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Economic & Financial Outlook

Robert Genetski **April 14, 2020**

	S&P 500	10-year rate	Oil	Gold	Bitcoin	ETH
Fundamental value:	3150	4.0	$40	$700	NA	NA
Actual price:	2846	0.7	$21	$1,745	$6,900	$160

A government induced lockdown has created an unprecedented collapse in the economy. The Markit purchasing managers' survey taken between March 12 to March 27 shows readings in the 30s (50 is breakeven). April indexes will decline much further due to the lockdown.

My preliminary estimate indicates US output from February to April will be down by 50% with 40 million unemployed.

As the spread of the virus shuts down an estimated half the economy, the economic toll amounts to a loss of roughly $11 trillion dollars of output at an annual rate. For the month of April alone the loss would be in the vicinity of $1 trillion. The $2.2 trillion "stimulus" bill doesn't make up for any of the lost output. You cannot replace output by printing or borrowing money.

Stimulus money redistributes income from those who are working and producing to those idled by the shutdown. Aside from the many flaws in the program, efforts to bolster the economy (even with paper money and borrowing) can limit the damage from the current shock to the economy. While these moves are appropriate during a crisis, they create significant longer-term problems.

As extensive damage to the economy from the shutdown increases, the pressure to restart the economy becomes greater. Significant progress from slower increases in the virus makes it likely restrictions on the economy will begin to be removed by the beginning of May.

After a 50% collapse in activity in April, my forecast calls for a 20% rebound in each of the following three months. Mathematically, this still leaves the economy about 15% below where it was at the beginning of the year.

Given my assumptions, by the end of the year the economy will be producing close to the level it produced at the beginning of this year. In spite of a significant recovery, the annualize GDP for the fourth quarter of this year will be $500 billion below where it would have been without the virus-induced shutdown.

Profits will be hit particularly hard. Airlines, leisure-related companies, hotels, oil companies and small businesses will bear the brunt of the decline. While we still don't even know the impact on first quarter profits, the peak to trough decline in profits could amount to 60% from the fourth quarter of last year to the second quarter of this year.

Workers will also suffer. Even after rehiring in May and June, I estimate the unemployment rate during this quarter will exceed 13%.

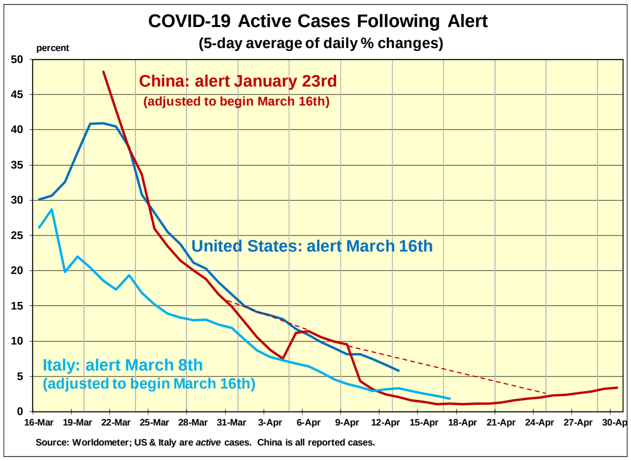
Could my estimates overstate the decline? Hopefully they do. They could also understate it, particularly if there is a delay in restarting the economy.

The current situation is unprecedented. However, the economy remains highly resilient. if government restrictions on businesses are removed in May, the worst of the nightmare will be over by the end of summer.

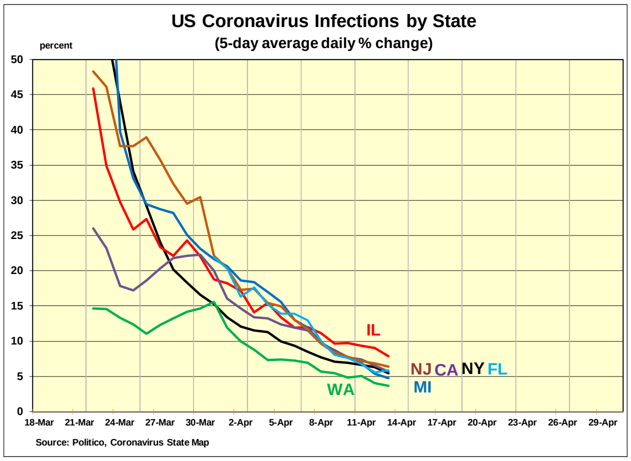
COVID-19 Charts

The charts below show the good and bad news surrounding the virus.

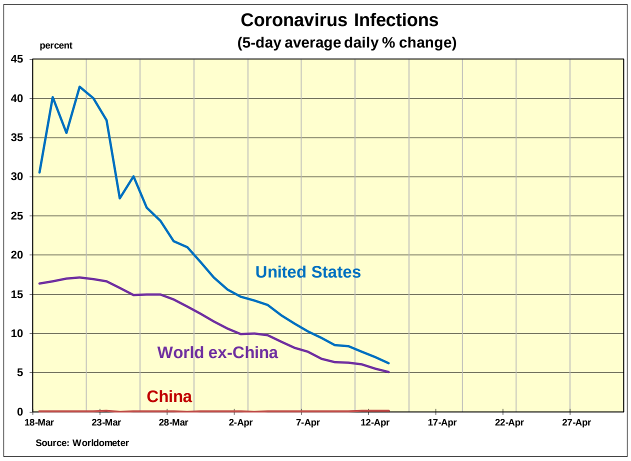
The good news is the daily increases in active US cases are approaching 5%. Increases in the daily rate below 5% have been associated with removing restrictions on the economy.



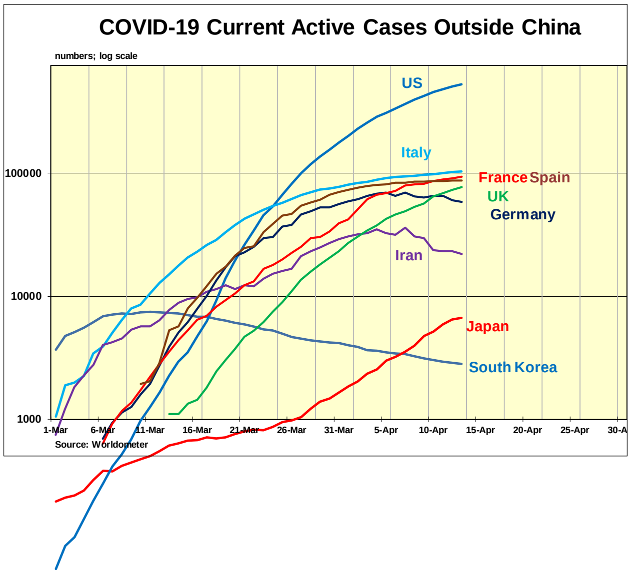
The progress in each of the key states has been impressive. All have been successful in lowering increases in active cases to below 10%.



The US has also been closing its cap with the rest of the world in terms of its progress on slowing the spread of the virus.



