May 2020 Market Outlook

A Global Pandemic, High Unemployment, A Stalled Economy…. Quagmire of Pending Doom or an Opportunity for Sustainable Recovery?

The COVID-19 pandemic has unleashed economic effects unlike any the world has seen before. Though the long-term economic impact is forecast to be less than that of the 2008 recession, a comparison of the current economic environment with past recessions speaks to the severity of the current shock (i.e. the immediate and shocking start of the recession). Day after day, week after week, and dare I say it, month after month, we are reading and analyzing the current economic environment and trying to compare it with past recessions. Like all of us, I want to synthesize the current environment into a nice neat package that ties to history and has a reasonably clear course to recovery. Joyce and I read and analyze, we listen to trusted economists and analysts, all the while seeking that nice neat path to recovery. The reality is that we are in an unprecedented global situation with no clear path forward from health, cultural, or economic perspectives.

Comparisons with the Great Depression are inappropriate; its economic shock lasted four years. Some economists have termed this the "Great Fall" as recovery could begin much sooner than in past recessions --once the biggest health risks are deemed to have sufficiently passed and businesses can resume operations. As of this writing, all but seven states have begun to reopen their economies and reduce social distancing measures. Though the level of reopening varies significantly from state to state, public health experts warn that this increased activity is likely to cause a surge of new infections. Yesterday, infectious disease expert Dr. Anthony Fauci stated in Senate testimony that premature opening will lead to "some suffering and death that could be avoided." The reality is that the spread of the disease is still largely unknown and the best way we do know to combat it is to maintain strict social distancing.

Though we are already seeing incredible increases to unemployment claims it is unclear when and at what level those claims will peak. 7.5 million Americans were collecting unemployment at the end of March – this was growth of 4.4 million over the previous week. The April Jobs report released late last week showed a record 20.5 million jobs lost and the unemployment rate increasing to 14.7%. These figures continue to grow, and current projections suggest that when currently unemployed (14.7%), significantly underemployed, and temporarily unemployed (which might become permanent) are combined, we will be facing an unemployment rate of 20-24%. This projection attempts to incorporate the many unknowns including states still processing backlogs of claims.

With unemployment so high already and corporate earnings for the first quarter of 2020 coming in solidly below expectations, we can only anticipate how the future will evolve. The Advance Estimate of 1st quarter U.S. Gross Domestic Product (GDP) was released on April 29 and suggested a decline of 4.8% on an annual basis. Remember that this figure is only preliminary and will be revised until June 25, and that this is an average of the first three months of the year and only March was really negative. Consensus estimates predict that annual GDP will be down 25% for Q2 and then up 8-10% for Q3 2020 due to an increase in consumer spending.

The recent action steps of the Federal Reserve and the Treasury have been absolutely essential to address the health and economic crisis of the COVID-19 pandemic. These actions, however, have and will have an enormous impact on both our debt and deficit. The federal government has now enacted four separate pieces of legislation to address the

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pandemic. The Congressional Budget Office (C.B.O.) estimates that these will add $2.7 trillion to the federal debt over the next 18 months. The benefits from these programs are only designed to support the economy until the middle of summer. Assuming that large parts of the U.S. economy will remain shut down until the distribution of a vaccine, hopefully by the second quarter of next year, the federal government will likely need to approve another $1 trillion of aid. The opening of the economy can be divided into three parts: the Cans, the Cannots, and the Coulds. The next stimulus would be best served to get those Could businesses up and running. For example, auto sales, service businesses, restaurants, and retail companies can adapt to social distancing regulations but may need support to adapt their operations so that they can operate under these new standards.

According to the C.B.O, the federal budget deficit will hit $3.7 trillion during the 2020 fiscal year (ending in September 2020) and an anticipated $2.1 trillion more during the 2021 fiscal year. Many analysts suggest these figures should be higher at $3.8 trillion and $2.9 trillion respectively. This deficit level is the largest size, as a share of the economy, since World War II. By the close of the 2020 fiscal year, the C.B.O. anticipates the size of the national debt to exceed the annual output of the economy. These debt and deficit levels sound large but without perspective mean very little.

