John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday May 13, 2020

I wish there were some positive news on defeating the Covid-19 virus. There are lots of promising developments for treatment and vaccines. But so far, nothing conclusive. The good news for us is that company after company is reporting data showing they can survive this unprecedented economic crisis. Johnson & Johnson, for example, reported better than expected quarterly profits and raised the dividend. Wyndham Destinations, a hotel and timeshare company, reported a quarterly loss, but said the company was cash flow positive in the quarter. And management said the company would be cash flow positive for this year. That means Wyndham can survive this unprecedented pandemic. And these are just two examples. There are many more similar examples of companies with survival plans. All we need now is a medical breakthrough on treatment and a vaccine.

There are pessimists like Minneapolis Federal Reserve Bank President Neel Kashkari who said: "With a vaccine and effective treatment unlikely for a year or two we are in for unfortunately a slow, long recovery from devastating job losses."

Apparently, he missed last week's FDA announcement of an approval for a COVID-19 vaccine candidate and other news of treatments that are showing real promise. With teams of experts working together to find a vaccine and treatments, odds are we will see progress much sooner than Kashkari expects.

He is right about how devastating the virus is on jobs. The April non-farm payroll report showed jobs fell by 20.5 million, the worst monthly drop since 1945. The unemployment rate shot up to 14.7%, the highest rate since the government started keeping records in 1948. Bad as that is, there were economists predicting a rise to 19%.

Note that some publications are saying this is the highest rate since the Great Depression. That is likely correct. The unemployment rate is believed to have soared to 25% in the Great Depression. But journalists should still be careful and accurate when writing about economic conditions. The Editorial Board of *The Wall Street Journal* is careful and points out that current unemployment records go back only to 1948.

By the way, notice that we aren't hearing anything about the yield curve, a supposed recession predictor. The reason is that the yield curve recently has steepened. The yield on a two-year treasury bond is now down to 0.16%. The yield on a ten-year treasury bond went up last week to 0.69%. I guess with interest rates so low, few are paying attention to the yield curve. Or perhaps this economic disaster has exposed the weaknesses in the yield curve, and it has lost its recession predicting qualities.

The question being asked of Federal Reserve policy makers is: what will the recovery look like? The prevailing view at the Fed is a U-shaped recovery rather than a V shaped one. San Francisco Federal Reserve Bank President Mary Daly put it this way: "What I'm hoping in the baseline is we can come back safely, we listen to public health officials, we take it slow but gradual….if we do these things and we re-enter safely, then I expect us to have positive growth in 2021."

Moody's Analytics chief economist Mark Zandi agrees: "We are at the apex of job losses. We should see a turn relatively soon in job statistics, but we are not going to regain all the jobs we lost in the last couple of months."

The other serious question being asked is: why has the stock market rallied when the economic news is so bad? The S&P 500 stock index has rebounded more than 30% from its March low and is now just 14% below its February peak.

Pessimists are trying to paint the stock market's rally as something to be feared. For example, *The Economist* magazine on the cover of its May 9th issue has a drawing of the earth with a big earthquake like crevasse and a title: "A Dangerous Gap." I was shocked when I saw that cover. I read the accompanying editorial, but was disappointed because I did not find an answer to why they think the situation is dangerous. All I found was phrases like: "Financial markets have got out of whack with the economy. Something has to give."

Really? Perhaps those editors should look back to the 1930s and the aftermath of the stock market crash and great depression. The Dow Jones Industrial Average hit bottom in 1932 at 41.2. The economy continued to contract in 1933 but the Dow more than doubled to 108.7. That huge "gap" between stocks and the economy did not turn out to be dangerous at all. Stocks, it turned out, rose in anticipation of a coming turn for the better in the economy. You can argue that today's stock market is expecting a V shaped recovery and that we could be headed for a U, with a period of flat to slow growth before a robust recovery can develop.

The investment team at BNY Mellon has this to say: "Even in the midst of massive job losses and a surge in the unemployment rate, equity markets are advancing. This suggests that dire economic news is already priced in and the market is looking ahead to the gradual reopening of the economy."

Then there is TINA, or There Is No Alternative to stocks. With treasuries yielding less than 1%, the 2% average yield on stocks in the S&P 500 is very attractive. Plus, dividends tend to go up over the long run. Buy a treasury bond and you are stuck with the very low yield until maturity.

Analysts at JPMorgan Chase summed it up this way: “While the earnings outlook will remain challenged at least through the first half of this year, investors are increasingly discounting the COVID-19 hit to fundamentals this year and turning their gaze to a 2021 recovery. We are bullish on stocks and are forecasting a return to previous highs by the first half of 2021.”

I will have the next market review and update one week from today on Wednesday May 20, 2020.

All the best,

John Dessauer