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Economic & Market Update

June 2020

Too Early To Determine The Severity

There were many signs the economy was faltering 6 months prior to March 2020. Not only was the Federal Reserve forced to slash rates beginning in August of 2019, they were forced to provide unprecedented daily support (bailout) to the overnight lending system between banks. Prior to cutting rates and providing upwards of $80 billion in assets on a monthly basis, the Fed was attempting to unwind its balance sheet and increase interest rates. The Fed's attempt to reduce its balance sheet and increase the Federal Funds rate has proven to be quite the farce, in other words, certain to fail!

In Q1 the US had the largest decline in GDP (-5%) since 2008. The economy was 85% through the quarter before it was decided to close large sectors of business activity. S&P 500 earnings fell -50% in Q1 as well. Both data points show that there was weakness in the economy before the shutdown for Covid-19. Estimates for Q2 GDP are far worse -40% to -50% ($8-$10 Trillion annualized).

Despite government support (stimulus checks, small business loans/grants, enhanced unemployment benefits) the month of May recorded the highest corporate bankruptcy filings since 2009. With "social distancing" requiring businesses to reduce capacity/traffic, the number of bankruptcy filings are only set to get worse. The recent jobs report has masked the real underlying issue. Despite there being many admitted flaws in the data, it is not surprising that jobs were added back in May as sectors of the economy re-opened around the country . However, there are still 19.5 million people that need to be put back to work. These aren't actually added jobs to the economy; this is just a rebound to get back to where the economy was to begin the year. Additionally, according to the most recent "jobs Report" another 6.5 million Americans who were working in Feb 2020 are no longer working nor are they looking for work. The 6.5 million are considered "not in the labor force" bringing the job losses to more than 25 million!!!

The permanent job losses and economic decline will become clearer in late Q3 and Q4. The economy was already struggling with too much debt prior to Covid-19. The demand shock from the shutdown will be devastating to a large percentage of the economy. Federal Reserve policies are of little support to the true economy, such as businesses and employment, but are intended to back stop the Banking System and Wall Street (stock market). Lower interest rates do not drive demand in an economy with historic levels of debt, but they appear to encourage “speculators” to make further bets on the market. Thus driving valuations in equity markets to levels never seen before.

As we progress through the “re-opening” the 10 yr. Treasury yield will fall below 0% (go negative) as it becomes clearer that the “shutdown” was fatal to many companies (both large and small)!