- First, it is important to understand the difference between the debt and the deficit. In simple terms, the budget deficit is the difference between what the federal government spends and what it takes in (revenue/receipts). The national debt, on the other hand, is the result of the federal government borrowing money to cover years and years of budget deficits. The national debt is nearly $25 trillion. This equates to almost $75,000 per citizen or $199,000 per taxpayer.
- High debt levels hamper the ability to grow. Our last economic expansion – the period since the Great Recession of 2008 – was the longest but shallowest expansion in history, largely due to high debt levels. The current massive increases to both our deficit and debt are coming on the heels of the long but debt-limited expansion.
- The deficit expansion will bring the debt from 79% of GDP at the end of the last fiscal year (extremely high for an economy in expansion) to 109% of GDP by the end of fiscal 2021. Back to my desire to connect with historical experience: the prior all-time record of debt to GDP was 108% set in 1946 as the U.S. addressed the extraordinary costs of fighting World War II. Some may argue that we grew out of such extreme debt levels in the past and we can do it again. Though, as I said in my opening remarks, we are all looking for a clear course to recovery, I would like to remind you of the historical events that took place following World War II, events that pushed our economy to new or previously unimagined levels of growth: the Cold War and Space Race; the development of computers and information networks; the development of healthcare and biotechnology including an understanding of molecular genetics that has revolutionized biomedical sciences; social technology and engineering; and of course, women entering the workforce. These developments and substantive increases to the labor force cannot be recreated. That does not suggest we cannot grow out of this crisis but rather that growth will not be at the exponential rates of the past.

Beginning on February 21, 2020, global markets experienced heightened volatility due to increasing concern over the economic impacts of the coronavirus pandemic. All major U.S. market indices fell into bear market territory on March 12 prior to a market bottom, to date, on March 23. At the March lows, the stock market was discounting the economic

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collapse that would follow – what we are immersed in currently – but the recovery out of these lows is less about economic optimism and more about Fed-provided liquidity.

Will the recovery be V-shaped, L-Shaped, U-shaped, W-shaped, or something else entirely? Ultimately, only time will tell. We are relying on historical knowledge that market recoveries typically occur 3-4 months ahead of the start of economic recoveries. We are considering current scientific data about the spread of the disease to know that we cannot open the economy as quickly as we would like and that even a phased-in approach will likely be fraught with setbacks. We are anticipating that there will be significant structural changes in our global culture and economies as we recover from this pandemic. These structural changes will affect the ways we shop, educate, consume, and work. Our goals for the management of your portfolios are multi-faceted: we aim to protect your assets while also seeking opportunities for future growth. Though it can be tempting to pull out of investments in order to limit risk, such action will also lead to missing the strongest part of recovery in the market. As I explained in the last CenterPoint market outlook, we have been shifting our outlook, and thus management of your portfolios, towards risk mitigation since last fall. We are not anticipating a rapid market turnaround but know that the global economy will recover and want to be well positioned for that recovery.

In summary, though we do not yet have a clear outlook for the future, we do have a clear plan for our management of your portfolio. As new information becomes available we intend to be responsive and nimble to adjust course as appropriate. As we explained in our last market outlook, we have adjusted our target portfolios to reduce exposure to U.S. stocks and increase exposure to U.S. Treasuries and investment grade corporate bonds. We are also maintaining exposure to both developed and emerging international markets as appropriate to each client's specific time horizons and risk tolerances. In further pursuit of diversity and opportunities for growth, we continue to invest in global clean energy and global clean water investments. We are evaluating each client portfolio versus these revised allocations. Where underweight to fixed income, we will buy into bonds to "stay ahead of the Fed" in their bond buying program. Where underweight to U.S. and international stocks, we will use Dollar Cost Averaging (slow, planned, periodic purchases) over 4-6 months to take advantage of volatility in the markets and allow us to watch for entry points that may be more attractive should the market fall further, and yet not miss the potential upside. As always, our approach is carefully considered to best protect your portfolio and also grow it over the long term or your specific time horizon.

Please reach out to us with any questions or thoughts about your specific situation. Especially in these days of social distancing, we love to hear your updates.

Warmly,

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