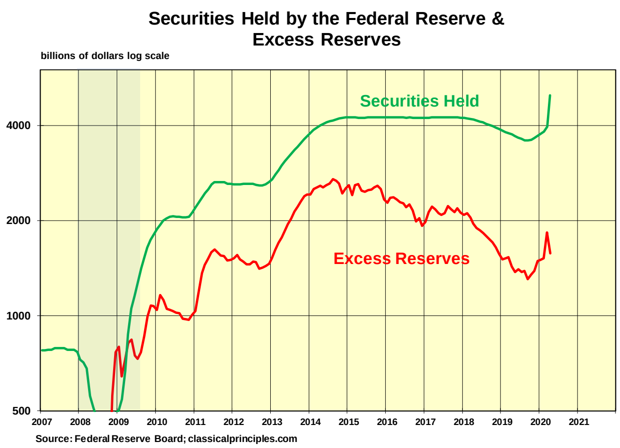
Most countries have had success in flattening or even reducing the number of active cases. Unfortunately, an acceleration of cases in Japan and the UK means there will be pressure from health officials to keep restrictions on the economy to prevent a resurgence of the virus. Containing the daily rate of active cases, remains the key to removing restrictions.



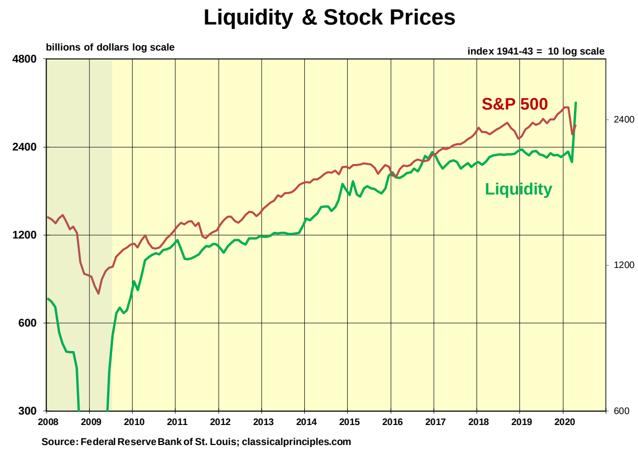
Monetary Policy Developments

The Fed has put its money-making machine into high gear in an effort to minimize the damage from the shutdown.

Monetary policy can't replace the disruption due to a shutdown, but it can prevent the disruption from getting even worse. From the middle of March to the first week in April the Fed purchased more than $1 trillion in securities.



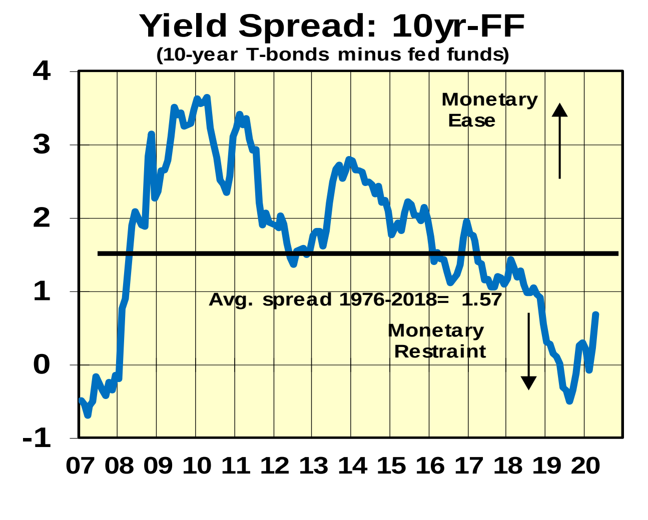
Initially, banks increased their deposits with the Fed (excess reserves). This offset some of the liquidity. However, banks reversed this going into April. The result has been a massive injection of liquidity which has helped to fuel the rise in stock prices.

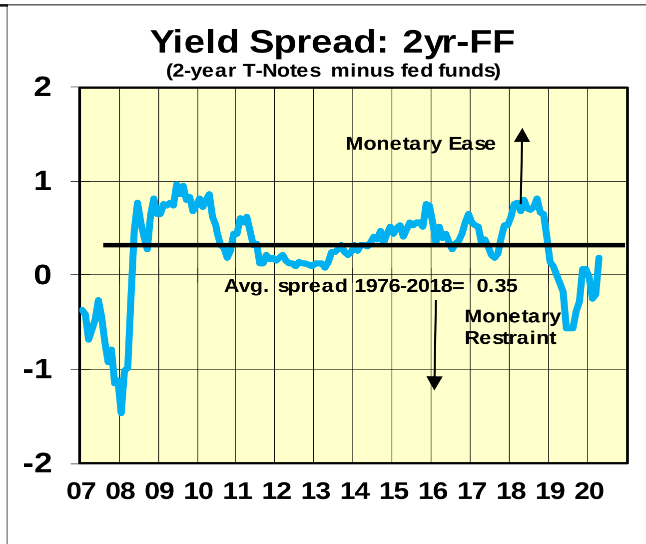


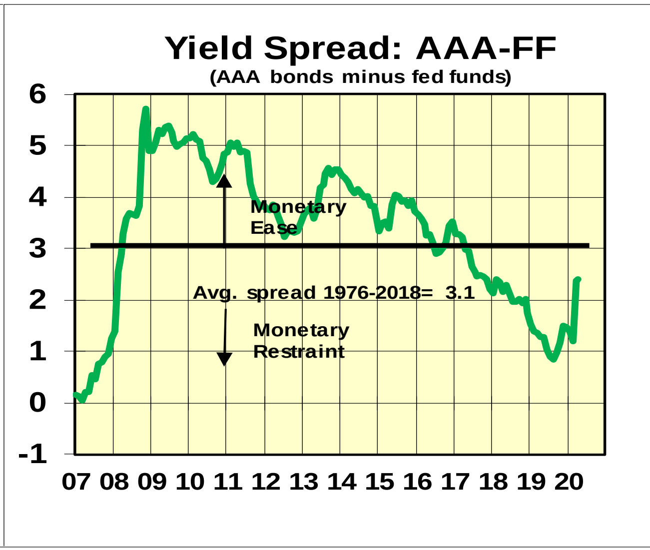
The massive injection of liquidity will help boost the economy beginning next month. At that point the Fed will face its real challenge. It's always easier to create money and lower interest rates than to take it away. Reining in the excess liquidity and raising interest rates, particularly in an election year.

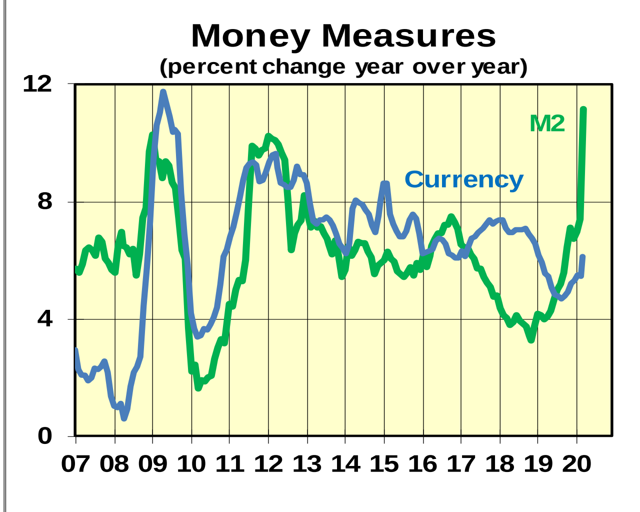
The forecast assumes the Fed will allow the massive increase in liquidity to remain in the economy and will keep its interest rate target close to current levels through to the end of the year.

