State of the Economy

June 2020

The past three months on Wall Street resulted in an unexpected turnaround for stock prices. The U.S. stock market recovered around 40% from its lowest point in March. This extraordinary comeback can be attributed to many factors, including the backstop created by the Federal Reserve. Optimism developed as Covid-19 treatment improved and the timetable for a potential vaccine inched closer. Unfortunately, there is a large disconnect forming between Wall Street and Main Street. As the market reverts towards its all-time highs, there are still 20.5 million people who have lost their jobs during this health crisis. In many states the reopening of business is underway. But, we are far from a V-shaped recovery that some predicted a few months ago. Nonetheless, the financial markets are clearly focused beyond the current economic weakness. The economic news was primarily dismal over the past couple months and one can anticipate more bad news ahead. However, economic data typically represents a snapshot of the past. In contrast, it's important to remember that the stock market looks forward.

Despite the advances in the stock market, doubts continue to rise among the public and small businesses. Consequently, there are many unanswered questions. How can the stock market continue to soar with an abundance of financial obstacles at the forefront? Do businesses expect consumers to buy their products? Will those currently unemployed get their jobs back in the foreseeable future? Can individuals be safe when they venture out to shop or dine? Even as restrictions are being lifted across America, the return to normalcy is far from a reality. Additionally, Congress faces an upcoming deadline on how to address the expiring provisions offered in the March CARES Act. The relief measures for businesses and unemployed workers helped keep the economy somewhat afloat over the past four months. But, the unemployment benefits are set to expire at the end of July. It remains to be seen if the government will continue to provide support.

The Federal Reserve took significant actions in recent months. The unprecedented steps to protect the immediate fallout from the pandemic encompass an expanded bond buying program, maintaining interest rates near zero and offering support to small businesses through various loan programs. These are a just a few of the measures taken by the Federal Reserve to help stimulate the economy. Federal Reserve Chairman, Jerome Powell, stated they will continue to support the economy and will be active if conditions worsen. The Chairman also presented three potential

phases of economic recovery if the virus remains reasonably under control. The first phase would be a sharp contraction, which would then lead to the second phase of a bounce back, followed by large increases in re-employment. Mr. Powell believes we are at the start of the second phase involving improved economic conditions. However, he warned the third phase of the recovery requires Americans to regain confidence to engage in activities with close indoor contact or large outdoor gatherings. This third phase could take a significant amount of time to transpire. In a prolonged scenario, I would predict the Fed implements further measures to help prevent a substantial pullback in the stock market.

The divergence in the performance of the major U.S. stock indexes this year is the widest in more than a decade. As the stock market fought to come back from its March low, the Nasdaq Composite Index is significantly outperforming the Dow Jones Industrial Average. The Nasdaq, which is composed of over 3,300 stocks, continued to hit all-time highs due to its large concentration in growth stocks that have an outsized influence. The surging stocks of Apple, Alphabet (Google), Amazon, Microsoft and Facebook make up about 40% of the index. Conversely, the Dow is comprised of only 30 large cap U.S. stocks and is exposed to various industries including oil and financials. These sectors were crushed by the pandemic and are lagging in their recovery. Thankfully, investors may hold funds that mirror a third index, the S&P 500. This index consists of the 500 largest U.S. companies, and the previously mentioned growth stocks make up about 20% of the index.

The disparities across various industries add to the challenges facing investors going forward. The economy is slowly improving, but many investors expect the recovery to remain uneven with so many unknowns. The U.S. is witnessing a rise in Covid-19 cases in numerous states with the potential for another large wave in the fall. The impact of the Presidential election in November is unclear. Each issue will test investors and their investment decisions. Will they bet on the "safer" technology companies due to their healthy balance sheets and ability to earn revenue in a stay-at-home environment? Or will investors turn to beaten down sectors like the airline industry looking for potential bargains while expecting a faster turnaround?

With so many uncertainties hanging in the balance, the only guarantee is that the stock market will always look to be ahead of the economic data.

Have a happy and safe Independence Day.

Sincerely,

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