April 14, 2020

Economic and Market Update

The stock market is not the economy, and that distinction has never been clearer than last week. Stocks jumped 12.1% - their best weekly performance since late 1974. Does it make any sense? The obvious answer is no. Many professional investors have been skeptical of the rally saying there is still too much uncertainty. We are calling the recent run a bull rally within a bear market. Many economists say predictions for a relatively quick economic rebound are overly optimistic and the head of the International Monetary Fund (IMF) said last Thursday the global economy is set for its deepest recession since the Great Depression. In the mean time businesses in this country continue to shut down and more than 17 million new jobless claims have been filed in the past 3 weeks. Most economists predict the unemployment rate is headed to 15%.

If the market highs continue this would be the shortest bear market on record. Bear markets, however, that are accompanied by a recession tend to be more prolonged and last on average about 11 months. The U.S. stock market has never reached its bottom in less than 6 months after falling more than 30% in value as it did earlier in March. Wall Street economists are unanimous in expecting a major decline in gross domestic product (GDP) during the first quarter and a jaw dropping plunge in the second quarter. According to Moody's analytics, 8 in 10 U.S. counties are under lockdown orders which represents nearly 96% of the national output. Data shows that about 80% of U.S. hotel rooms across the country are empty. Scheduled flights in the continental U.S. have decreased approximately 90% from this time last year. Mortgage lenders are preparing for what may be the biggest wave of delinquencies in history – up to 15 million U.S. mortgage defaults.

The kickoff of earnings season this week will give investors a first glimpse of the impact of the coronavirus shutdown on corporate profits and potentially clues on the outlook for the rest of the year. To date, the market hasn't really reflected the full extent of the damage that the coronavirus is having on corporate profitability. Markets will have a lot to digest in the coming months.

The Federal Reserve (Fed) is using all its fire power to bolster the economy. This includes an open-ended quantitative easing program, with purchases of treasuries and other assets designed to keep interest rates low. The Fed will also, for the first time in its history, purchase corporate investment grade bonds. In effect, the Federal Reserve is acting like the central banker, flooding the world with trillions of dollars to keep up with the liquidity demand.

Congress has passed 3 major pieces of legislation including a $2 trillion economic bailout – the largest ever – to keep the virus outbreak from sending our economy into a depression. The bailout packages include money for large businesses, small businesses, and individuals affected by the virus.

The current economic crisis is unlike past crises such as the 2007-09 recession, which was caused in large part by a massive run up in household and business debt and the housing crash. That recession began with what is known as a demand side-shock – a loss of household wealth and income that lead to decreased spending, which eventually harmed the supply side or businesses. This time the reverse is occurring – the supply side, businesses are closing first, which in turn is hurting households.

In short, we don't know how long our country will remain in lockdown so we don't know how bad the economic and financial damage will be. Can the economy really come roaring back from the coronavirus recession as soon as this summer? Some economists say the answer is yes, but many economists say the comeback is likely to be far more gradual and uneven, lingering well into next year. We believe the latter of the two scenarios is most likely to occur.

We will do our best to keep you informed as to what is happening and when it may be the best time for us as long-term investors to start getting back into the equity markets.