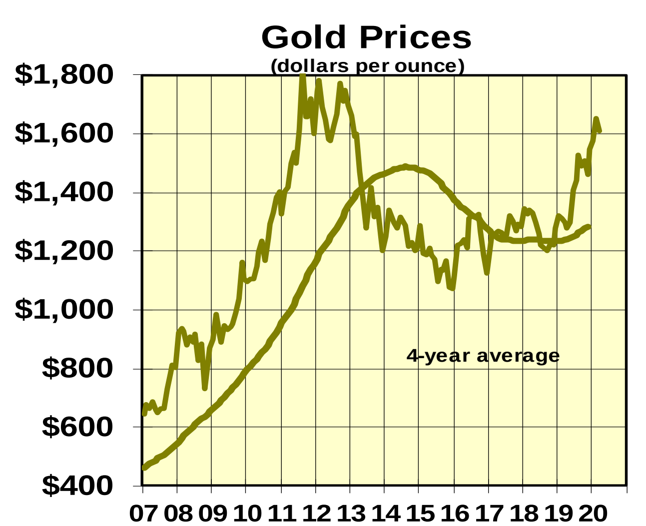
MONETARY INDICATORS

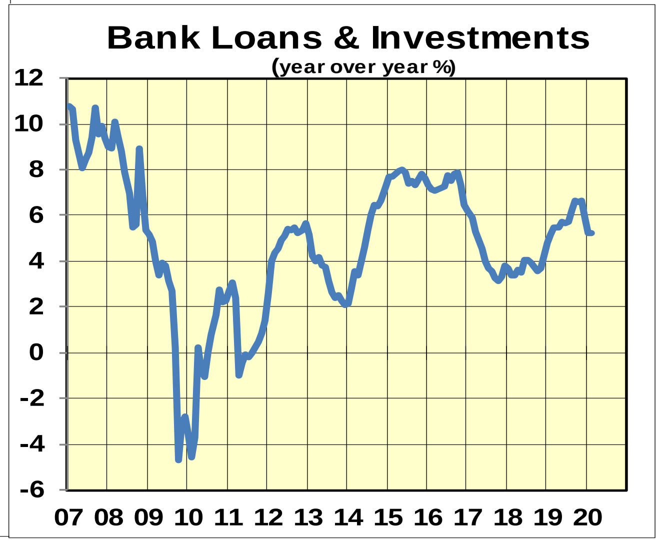








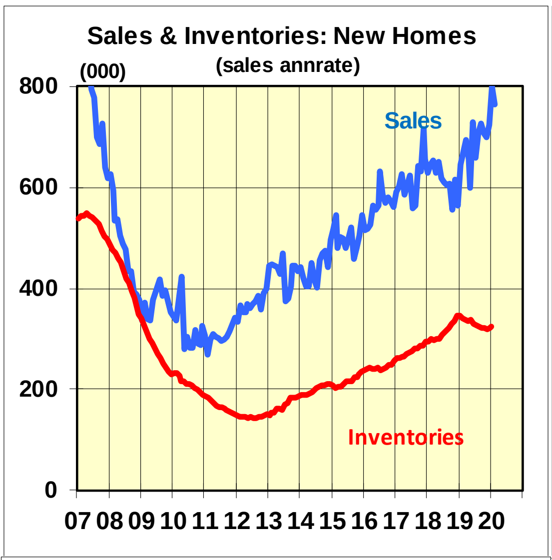


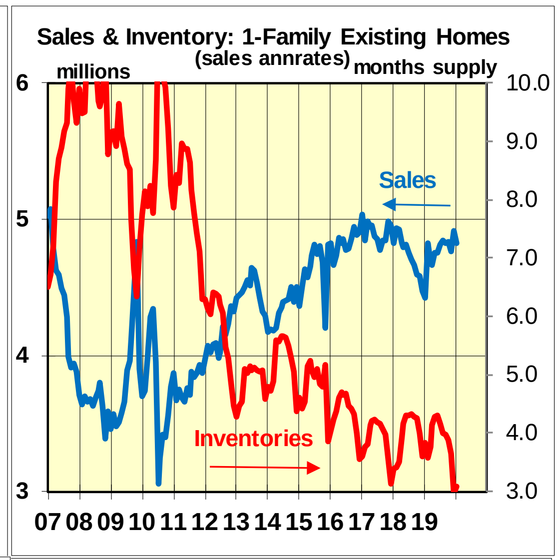


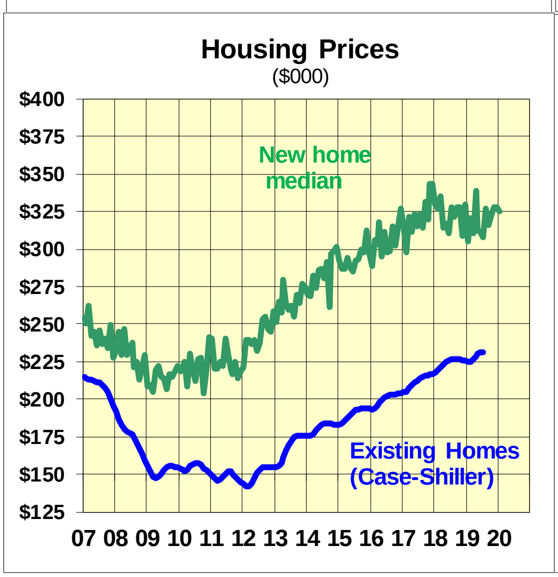
. Sensitive Indicators

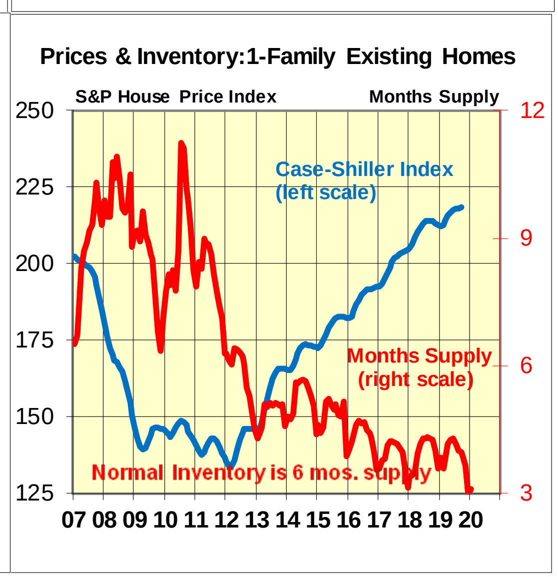
For the most part, both sensitive and coincident indicators held up well in March. As the economy shut down beginning in the middle of the month, the change in activity going into April will capture the full effect of the lockdown.

The data for April will be unlike anything we have seen. This is why the Fed was compelled to do what it could to cushion the fall.



