Weekly Capital Market Comments

May 1, 2020

NORTHEAST SEQUOIA PRIVATE CLIENT GROUP

Welcome to Starbucks. What can I get started for you today?

Starting next week, Starbucks plans to begin limited openings of stores across the United States. In mid-March, the company decided to close over 50% of its stores nationwide, limiting service to drive-through and delivery only. For many, store openings will be great news, as it will create a welcome distraction and a reason to leave their home and help break the monotony caused by a six-week shelter-at-home order.

For us, the reopening of Starbucks signals much more. In our opinion, no other consumer-facing retailer has a better prism into consumer behavior coming out of COVID-19 than Starbucks. Starbucks has seen first-hand how the infection curve of COVID-19 has evolved, first in China, and then across Asia and Europe, and finally reaching us in the U.S. Further, the specific type of consumer experience offered at a Starbucks is unique. It will be interesting to see how consumers react to a product that is “touched” and “handled” such as a cup of coffee, a slice of banana bread, or a breakfast sandwich.

Further, the rate of re-openings (or re-closings), the location of re-openings, and the format (drive-through, handoff, limited seating) will provide valuable insight as to how Starbucks is assessing consumer demand and public safety. In our opinion, Starbucks will be the litmus test that foreshadows how the consumer might navigate through any staged reopening of the U.S. economy, and the challenges the economy may encounter to normalize, in general.

Today, nearly 100% of Starbucks stores in China are open, with the limited exception of those located in cinemas or enclosed entertainment centers. But there are several key differences between the U.S. and China to note. First, it took longer to open stores in China because openings were determined centrally by the government on a city by city basis. Here, the openings will be determined mostly by Starbucks. Also, the initial shelter-at-home lockdowns in the U.S. and China were dramatically different. The Chinese shelter-at-home lockdown lasted only three weeks, while here in the U.S., many citizens are approaching six weeks. And the breadth of the lockdowns was also different. In China, soon after the initial lockdown announcement, severe restrictions were placed on transportation and travel, the closing of non-essential companies and manufacturing plants, as well as limiting individuals from even leaving their homes.

So while there may not be an exact comparison between the Chinese and U.S. market, **we believe that all any consumer wants is a safe, familiar, and convenient experience**. We look forward to driving by or ordering at one of several local Starbucks stores in our area over the next several weeks. We hope we will find long lines, and unlike those at Costco, the ones we look forward to standing in.

Now the fun part, how should investors interpret a 30% upward retracement in the S&P 500, from its March 23, 2020 lows? **In our opinion, with skepticism.** As we have continued to point out, the bottom in this market is a process, not a number. And while the country may be at the beginning of the end as it relates to the COVID pandemic, the economic scars caused by a global economic shutdown are just beginning to surface. On Thursday, the Department of Labor reported an additional 3.8 million unemployment claims filed this past week, **bringing the total number of jobs lost since the pandemic started to over 30 million**. Also this week, the Department of Commerce reported 1Q20 GDP of negative 4.8%, missing the consensus expectation of negative 4.0%. We also witnessed a 31-point plunge in

consumer confidence to 86.9 and a 12.4 point drop in the Chicago PMI to 35.4. **<u>Yet the S&P 500 now trades at 20x forward earnings, compared to the long-term average of roughly 16.0x</u>**.

We believe the U.S. has already entered into the deepest economic recession since The Great Depression and would not be surprised to see the unemployment rate skyrocket well over 15% (from February's print of 3.5%) when released next week. But unlike the Great Depression, we believe the duration of the current recession will be shorter than previous recessions and could end much more abruptly. Still, it is our view that the economy will exhibit a "U" recovery, as consumers and businesses struggle to find the path back to a new normal. This is why we believe observing foot traffic, and opening trends for Starbucks is so essential.

But from a market perspective, we continue to suggest a "W" recovery is in the offing. Following a steep initial decline and subsequent bounce in equity markets, we expect as more disappointing economic data is reported and corporate earnings disappoint, the reality of a weak U.S. economy will be accepted by the markets. And despite countless efforts by the Federal Reserve and Congress to resuscitate consumers and businesses with a plethora of QE, helicopter money, and fiscal stimulus, the equity markets will once again retreat and possibly approach the March lows. 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.