John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday April 22, 2020

The news has continued to be bad, but not universally bad. Yes, there are now 22 million Americans out of work and most of us are still staying home. The threat of the virus, by itself, is enough to keep most at home. Federal and State governments may want to open the economy, but it will take more than politics to convince people that it is truly safe to go back to work, to restaurants, and to theaters.

On a recent call from BNY Mellon their chief bio-tech strategist pointed out that there are 70 different vaccines being worked on by independent organizations. We need only a few that work to defeat the virus. In addition, doctors and researchers are finding new, effective treatments almost every week. Clearly, we will win the war against this virus, and in the process, be better prepared in case another one shows up in the future. What we don't know is how much longer it will be before the "all clear" can really be sounded.

Argus Research has recently updated their outlook for the U.S. economy and financial markets. They now see the U.S. economy in recession this year, with a slight decline in the first quarter followed by mid-to-high single digit declines in Q-2 And Q-3. That would mean three consecutive quarters in decline, easily fulfilling the standard definition of a recession. They also think the economy will achieve fractional growth in the final quarter of this year. Of course, they add that this outlook is contingent on the success of the stay-at-home initiatives and medical advances in treatments and vaccines. But at least they are willing to stick their necks out and give us their best current guess on the timing.

There have been 13 recessions since the 1929 great depression. In 12 cases the stock market bottomed 3-9 months before the economy did. The March 23 recent low for the stock market, if the bottom, would fit the historical pattern and be six months ahead of the Argus Research expectations for the economy.

There has been a lot of stock market selling by individual investors. As BNY Mellon said a week or so ago, “investor sentiment has tanked.” That is unfortunate. Over the last twenty years the S&P 500 stock index has averaged a gain of 6% a year. If you missed the 10 best days in the twenty years, the long-term return dropped to 2% a year. If you missed the 30 best days the long-term return went negative at -3% a year. The additional problem for scared investors is that the best days tended to come shortly after the worst days.

Argus Research sees U.S. corporate profits being hit hard by the virus and the lockdown. For this year they now see S&P 500 profits declining 10% instead of growing 10%. For next year they say to look for an 11% rebound and they add that the rebound has the potential of being much stronger. Their year-end 2020 forecast for the S&P 500 is 2,800 with a range of 2,000-3,500. The S&P 500 closed April 17 at 2,875. That says the Argus team does not see a lot of risk in the stock market at these levels and sees a possible gain if the virus news improves.

In support of their outlook Argus writes: “Fears of the global pandemic prompted investors to pile into safe assets, led by U.S. Treasuries. Amid that crush, interest rates bounced around while remaining near historic lows. More than the absolute level of interest rates, investors are focused on the Fed’s ability to maintain liquidity in the markets while lessening the burden of interest owed on short-term assets.

The Fed has been able to provide monetary relief rapidly, slashing the fed funds rate to zero, providing open-end quantitative easing, backstopping the Commercial Paper Funding Facility and strengthening the Primary Dealer Credit Facility. This in contrast to 2008, when liquidity evaporated and the credit window closed."

On April 16, the Fed unveiled a sweeping $2.3 trillion loan program for small and medium-sized businesses. The Fed also unleashed a massive program to buy Treasuries and mortgage-backed securities, while President Trump signed a roughly $2 trillion stimulus package, the biggest relief package in U.S. history.

Zhiwei Ren, a portfolio manager at Penn Mutual Asset Management said: "They took away the depression. The Fed is the fundamental reason for the stock market rebound." (From the March 23 low.)

Still for 2020 to date, every stock market sector has seen losses. But the market has never-the-less been following the patterns of recent years - growth stocks are outperforming value. Nasdaq is relatively outperforming blue-chip stocks. And the small-cap Russell 2000 is deeply lagging.

The stock market is not trading based on fundamentals, but on fear of the virus pandemic. That is the good news because it means that stocks can quickly recover and return to the pre-pandemic themes once the virus has been contained.

For those who need something very real to worry about think of all the trillions being added to government debts at home and around the world. The debts incurred to fight the economic impact of the virus will not go away when the virus is beaten. The debts will be there, rolling over in a very competitive global credit market. The long-term risk from all the debts is that interest rates may rise even as inflation stays low. Rising interest rates on top of record amounts of debt will strain government budgets. In Europe, the euro single currency could be threatened because of the disparity in the virus impact in various countries. For example, Italy has been very hard-hit by the virus, and Italy had too much government debt before the virus hit. Spain and France have also been hard hit and their economies were under stress before the virus. The stress and strain in the euro region was severe when the Greek economy blew up. The coronavirus could be what stresses the euro to the breaking point. Stay tuned. I will be watching Europe as well as the U.S.

I will have the next market review and update one week from today on Wednesday April 29, 2020.

All the best,

John Dessauer