EXTRAORDINARY

What likely seemed like the longest month in history – one in which many could likely count on two hands the number of times they traveled more than 5 miles away from home - provided no shortage of improbable plot lines. Sobering virus statistics (cases and deaths) notwithstanding, not the least of the month's extraordinary stories were incredible weekly reports on unemployment claims, an initial read on how bad the economy fared in a period that included just one month (March) of the Great Lockdown, and negative (!) oil prices. Perhaps stranger still in the face of such economic news: Global Equity markets reacted by producing one-month gains of +10.7%.

Unprecedented and Uncharted

We have recently – and at some length – written about the current US economy in the context of normal outcomes and past downturns. Rather than reprise those analyses here, we think that it is worth memorializing the following April datapoints:

- Inclusive of the weekly numbers reported for the week ended April 25, 30.3 million people have filed initial unemployment claims since mid-March. Month-end data (to be released May 8) are expected to show that the unemployment rate reached 16.0%. Prior post-Great Depression joblessness peaks: 9.9% during the Global Financial Crisis and 10.7% at the tail-end of the 1981-82 recession.

- The initial report on First Quarter US GDP (two updates will follow as more information becomes available) showed a -4.8% annualized decline in economic activity. Though not far removed from forecasts made just prior to the data's release, the outcome was far worse than the consensus forecast (+1.4%) in early March.

- Notably, Personal Consumption Expenditures (the goods and services that all of us collectively purchase) declined an estimated -7.6%. This outstripped the GFC's worst quarter (-3.7%) and was the second worst (to 2Q 1980's -8.7%) period in more than 60 years. Not surprisingly, the hardest hit sub-segments of the economy (and the one big beneficiary of social distancing) reflect the unique character of the Great Lockdown:

	1Q 2020	4Q 2008	2Q 1980
Personal Consumption Ttl	-7.6%	-3.7%	-8.7%
Healthcare (Hosp. and Doctors)	-18.0%	1.1%	-3.0%
At Home Food	25.1%	-5.6%	-2.9%
Restaurant/Bar/Hotels	-29.7%	-4.9%	-5.1%
Motor Vehicles	-33.2%	-39.4%	-58.7%
Car Repairs/Air Travel	-29.2%	-13.2%	-15.0%
Clothing and Footware	-36.0%	-12.9%	-1.9%
Total Change in GDP	**-4.8%**	**-8.4%**	**-8.0%**

- Crude oil prices (in the "spot" and futures markets) plunged, the result of withering global demand for energy and some recalcitrance on the part of major producers to cut supplies. Three days of market dysfunction aside (at one point, the market was paying buyers $37/barrel to take supply off its hands), US crude oil prices traded within a range of $12-$20/barrel in April. Market execution issues during the month highlighted the difficulty of using futures strategies to track commodity price changes; the largest ETF in the oil space (the US Oil Fund, ticker USO) returned -43% in April versus oil's -18% price decline.

US Equity Earnings: Reporting Season in Full Swing

The schedule of quarterly earnings reports continued apace, with roughly half (e.g., 273 of all S&P 500 Index companies) announcing their revenues and profits for the most recent three months. Virtually all managements were unwilling (and very likely unable) to provide guidance on outcomes for the quarter ahead. Of note:

- Companies operating principally in sectors that have been most immediately adversely affected by the economy's contraction (i.e., Industrials, Consumer Discretionary, Financials) collectively reported double-digit earnings declines. Results for banks and credit card companies were particularly hard-hit due to provisions made for potential lending losses.

- Relatively flat Energy sector earnings are not yet reflective of plunging crude oil prices, mostly because companies that have reported so far are not fully representative of the industry. However, the small sub-set of oil exploration and production companies whose results are out have reported an average -51% decline in quarterly earnings.

- Similarly, the Consumer Staples and Information Technology sectors have been net beneficiaries of mandated stay home/work from home policies. Manufacturers of food, beverage, and household products increased their profits, as did software services providers in the Information Technology sector.

- The Healthcare sector – chiefly its biotechnology and pharmaceutical sub-sectors – have been reporting rising sales and strong earnings growth, a not unsurprising eventuality given elevated demands created by the COVID-19 crisis.

Consensus earnings estimates for all of 2020 (and estimates for 2021, which are admittedly very early and likely very imprecise) have finally begun to adjust to the radically changed economic environment. Optimistic pre-crisis estimates (i.e., a rise of +12% in 2020) have since given way to predictions of a -14% decline. But by December 2021, consensus estimates predict that a rebounding economy would lift earnings well-above both the current year and their 2019 peak. From our perspective, given so many uncertainties and the damage inflicted on the economy so far, these projections seem overly rosy.

Estimated S&P 500 Index Earnings

Estimate Date	2020 est	2021 est
12/31/2019	$ 179.86	$ 193.12
2/19/2020	$ 173.30	$ 193.35
3/31/2020	$ 150.52	$ 177.28
4/30/2020	$ 129.61	$ 164.23

Interest Rates and Bond Markets

US bond markets exhibited less conviction that the economy is nearing an inflection point that will soon put consumers, government entities, and corporations on a sounder financial footing.

- US Treasury bond yields, little changed in April, remained at all-time lows in the face of a debilitated economy. At month end, two-year bonds were yielding 0.20%; 10-year maturity yields were 0.64%. Though consumer prices are low and likely headed lower as the current recession deepens, these bond yields provide no long-term protection against even modest inflation.

- A record volume of investment grade bonds was brought to market in April, as many large corporations (e.g., Boeing, IBM) took advantage of accommodative capital market conditions to proactively boost cash reserves to insulate themselves against falling revenues. Credit spreads tightened during the month, not so much a marketplace vote of confidence in issuers as it was a result of excess capital flowing into these segments of the market and the Fed's commitment to buy bonds in support of market liquidity.

- Price trends in the municipal bond market continued to diverge from the taxable bond market, especially at the bottom (BBB-rated) end of the investment grade credit quality scale. Cash flows in this retail investor centric market continued to affect pricing, and political commentary by Senate Majority Leader McConnell about allowing states to go bankrupt rather than provide them with financial support somewhat rattled the market.

Looking Ahead

The next two months will remain challenging – perhaps still extraordinary – as more data becomes available on the spreading and/or peaking of COVID-19 across the US and globally. The economic news will likely get worse before it gets better, and capital markets will continue to evaluate whether they have correctly anticipated earnings trends and credit risks. We think that investors need to remain cautious and broadly diversified to best balance still unknown outcomes with the potential to participate in any extraordinary good news.

Investment Strategy Team

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