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Economic Update
April 2020

Andrew Kohl
Chief Investment Officer

By Andrew Kohl

Commentary

The stock market has mounted an impressive rally over the past month. At the depths of the downturn in equity prices, all the gains since the end of 2016 were wiped out. Since that time, the S&P 500 has rallied over 30%. Year-to-date, losses now stand at less than 10%. The market is looking past the current economic data (which have been nothing short of dreadful). Instead, the focus has been on the pace of new coronavirus cases (which is lessening) and looking towards a potential reopening of the economy.

Absent a vaccine or treatment for COVID-19, certain prerequisites need to be met before an economy can effectively reopen. There needs to be declines in new cases, excess hospital capacity, better testing capabilities, and an ability to trace the people that have been infected and those who might have been exposed to them. In the U.S., there has been significant progress on many of these fronts, but we are still lagging on the last two measures. We hope that we wait for broad-based reopening until there are better capabilities for testing and tracking but understand that patience with the lockdowns is wearing thin.

Once the decision is made to reopen, there are several philosophical questions surrounding how the reopening should progress. Should we let the businesses that have the biggest impact to the economy open first or the ones that have the least personal contact? How do we handle the workers that are most at risk from the virus? As for how swiftly businesses can return closer to normal, we can learn lessons from the other countries around the world that experienced infections earlier than us and have already begun to open their economies.

We have seen that recovery has been much easier in the manufacturing and construction sector since workers can be more easily spread out and there is little contact with the end consumer. In almost all cases, the reopening timelines were too optimistic and had to be scaled back. In addition, reopening has been much more gradual than initial expectations. Many companies are leery about jumping in too quickly and fully ramping up production.

The implications for the U.S. (which is largely a services economy) are that more fiscal support will be needed to at least partially shield the population from the impacts of the shutdown. The help to consumers from the CARES Act essentially kept aggregate income levels near pre-crisis level through the end of May. Given that the recovery will likely be much slower than previously expected, we believe there will be another round of stimulus that will effectively keep aggregate income levels flat through the end of July. Hopefully, the economy will be on much better footing by then.

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Fixed Income Outlook

Interest rates remained little changed in April versus the end of March. The Fed met today and made it clear that rates will be staying low for a long time. They did not make any formal guidance about how long they will hold rates near zero or announce any yield controls but indicated that those types of discussions will be happening at future meetings. The Fed has been aggressive and will continue to be throughout this period.

The key to more aggressive actions will be what happens to inflation expectations. Given the massive declines in oil prices, there will be negative headline inflation data over the next few months. As long as consumers don't expect overall prices to continue to fall, the Fed may not need to use new tools to spur the economy and inflation. If inflation expectations do fall significantly, the Fed will try everything it can to ensure that deflation does not get embedded into consumers' psyche.