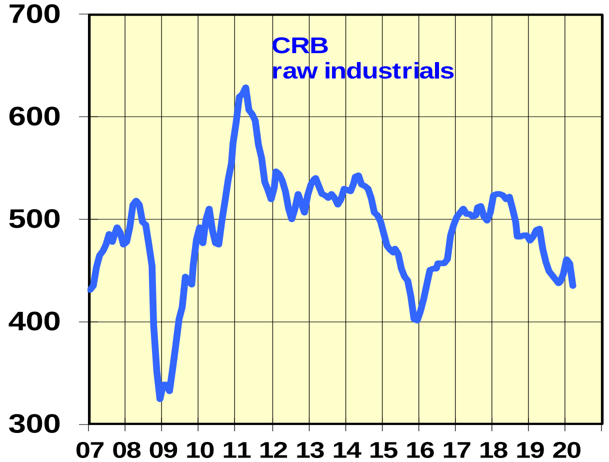






SENSITIVE INDICATORS

Commodity Prices



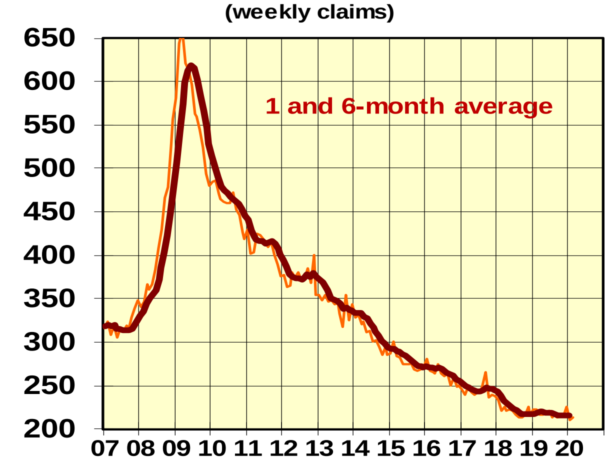
S&P 500 Stock Prices

Homebuilders' Survey

(over 50 represents expanding activity)

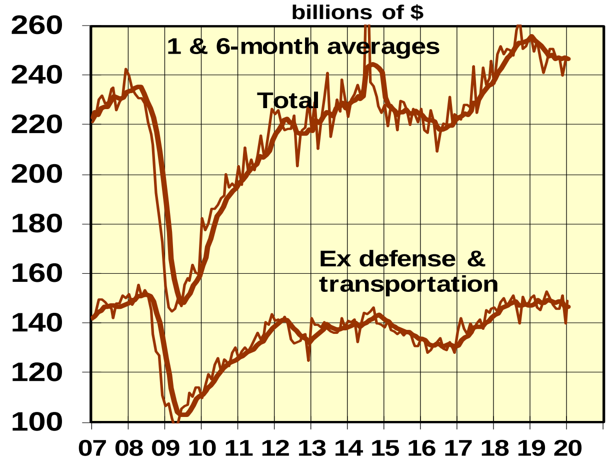
Unemployment Claims

(weekly claims)



New Orders Durable Goods

billions of $

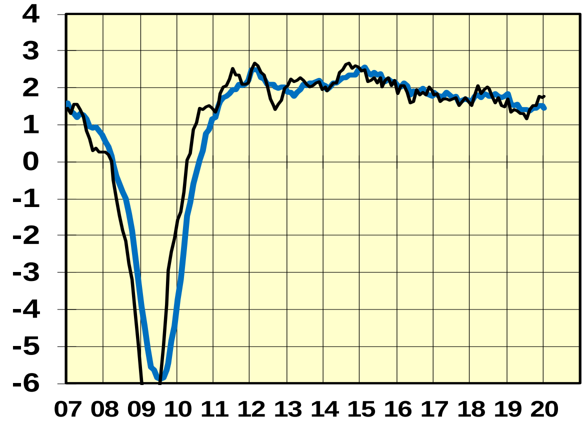


ISM: New Orders

(above 50 represents expanding activity)

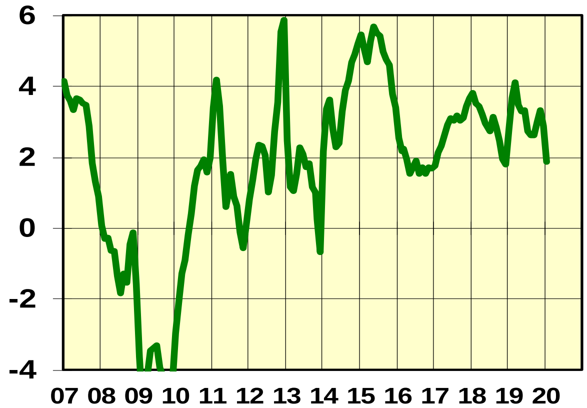
ECONOMIC INDICATORS

Jobs: Private Payrolls
(annual rates of change-- 6 months & 1 year)



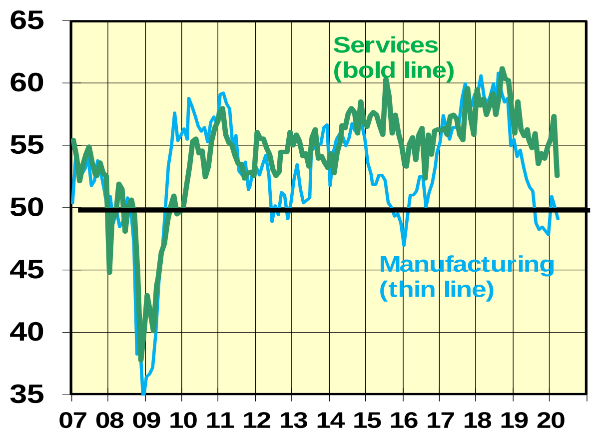
Manufacturing Production
(index 2012 = 100)

Real Wages & Salaries
(year-over-year percent change)

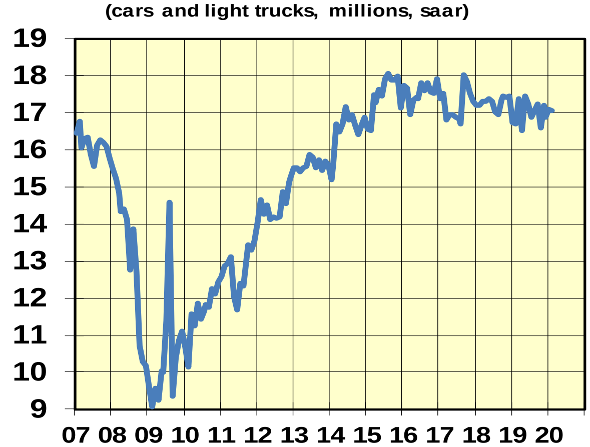


Real Consumer Spending
(annual rates of change 6-month & 1 year)

ISM: Composite
(over 50 represents expanding activity)



Vehicle Sales
(cars and light trucks, millions, saar)

