FCI ADVISORS

CAPITAL MARKET COMMENTARY

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Grappling with Reopening

As we enter the fourth month of global economic dislocation caused by the pandemic, several observations can be made. The U.S. stock market's decline to a bear market from February 19 to March 23 was the fastest in history. The length of the bear market was also the shortest in history. The rebound in the equity market off the March 23 lows has been dramatic. The recovery of stock prices appears to reflect a recognition by investors there is a "time limit" to the virus and the economic impact it is having on global business. As markets continually look ahead, investors, for the moment, are looking through to the other side of this pandemic challenge. The equity markets have not reacted in a traditional way in large part because this has not been a traditional recession and bear market scenario.

As one would expect, the recovery in the equity market has been led by companies benefitting from a "stay at home" environment. However, as stay at home restrictions ease in all 50 states, investors now appear to be grappling with the uncertainties of reopening the economy on a broader scale.

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News regarding results of a potential vaccine has been a positive for investors as it gives a light at the end of the tunnel for a "return to normal". The prospect of a second wave remains a concern, but we are in a much better position now to make it through with fewer negative impacts than we experienced before. Also, every month that goes by gets us closer to an effective vaccine.

The Federal Reserve and Congress have been aggressive from the beginning in providing liquidity to corporate America, consumers and small businesses. They have also provided liquidity to the financial markets to prevent some of the disruptions seen previously. Corporate America has also been making moves to conserve cash which, in some cases, have necessitated dividend cuts, or dividend suspensions. However, there have also been companies that have been able to continue their history of annual dividend increases. Additionally, companies have taken advantage of the unprecedented low interest rates to issue new corporate debt, providing a financial cushion to survive for a longer time, if needed. According to Bloomberg, $1 trillion worth of investment-grade debt was sold in the market in the first 149 days of the year. In 2019, that figure was not reached until November.

The impact on the economy from the lockdowns and quarantines has been swift and deep. This Friday, the U.S. unemployment rate is forecasted to increase to levels around 20%. GDP is expected to decline to a degree most of us have not seen. Ed Hyman of Evercore ISI estimates real GDP may decline 40% at an annual rate quarter-over-quarter in the second quarter. This puts the economy firmly in a recession, but again, this is very much a non-traditional recession caused by the virus and the actions taken to combat it. The lockdowns have caused a sharp decline in consumer spending which has resulted in a spike up in the savings rate. With these funds available to be spent, there is the likelihood of a strong reopening of the economy to satisfy this pent-up demand. Ed Hyman is also estimating real GDP to be **up** at a 20% annual rate quarter-over-quarter in both the third and fourth quarters.

As the economy reopens, there most likely will be more than a few bumps in the road. There is the danger of a second wave of the virus but the country should be better prepared to handle it. The civil unrest in several major U.S. cities in recent days adds another element of uncertainty. At this point, its overall national economic impact is minimal. However, this development will be monitored and evaluated for its potential impact on markets.

It is expected there will be another round of stimulus from the government, addressing state and local governments, as well as another round for the consumer. Companies will gradually start back up and employees will get back to work. As the economy gets going, there will gradually be more confidence in earnings estimates for 2021. This will enable investors to focus once again on valuations.

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