

DON'T ARGUE WITH THE FED

While 2020 will undoubtedly be remembered as the year of the coronavirus, for investors it has also been a year of extremes. By the end of March, the S&P 500 average had fallen 20%, the worst three-month performance since 2005's fourth quarter. Yet the second quarter saw an equally historic move to the upside with a 20+% gain—almost matching the gains in the first quarters of 1987 and 1975. While the coronavirus and measures necessary to combat it caused the decline, it was the unprecedented response by the Administration, Congress, and the Federal Reserve that fueled the swing back. Money has literally been thrown at nearly everyone and everything—people, banks, corporations—with \$2.5 trillion in responses so far and a \$3 trillion expansion of the Fed's balance sheet. It would appear that still more is on the way.

For the moment, the response seems to be working. From depressed economic levels we continue to see some very large growth rates. In June the manufacturing Purchasing Managers Index returned to expansion territory in the U.S., rising to 52.6 with a surge in the new orders component. The Conference Board survey of consumer confidence rose to 98%, with increases in both the present situation and expectation components. The U.S. job report was also generally strong with non-farm payrolls up 4.8 million. But the effects of lingering unemployment are still being felt and at the last reading, was an elevated 11.1%. Initial jobless claims were 1.427 million for the week ending June 27th and continuing claims were 19.29 million in the week of June 20th.

High unemployment is unstable economically and politically, and with restaurants, hotels, and airlines, working at 50% capacity, at best, it will be difficult to get back to 2019 levels of GDP in a social-distancing world. Fiscal policy has patched the income gap over the past several months, but more is likely necessary. The second half of 2020 will be further complicated by the congressional and presidential elections. It would appear that former Vice President Biden is leading in the polls, and he is proposing \$4 trillion in tax increases spread out over the next 10 years, or roughly 1.5% of GDP. How realistic these proposals will be in a still-struggling economy will be open to question, and difficult to forecast.

In spite of the uncertainties we face, we are optimistic that the American spirit of resolve and entrepreneurship will lead to a better future. Localities that have embraced proactive steps to mitigate the spread of the virus have been successful and there are more than 165 COVID-19 vaccines in development, including 27 currently in the human trials phase. Therefore it is a question of when, not if, businesses and economies return to sustainable growth, in spite of the virus. With all its fits and starts, the economy is gaining steam, most household balance sheets are flush with cash, and both Congress and the Federal Reserve have pulled out all the stops. In particular, history has proven that it does not pay to argue with the Fed.

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