Hit Them Harder

Once again, life imitates art.

In the last of the Ocean's Trilogy, Ocean's 13, there is a scene where Basher (Don Cheadle) and his crew are boring into the foundation of the new hotel/casino owned by Willy Bank (Al Pacino). The plans are to mimic an earthquake and temporarily reboot a supercomputer (the Greco) intended to eliminate cheating. After the first man-made quake, Bank rushes to the control and receives a call on his new gold-plated cell phone, which really is a device to disrupt the Greco. This allows a three-minute windfall for the gamblers, as all the rigged machines and compromised dealers on the casino floor go undetected. But when it comes time for the second man-made quake, intended to force the gamblers from the casino with their winnings, the speculators go undeterred and continue to place wagers. This forces Rusty (Brad Pitt) to utter the line, "***Hit them harder***." The crew initiates a third man-made quake, which causes an actual and more violent earthquake, ultimately forcing everybody from the casino floor.

So this morning, we received confirmation that the U.S. has lost over 20 million jobs in the last month, more than was created during the previous ten years. We also were presented with an unemployment rate of 14.7%, on par historically with the period following The Great Depression. Yet like in the movie, investors are undeterred and unmoved, driving equities higher.

We remain puzzled as to what direction and magnitude of the recent rebound in equity markets. Perhaps the latest economic data releases are better than feared. Maybe investors are relieved that the escalating discontent between the U.S. and China over trade will dissipate? **Or perhaps fund managers and traders are pricing in negative rates or for the Fed to buy equities?** Or maybe investors believe that earnings do not matter, especially as most of the S&P 500 companies have pulled guidance going forward. But we just don't get it.

The COVID Tracking Project and Johns Hopkins suggest that the pandemic here in the U.S. is trending in the right direction, as citizens continue to accept the new normal of social distancing. And as we pointed out last week, in our note entitled, "Welcome to Starbucks," SBUX could herald how the broader economy will open up. We drove by our local Starbucks this week and was pleasantly surprised, witnessing a line 20 people deep. But we couldn't help but notice patrons insistently wiping down cups and bags with antibacterial wipes, as baristas became part-time waiters/waitresses delivering orders to the front door. Our local bakery and liquor store have also implemented similar protocols; order online, and your order is waiting for you, behind a locked door.

The NJ Governor opened parks and golf courses last week while suggesting that beaches, curb-side businesses, and construction sites may open soon. But he also extended the public health emergency status by 30 days. Personally speaking, my wife drove to NYC today to see an orthopedic doctor, something she couldn't do a couple of weeks ago. And my daughter's college sent a parent letter stating, "Although the pandemic continues to create uncertainty, we are cautiously optimistic that we'll be able to start the fall semester in person and on time."

So, we believe that the U.S. stands firmly at the beginning of the end, as it relates to the COVID pandemic. But we fear this may be the end of the beginning from an economic perspective and remain clearly in the troughing phase of a "U" recovery. The real question is, how long will we stay here?

How long will it be until you feel comfortable getting on a plane, getting on the subway car, or even go to a movie theater? When will it be acceptable to shop for groceries without a mask, or work out at a gym? For some, the answer is "now," but for most, the answer is, "I don't know." **We are in the latter camp but believe we will eventually get back normal.** But until we see real headway in either mitigation or prevention for COVID, we think it is hard for corporations to budget for demand and hence, revenue, expenses, and ultimately earnings. As a result, this makes sell-side analysts and strategists' projections inexact, at best.

Therefore, we continue to view the recent upward retracement in the S&P 500 **with skepticism. The S&P 500 now trades at 20x forward earnings, compared to the long-term average of roughly 16.0x. Even if we use our "mulligan" for 2020, and focus on 2021 earnings, this implies the S&P is trading at 19.4x. To us, this is simply too rich, given the magnitude of the unknown unknowns.**

As more disappointing economic data is reported, we believe the evidence will mount, suggesting that the U.S. economy will not exhibit a "V" recovery (as the market is currently suggesting). Therefore, we continue to suggest a "W" recovery is in the offing for markets. Once again, we wish we felt different, and we hope we are wrong. But for those who may think they have "missed it," we suggest you may just get another bite of the apple.

We'd love to hear your thoughts.

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