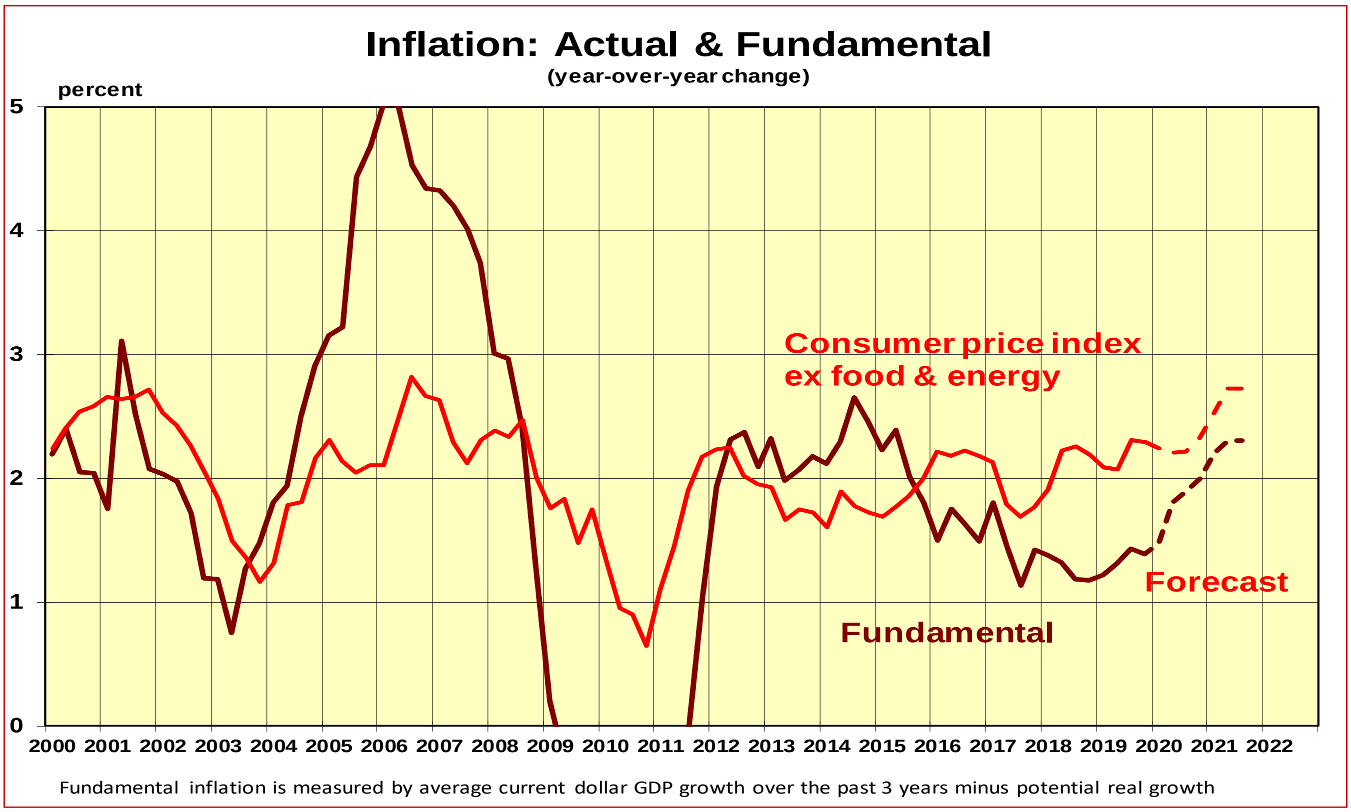


Inflation Indicators

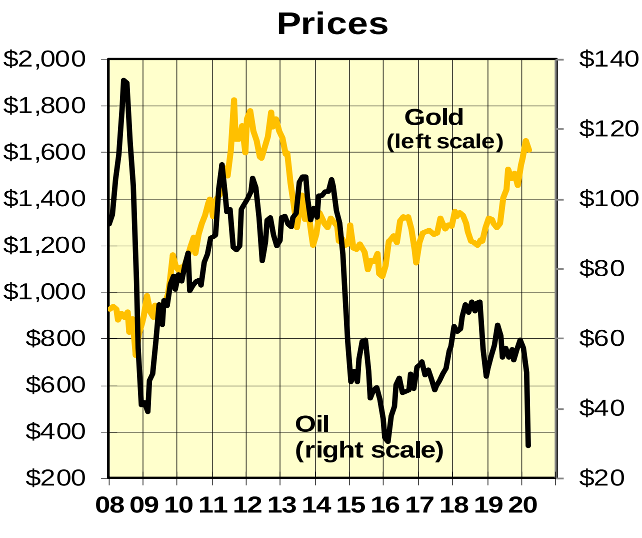
The combination of massive monetary stimulus amid a sharp collapse in business activity is unique. The initial reaction is for lower prices amid an immediate decline in demand. The subsequent reaction is for higher prices as the increase in money works its way through an economy with less output.

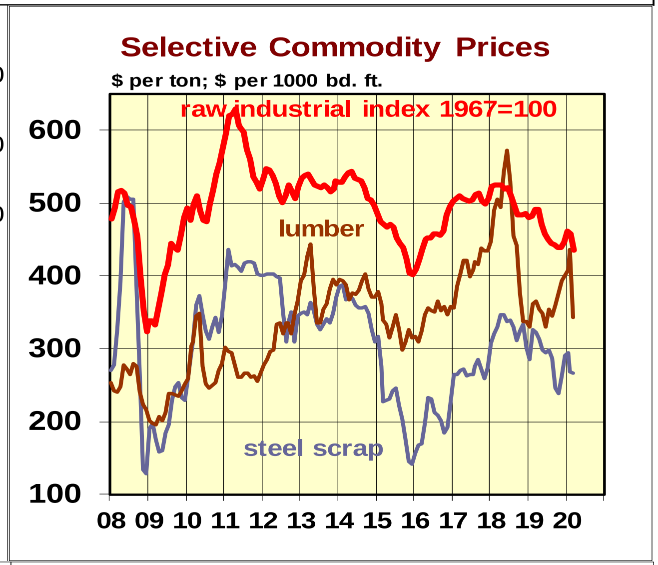
The collapse in oil prices is consistent with this initial reaction. In anticipation of signs of a recovery in the economy, Gold prices should rise. This rise is likely even though gold remains overvalued on a longer-term basis.

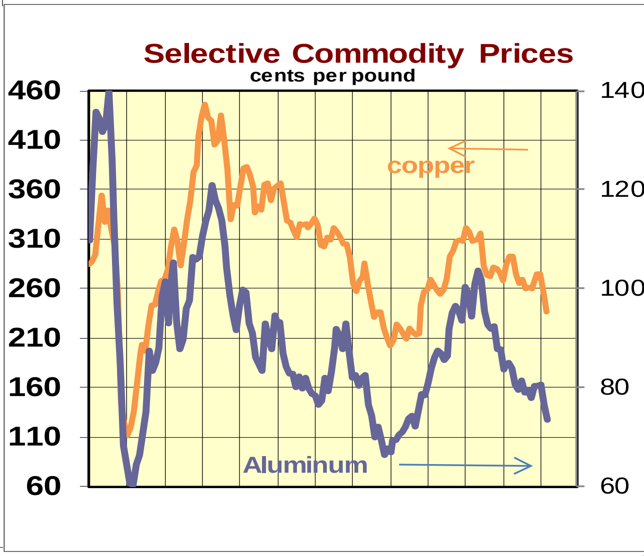
The extent of the pickup in inflation depends on the Fed's willingness to remove liquidity once the crisis has passed.

