Economic Update

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This weekly update provides a snapshot of changes in the economy and markets and their implications for investors.

Growth

The deterioration of economic conditions due to COVID-19 and social distancing measures implemented to combat the spread of the virus have pushed the U.S. economy into a deep recession. The shape of the recession and subsequent recovery is likely to be a fall, a stall and a surge, with 1Q slightly negative, 2Q sharply negative, a stall into year-end and a rebound in 2021 once a vaccine is developed and released for COVID-19. Last week, retail sales fell 8.7%, the sharpest fall on record, and industrial production fell 5.4%, the sharpest drop since 1946.

Jobs

Nonfarm payrolls fell by 701,000 in March, which was an unexpected decline, since the impacts of social distancing were less widespread when the data were collected. Over the last four weeks, initial jobless claims totaled a cumulative 22 million, erasing all job gains made during the last decade. This suggests that the unemployment rate, which was 4.4% in March, could rise to the mid-teens in the April report due out May 8. Wages rose 0.4% m/m for all workers and for production and nonsupervisory workers, 3.1% y/y and 3.4% y/y, respectively, likely given that job losses were concentrated in lower wage industries.

Profits

With 41 companies having reported (12.1% of market cap), our current estimate for 1Q20 earnings is $32.45, with EPS growth declining 14.6% y/y. Revenues and margins will drag on profit growth but buybacks may provide a minimal positive contribution. The halt in economic activity in March is the primary cause of the earnings slide, although oil prices, which were down 16% on average during the quarter, will also have contributed to earnings weakness. Consumer discretionary, energy, financials and industrials sectors are expected to have the sharpest declines in earnings, while health care and info. tech could produce positive growth.

Inflation

Headline CPI, which includes food and energy, fell 0.4% m/m in March, increasing 1.5% y/y. Core CPI (ex-food and energy) fell 0.1% m/m, increasing 2.1% y/y. February headline PCE rose 0.1% m/m and core PCE rose 0.2% m/m, and both rose 1.8% y/y. The significant decline in energy prices and growth challenges should put downward pressure on inflation ahead.

Rates

The FOMC has delivered two emergency rate cuts, bringing the federal funds target rate to a range of 0.00%-0.25%. It also announced unlimited asset purchases, expanded USD swap lines, reduced rates at the discount window, dropped reserve requirements to zero and established several lending facilities. It has just announced it will provide $2.3 trillion in loans to support the economy. These comprehensive actions should alleviate liquidity pressures in the financial system, and support the flow of credit broadly.

Risks

- Impacts from COVID-19 may cause a global recession.
- Political headlines may foment market volatility.
- Earnings growth has slowed and could stall if there is an economic recession.

Investment Themes

- Quality should be a focus for U.S. equity investors.
- Fixed income investors should move up in quality, and look to core bonds for portfolio ballast.
- Long-term growth prospects and cheap absolute and relative valuations support international equities.

■ Denotes updated information

Data are as of April 20, 2020

Past performance does not guarantee future results.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

The S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market. This world-renowned index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 Index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market. An investor cannot invest directly in an index. Indexes are unmanaged.

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