR PORTIONS OF THE ECONOMY."

We vividly recall the financial crisis of 2008. The economy was quickly contracting, several financial institutions required bailouts, layoffs abounded, and the stock market plunged.

However, we weren't grappling with fear tied to a health crisis then. We could attend the theater, eat at a restaurant, travel, or enjoy a live sports event. The roots of today's crisis are different, and nowadays we are in the midst of both an economic and health crisis. Activities outside the home have been greatly curtailed.

It's unsettling for everyone.

As we are all aware, the speed of the decline in stocks has been swift. Since the February 19th peak, the S&P 500 Index shed 34%, plummeting to its most recent low on March 23rd (St. Louis Federal Reserve data).

Since last month's low, the S&P 500 Index has rallied more than 25% through April 16th. As of April 16th, the S&P 500 Index was approximately 15% below its February 19th peak.

The pace of the sell-off can be traced to the enormous amount of uncertainty tied to shutting down major portions of the economy. What will its ultimate impact be? The brightest minds continue to debate this.

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"WITH SIGNS THAT NEW CASES MAY BE PEAKING, TALK IS SURFACING OVER HOW TO BEST REOPEN SHUTTERED INDUSTRIES."

We strenuously counsel against trying to time the market. Many analysts are experts at their craft, but they don't have a lock on the future. There are too many unknown variables.

We don't know what might happen next year, but the long-term historical trend has been favorable. Let's continue to keep our long-term financial goals in mind, even during these trying times.

A Bounce off the Bottom

Since last month's low, the S&P 500 Index rallied 25% through April 9th. Technically, a 20% rally from the market's bottom constitutes a new bull market–technically. As of April 9th, the S&P 500 Index was a modest 16% below its February 19th peak (St. Louis Fed data). The recovery has been cautiously encouraging, and we believe there are three variables that can be cited.

First, the federal government passed the CARES Act. The bill includes over $2 trillion in spending, generous jobless benefits, loans and grants to businesses, stimulus checks, and more. It offers a much more aggressive response than in 2008. More will be needed, but it is a good start.

Second, the Federal Reserve has aggressively responded. Pre-crisis, there were questions whether the Fed had the necessary tools in its tool kit, given that interest rates were already low. Apparently, they do.

With much greater speed than in 2008, the Fed has launched numerous programs aimed at propping up the economy–from big business to Main Street.

The two-pronged attack has not been executed flawlessly, but it has cautiously encouraged investors to dip their toes back into stocks. While the economic outlook remains fluid, investors are trying to discern some form of an economic recovery in the second half of the year.

Third, there are signs the virus may be peaking. An April 12 headline in Bloomberg News offered a cautiously upbeat headline: "CDC Says U.S. Near Peak; 70 Vaccines in Pipeline."

With signs that new cases may be peaking, talk is surfacing over how to best reopen shuttered industries.

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"EXPECT LARGE DAILY SWINGS, BOTH TO THE UPSIDE AND DOWNSIDE, TO CONTINUE AMID THE UNCERTAINTY."

Q2 Will Be Ugly

The St. Louis Federal Reserve estimates that the GDP, the largest measure of economic activity, could contract at an annualized pace of 50% in Q2. That's unprecedented. Yet, forecasts vary widely. In reality, we don't know how steep the downturn may be during the April through June period.

In just a three-week period, the number of first time claims for jobless benefits totaled an astounding 17 million (Dept. of Labor). For perspective, during the 18-month long 2007-09 recession (as defined by the NBER), first-time claims totaled 9.6 million.

A sharp contraction in the economy in Q2 is expected, and layoffs are the first, bitter fruits of the economic crisis.

However–and we believe this is important–the discouraging number of layoffs was brushed aside by investors. The more familiar Dow Jones Industrial Average added 2,107 points over the three days.

It's not that bad news for Main Street is a reason for Wall Street to celebrate; far from it.

We are in uncharted economic territory, and the future is quite opaque. But, the rally in stocks is an attempt by investors to sniff out an economic bottom and eventual economic recovery.

Remember, no one rings a bell that sounds the all-clear signal. Collectively, markets attempt to price in future events. We would expect large daily swings, both to the upside and downside, to continue amid the uncertainty.

We don't know if we'll see an uptick in new cases this summer when the economy reopens. We don't know if an effective treatment will be developed or how quickly a vaccine might come online. And, for that matter, we don't know how quickly folks will venture back into restaurants, airplanes or the public square.

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What Milestones Are We Watching?

Everyone is asking the question "What should we look for to indicate things are getting better, and is it time to consider reinvesting cash?"

1) The U.S. Federal Government and Federal Reserve are continuing to add stimulus and liquidity to the economy and markets. The same holds true for other developed countries. By our estimation, there needs to be significantly more stimulus of a variety of forms until economies re-start and regain at least greater-than stall speed rates of growth. In for a penny, in for a pound!

2) When is the first day that people will start to go back to work? How many? Where? What are the criteria and conditions for returning to work? The economy was fine, the people got sick, then the government told everyone to go home and shut down the economy. The only way this starts getting truly better is when we reverse those steps.

3) When a widely available, fast, easy, cheap COVID 19 test that can be manufactured in very large quantity. Without testing to tell us who really has to stay at home, we all will continue to stay at home. The answer from authorities going forward can't be, "We made everyone stay at home, and now we have no good way to decide how and when to tell them to go back to work." No politician is going to want to be the first to take a chance on getting that call wrong!

4) Credit spreads as the markets' aggregate determines the health of corporate America. Spreads appear to have peaked and to be narrowing. A continuation of this trend will, in our estimation, tell us much more than the volatile and noisy stock market, unemployment, earnings, and other traditionally reliable data points.

5) The market reaction when the Government and the Federal Reserve announce the end of additional stimulus. At some point the money pump has be turned off or run out. If the market swoons, then we risk sliding backwards.

Final thoughts & hope

We don't want to downplay the havoc created by COVID-19. We are living in a world that nobody could possibly have envisioned a few months ago. The impact caused by the virus has disrupted life around the globe. We have friends and loved ones who are dealing with this disease. It's incredibly unpleasant.

Yet, unexpected blessings have surfaced. People are reaching out to family and friends via texting and emails. Some are even connecting the old-fashioned way–by phone.

Families are closer than they have ever been before. Activities and jobs around the country have been suspended but not ended. And we are confident we will see an economic recovery take root and the pandemic will subside.

We are a resilient people. Together we will get through this dark night, and we will be stronger for it.

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