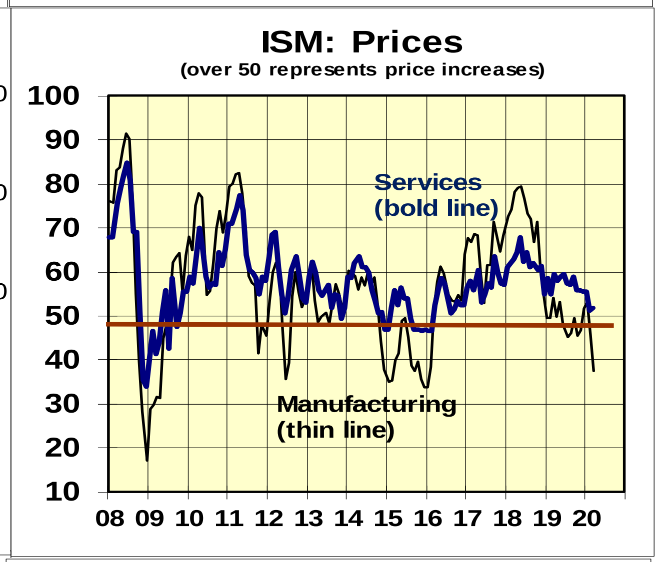


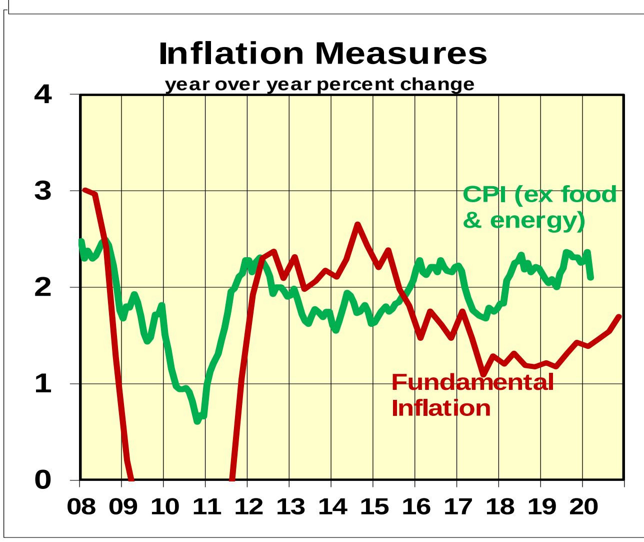
INFLATION INDICATORS

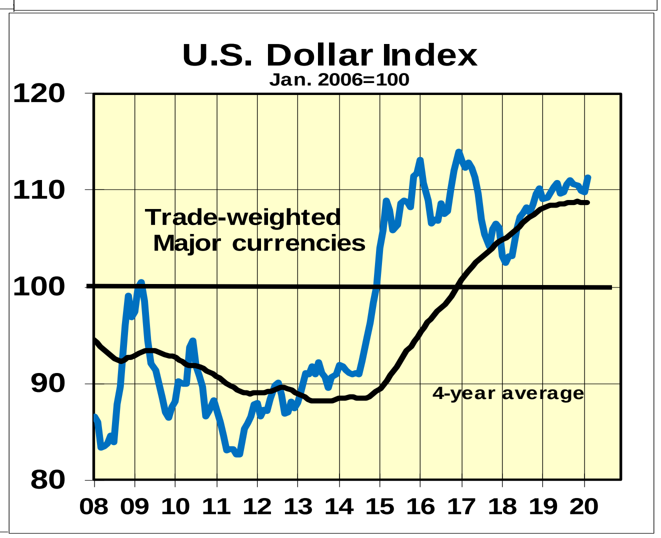






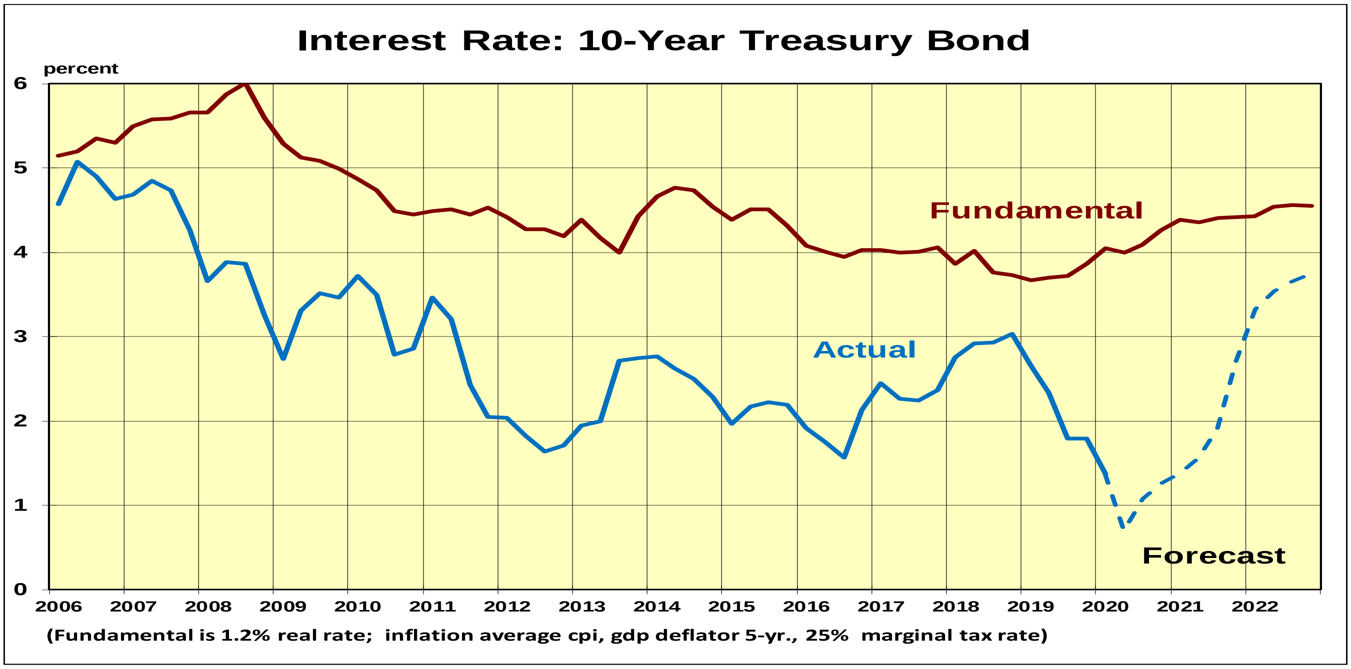


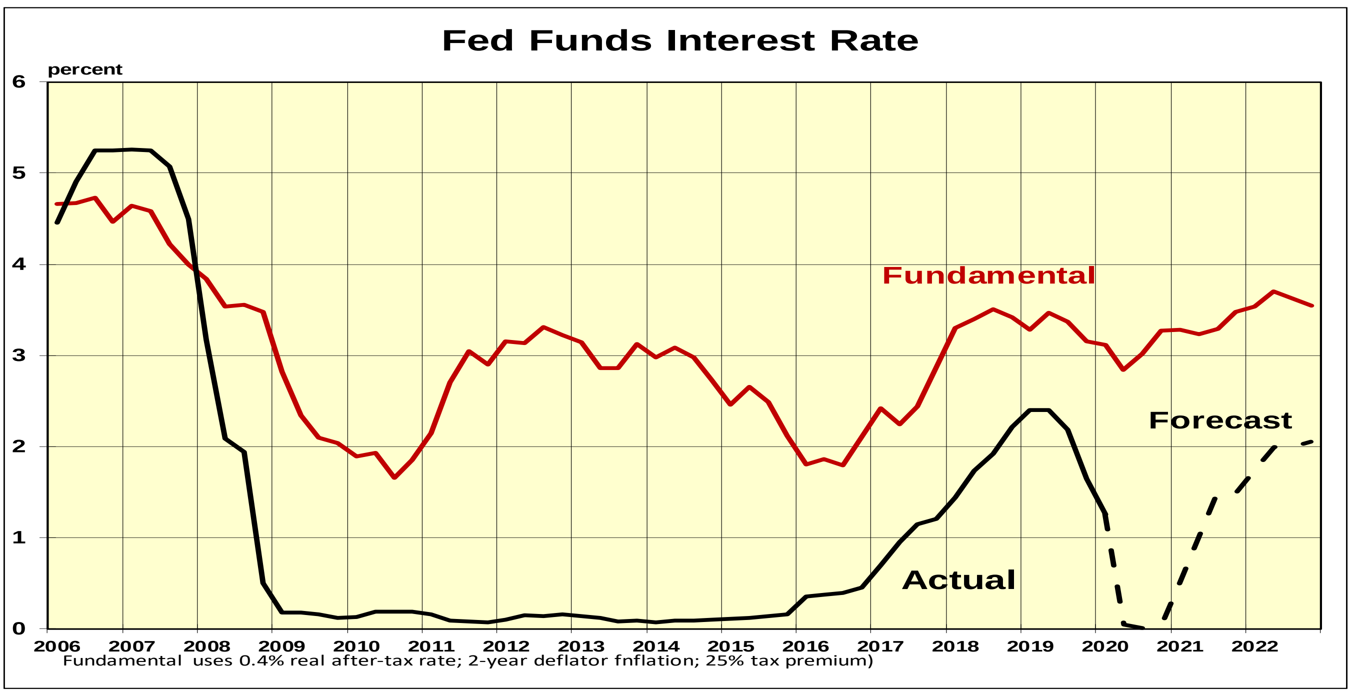




INTEREST RATES

Given political pressures during an election year, the Fed is likely to be slow to reverse its interest rate target. If spending and growth accelerate as I expect, market interest rates are likely to move only slightly higher in the second half of the year.



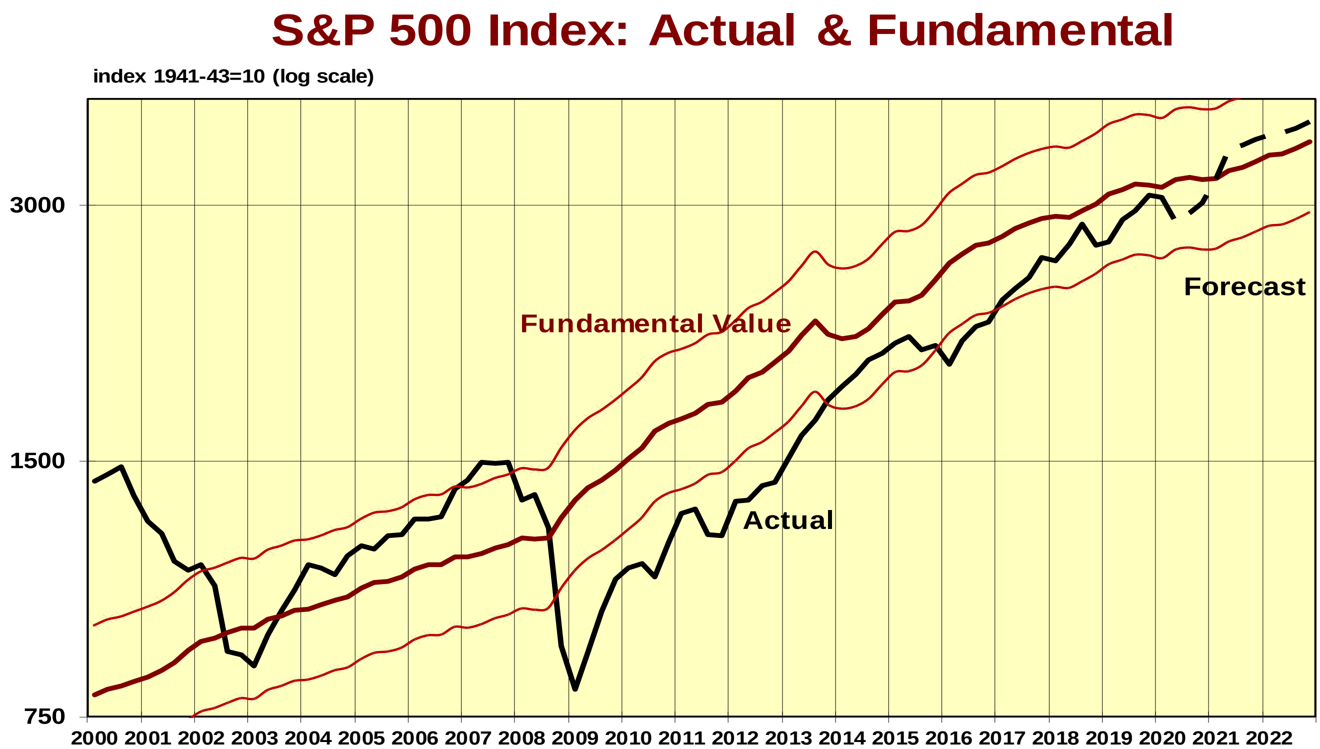


STOCK PRICES

The stock market has reacted dramatically to the threat of damage from the virus. At the peak, the S&P 500 index was 7% above my estimate of fundamental value. At the low, it was undervalued by 25%. With the S&P500 at 2846 the index is undervalued by 12%.

The economy and the stock market remain vulnerable. If the virus fails to abate as I expect, the recovery could be delayed. Also, as investors begin to see the damage to the economy in April and the magnitude of the collapse in second quarter profits, fear can return.

While there are always risks to holding stocks, the greater risk is betting against the US economy. Businesses are highly resilient. Once restrictions are removed, the economy will experience explosive growth. Stay bullish.



Fundmental value of stocks is based on a regression with the S&P's average PE, trend 6.5% earnings and fundamental AAA corporate interest rates as explanatory variables; boundary lines plus & minus 1 standard deviation