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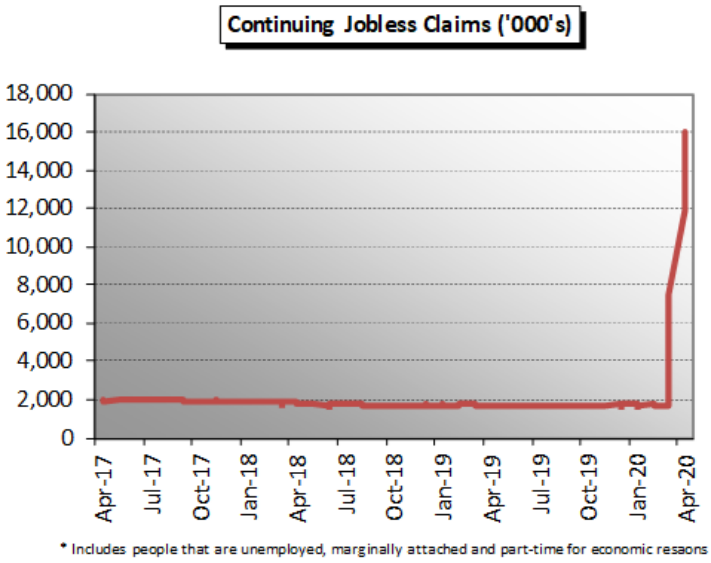
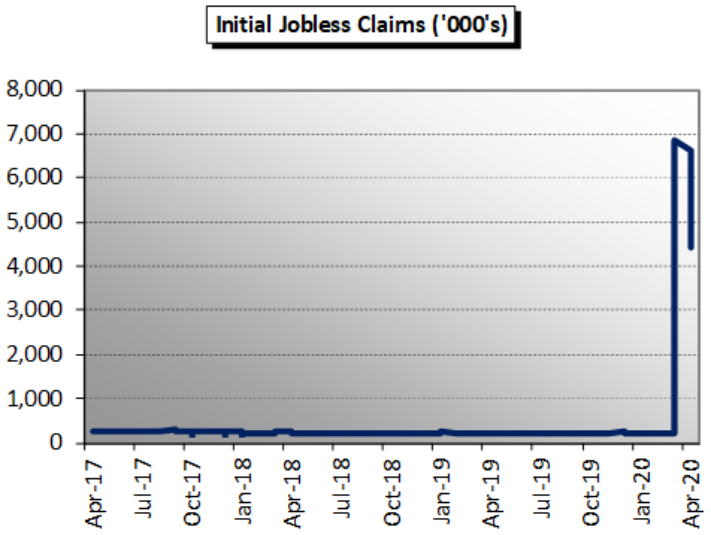
Labor Readings
(Data source: Bloomberg)



Continuing Jobless Claims Expand
Continuing jobless claims increased by four million jobs from the prior week and now stand at almost 16 million. This pushed the insured employment rate to 11%. This implies that the overall unemployment rate in April is likely to exceed 15% and possibly even 20%. This would be the highest unemployment rate since the late 1930's.



Jobless Claims Remain Elevated
Initial filings for jobless claims continue to come in at staggering levels. In the past 30 days, a total of 26 million people have filed for unemployment. That represents approximately 16% of the total labor force. The extra $600/week for unemployment benefits from the CARES Act should help to cushion some of the blow.

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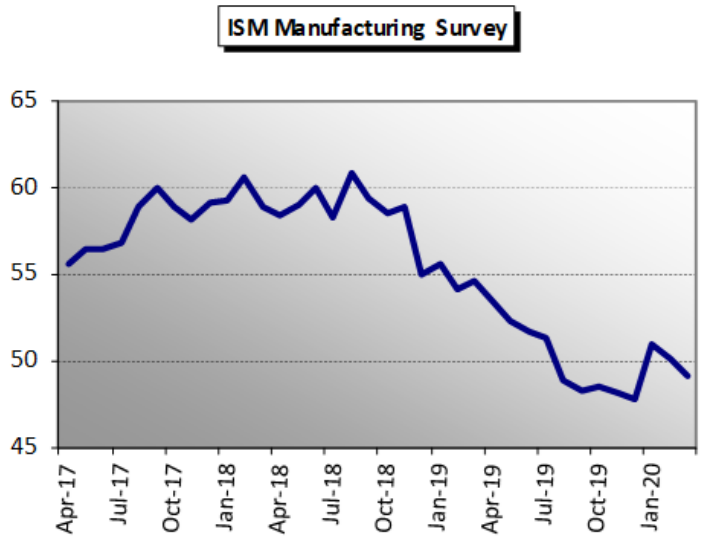
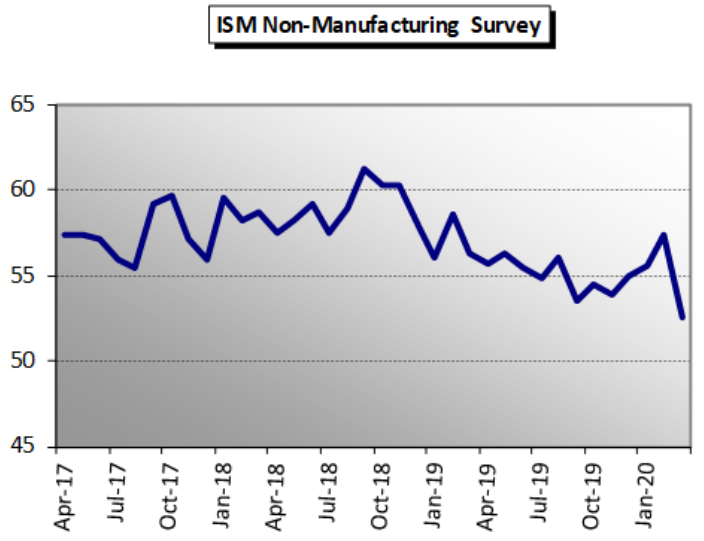
Economic Growth Readings
(Data source: Bloomberg)



