John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday March 11, 2020

Here at home economists are cutting their estimates for GDP growth. For example, economists at Goldman Sachs have cut their estimate for first quarter growth from 2% to 0.9%. Meanwhile, economists have been raising first quarter growth estimates for the Chinese economy. China's economy is now expected to grow 4% year-over-year in the opening quarter. Many analysts think China's businesses will be back to full capacity by the end of this month. The province of Zhejiang, a manufacturing hub, has 90% of its large industrial firms back in business. The Chinese government has decided that the epidemic is under control to the point that much of the country can go back to work. Keep in mind that the coronavirus outbreak began in China in December, and nearly shut the Chinese economy down with widespread quarantines, cancelled flights, and government restrictions. Now, just three months later, the worst seems to be over in China. But that news is hard to find in the U.S. media. Instead we are focused on every new case and every new death and are locked in fear that the virus will severely damage the U.S. economy, corporate profits and the stock market.

The extent of our collective pessimism was made clear earlier this month when the Federal Reserve made a surprising 0.5% cut in the Fed Funds rate, bringing that rate down to 1%-1.25%. The Fed also cut the rate it pays banks on excess reserves by 0.5% to 1.1%. Ordinarily a cut in interest rates is greeted with a cheer from investors. Not this time. No sooner did Fed Chair Powell finish his announcement than the U.S. stock market turned and plunged - down more than 500 Dow points in just a few minutes. Instead of looking at the surprise interest rate cut as a gift for the economy, economists and investors said, oh-oh, the economy must be in real trouble for the Fed to take such drastic action. Chairman Powell didn't help when he said: "the virus and the measures being taken to contain it will surely weigh on economic activity both here and abroad for some time."

That statement opened the questions, how much will the virus weigh on the economy and for how long? Investors don't like big unknowns. Fear and uncertainty drove the downward plunge in stocks. Investors poured money into safe treasury bonds. The yield on a ten-year U.S. government bond fell to a historic low of 1%.

A few days later we learned that the economy is actually in great shape. The employment report for February showed surprising strength. The U.S. created 273,000 new jobs in February and the unemployment rate fell to 3.5%. Economists had expected 175,000 new jobs and the unemployment rate to rise to 3.6%. Revisions for December and January added another 85,000 new jobs to the tally. As the editors of the *Wall Street Journal* wrote: "The labor market entered 2020 with a roar."

That good news is, of course, backward looking. Coronavirus fear is all about the future. The virus shock, with businesses closing and supply chains being interrupted, is the kind of economic event whose severity is impossible to predict and for which there is no easy economic fix. However, China has been criticized for not responding to the virus sooner, even hiding facts that might have reduced the damage. The rest of the world, however, has responded quickly. Governments have launched efforts to treat victims quickly and also to isolate the virus through quarantines. Businesses likewise have taken strong actions. Lufthansa, the German airline, for example, has cut 7,100 flights to places that have a virus outbreak. Collectively these efforts will likely prevent the virus from spreading rapidly and may help to bring an end to the virus-based fear.

As far as monitoring the impact on the U.S. economy is concerned, the number economists will be watching closely is the weekly jobless claims. If the virus does start to take a bite out of the U.S. economy jobless claims will rise.

Current estimates for the companies in the S&P 500 are that earnings will rise 7.4% this year. Just as there is uncertainty about the future for overall economic growth, there is uncertainty about the future for corporate earnings growth. One analyst, David Kostin at Goldman Sachs, is now forecasting no growth in S&P 500 earnings this year.

The stock market's decline now seems to be pricing in a U.S. recession and a decline in corporate profits. While both are possible, current data do not support either prognosis. The Fed is expected to cut interest rates by another 0.5% at the regular meeting later this month. Hopefully that will blunt the recession/profit decline in pessimists' claims. Easing monetary policy will not stop the virus, but it is an unequivocal stimulus for the economy. The bottom line is that the U.S. economy is well prepared for an impact from the virus.

"How should investors react to the coronavirus?" Mitch at Zacks Investment Management answers:

"Throughout history, there have been dozens of virus outbreaks, epidemics, and a handful of pandemics. Virtually all of them resulted in short-term volatility and downside, followed by long-term price appreciation. In my view, it is very reasonable to expect a wild ride for the next few weeks. But that does not mean the right move now is to sell or panic. Longer-term, the actual impact to the equity markets has almost always been fleeting."

And this virus is still much less widespread than annual flu epidemics, which cause up to 5 million severe cases around the world and up to 650,000 deaths annually, according to the WHO (World Health Organization).

I will have the next market review and update one week from today on Wednesday March 18, 2020.

All the best,

John Dessauer