4/13/2020	Actual			Estimate	Forecast				YEARS				
	2019 II	2019 III	2019 IV	2020 I	2020 II	2020 III	2020 IV	2021 I	2018	2019	2020	2021	2022
GROSS DOMESTIC PRODUCT	21340	21543	21729	21950	13686	20860	21486	21951	20580	21428	19495	22600	23854
%ch	4.7	3.8	3.5	4.1	-84.9	439.7	12.6	8.9	5.4	4.1	-9.0	15.9	5.6
REAL GDP	19022	19121	19222	19320	12000	18150	18550	18900	18638	19073	17005	19299	19887
%ch	2.0	2.1	2.1	2.1	-86.4	436.6	9.4	7.8	2.9	2.3	-10.8	13.5	3.0
CHAIN PRICE INDEX	1.122	1.127	1.130	1.136	1.141	1.149	1.158	1.161	1.104	1.123	1.146	1.171	1.199
%ch	2.4	1.8	1.3	2.1	1.5	3.1	3.2	1.1	2.4	1.8	2.0	2.0	2.7
CPI- ALL URBAN%ch	3.0	1.8	2.4	1.2	2.0	2.4	2.4	2.4	2.4	2.0	2.0	2.6	2.6
FUND. INFLATION%ch	1.3	1.4	1.4	1.5	1.8	1.9	2.0	2.2	1.3	1.3	1.8	2.3	2.7
PRETAX PROFITS	2085	2046	2127	2080	817	1664	1822	1971	2063	2068	1596	2029	2142
%ch	14.5	-7.3	16.7	-8.4	-97.6	1624.9	43.6	37.0	-3.3	0.2	-22.9	27.2	5.6
PRETAX PROFITS ADJ (1)	2083	2078	2131	2085	821	1669	1826	1976	2074.6	2074.7	1600.4	2034.0	2146.9
%ch	16.0	-0.9	10.6	-8.3	-97.6	1605.7	43.4	36.9	3.4	0.0	-22.9	27.1	5.6
AFTER-TAX PROFITS	1864	1826	1901	1859	729	1487	1628	1761	1843	1848	1426	1814	1915
%ch	14.3	-8.0	17.4	-8.4	-97.6	1627.2	43.6	37.0	1.6	0.3	-22.9	27.2	5.6
AFTER-TAX PROFITS ADJ(1)	1862	1858	1905	1864	734	1492	1633	1766	1854	1855	1431	1818	1919
%ch	16.0	-0.9	10.6	-8.3	-97.6	1605.7	43.4	36.9	9.9	-22.9	-22.9	27.1	5.6
PERSONAL INCOME	18556	18677	18821	19012	11854	18068	18610	19013	17819	18602	16886	19575	20662
%ch	4.4	2.6	3.1	4.1	-84.9	439.7	12.6	8.9	5.6	4.4	-9.2	15.9	5.6
REAL DISPOSABLE INCOME	14934	15012	15073	15182	9134	13906	14245	14472	14556	14974	13117	14761	15194
%ch	1.5	2.1	1.6	2.9	-86.9	437.3	10.1	6.5	4.0	2.9	-12.4	12.5	2.9
PRODUCTIVITY	1.079	1.078	1.082	1.088	1.094	1.100	1.106	1.112	1.058	1.078	1.097	1.122	1.147
%ch	2.6	-0.3	1.2	2.3	2.3	2.3	2.3	2.3	1.4	1.9	1.8	2.2	2.2
CIVILIAN EMPLOYMENT	156.9	157.8	158.6	157.7	139.0	152.0	159.0	159.6	155.8	157.5	151.9	160.3	162.1
%ch	0.4	2.4	2.0	-2.2	-39.7	43.0	19.7	1.4	1.6	1.1	-3.5	5.5	1.1
UNEMPLOYMENT RATE	3.6	3.6	3.5	3.8	13.1	5.6	5.0	4.0	3.9	3.7	6.9	3.9	3.9
INDUSTRIAL PRODUCTION: mfting	104.6	104.8	104.6	104.5	62.7	97.2	101.1	105.1	105.0	104.8	91.4	106.1	108.7
%ch	-3.2	0.8	-0.6	-0.4	-87.0	477.2	17.0	17.0	2.3	-0.2	-12.9	16.1	2.5
LIGHT VEHICLE SALES (2)	17.1	17.1	16.9	15.2	8.4	14.5	13.9	13.2	17.3	17.0	13.0	13.3	13.6
Domestic	4.9	4.7	4.6	4.0	2.3	3.9	3.7	3.5	5.4	4.8	3.5	3.6	3.6
Imports	12.2	12.4	12.3	11.2	6.1	10.6	10.2	9.6	11.9	12.2	9.5	9.7	9.9

(1) Profits adjusted for capital consumption and inventory adjustment.
(2) Millions at seasonally adjusted annual rates.

4/13/2020	Actual				Forecast				Annual				
	2019	2019	2019	2020	2020	2020	2020	2021	2018	2019	2020	2021	2022
Monetary Aggregates quarterly:	II	III	IV	I	II	III	IV	I					
M2 %ch at annual rates	5.5	7.7	8.4	25.4	10.0	5.0	5.0	5.0	3.9	6.8	11.3	5.0	5.0
Securities less excess reserves (bil$	2301	2248	2259	2237									
year over year % change	2.8	-0.6	-1.6	-2.8									
Interest Rates:													
Moody's BAA corp bonds 15+years	4.60	4.02	3.91	3.89	4.30	3.02	3.33	3.58	4.80	4.4	3.6	4.1	6.0
Moody's AAA corp bonds 15+years	3.60	3.10	3.03	2.91	2.40	2.32	2.53	2.68	3.93	3.4	2.5	3.2	5.1
10-YR GOVT SECURITIES	2.33	1.80	1.79	1.38	0.70	1.08	1.26	1.38	2.91	2.1	1.1	1.9	3.6
5-YR GOVT SECURITIES	2.12	1.63	1.62	1.16	0.49	0.59	0.78	0.97	2.75	2.0	0.8	1.5	2.8
2-YR GOVT SECURITIES	2.12	1.69	1.59	1.10	0.28	0.10	0.30	0.55	2.53	2.0	0.4	1.2	2.0
3-MONTH T-BILL	2.31	2.01	1.59	1.18	0.20	0.05	0.25	0.50	1.94	2.1	0.4	1.1	1.9
FEDERAL FUNDS RATE	2.40	2.19	1.64	1.26	0.05	0.05	0.25	0.50	1.83	2.2	0.4	1.1	1.9
3-MONTH LIBOR RATE	2.51	2.19	1.93	1.53	0.05	0.05	0.25	0.50	2.31	2.3	0.5	1.1	1.9
BOND EQUIVALENT RATES:													
FEDERAL FUNDS	2.43	2.21	1.66	1.27	0.05	0.05	0.25	0.50	1.85	2.2	0.4	1.1	2.0
3-MONTH LIBOR	2.54	2.22	1.95	1.55	0.05	0.05	0.25	0.50	2.34	2.4	0.5	1.1	2.0
3-MONTH T-BILL	2.36	2.05	1.62	1.20	0.20	0.05	0.25	0.51	1.98	2.1	0.4	1.1	2.0
STOCKS:													
S&P 500	2883	2959	3086	3069	2871	2939	3022	3229	2745	2913	2975	3459	3687
S&P 500 reported earnings past 4 Qtr:	135.3	132.9	139.5	137.5	115.7	111.7	109.2	113.1	125.2	135.5	118.5	136.7	157.0
S&P 500 p/e on reported earnings	21.3	22.3	22.1	22.3	24.8	26.3	27.7	28.6	22.0	10.4	25.3	25.5	23.5
S&P 500 operating earnings past 4 Qtı	154.5	153.0	157.1	155.4	129.8	123.0	120.1	124.4	143.7	154.4	132.1	150.4	172.7
S&P 500 p/e on operating earnings	18.7	19.3	19.6	19.7	22.1	23.9	25.2	26.0	19.1	18.9	22.5	23.0	21.3
S&P 500 trend earnings*	132.0	134.1	136.2	138.4	140.6	142.8	145.1	147.4	125	133	142	151	161
S&P 500 p/e on trend earnings****	21.8	22.1	22.7	22.2	20.4	20.6	20.8		22.0	21.9	21.0	22.9	22.9

*reported earnings based on a 6.5% long-term growth rate; current quarter annualized.

*price earnings based on reported earnings trend

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Standard Deviation is a measure of the volatility of returns of the portfolio and is a method of quantifying the risk associated with an investment. In mathematical terms, standard deviation is the square root of the variance. Variance is a measure of dispersion of a set of data points around their mean value. The mathematical expectation of the average squared deviations from the mean.

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Chain Price Index is an alternative measurement of the Consumer Price Index that considers product substitutions made by consumers and other changes in their spending habits.

Government and Treasury Bills are guaranteed by the U.S. Government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.