Manufacturing Survey Beats Expectations
The manufacturing business survey exceeded expectations in March. The overall index was buoyed by strength in the food sector, chemical products and electronics. The index components showed much more weakness. New orders and employment fell to the lowest levels since the last recession.



Services Business Survey Declines
The Institute for Supply Management (ISM) service industry survey declined to the lowest level since March 2016. The business activity and employment components of the index experienced the largest monthly declines since 2008.

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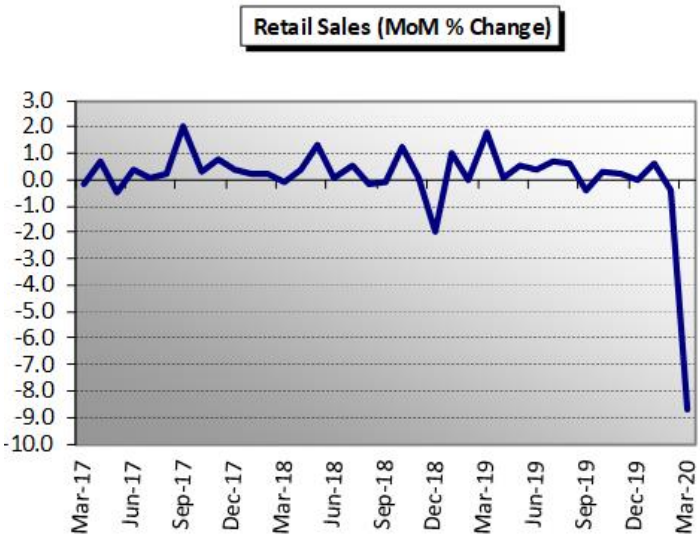
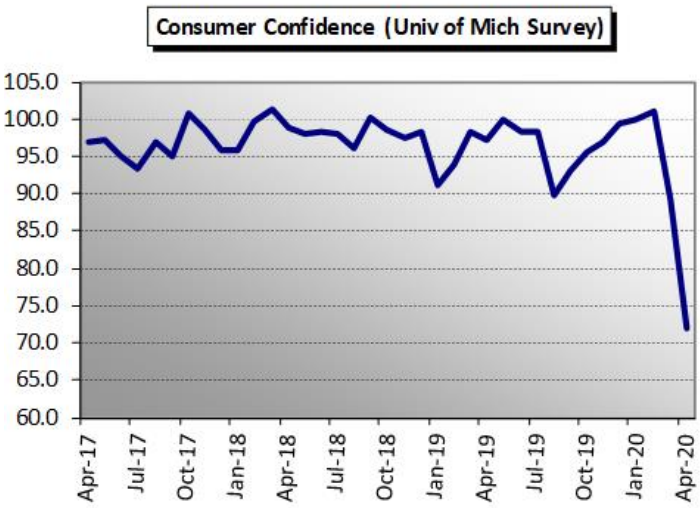
Consumer Readings
(Data source: Bloomberg)



Retail Sales Plunge
Retail sales fell in March by the largest percentage since records began back in 1992. Sales fell by 8.7% from the previous month. The data are likely to worsen in April as many businesses were still open during the first half of March and have been closed for the entire month of April.



Consumer Confidence Declines Rapidly
Consumer confidence fell by the largest monthly amount ever in April. Overall confidence now stands at its lowest level since 2011. Surging unemployment levels amidst the closing of several businesses across the country is weighing heavily on confidence.