CONWAY• JARVIS LLC
Investment Outlook

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Eye of the Storm or a New Bull Market?

Is this a bear market rally or something we haven't seen before? That's the question posed by investment professionals as we survey the carnage emanating from the economy and attempt to reconcile that with the stellar stock market performance of the past six weeks. We've witnessed the infrequent *bear* market in 1987 that predicted a recession that never was. Never before have we seen a bull market *coincide* with the *start* of a recession. As enduring as Newton's Law, the stock market has risen and declined, over time, in tune with the economy as it expands and contracts. That tenet is part of every one of the many definitions of a bull market that exist. No exceptions. Will 2020 be the first?

Is it Different This Time?

We cringe when we hear that question. Asked innumerable times about super-heated stock markets, the answer has always turned out to be "no". It always ends in tears. The only differences are the events and conditions that prompt it and how they unfold. Let's look at what *is* different in that respect. The outbreak of the virus could be viewed as a societal event, altering the behavior of those within an identifiable risk category, defined by age or compromised health condition. The response by policy-makers dictated a behavioral change by *everyone*, not just those at risk. It's generally agreed that, absent such a response, many more deaths would have occurred. However, the result was a cataclysmic economic event.

Never before had the economy been intentionally "*switched off*" to save lives. That's different. Those at the federal level recognized the longer-term risks to the economy and unleashed an unprecedented amount of fiscal and monetary support as they sought to achieve a balance between mortality and economic considerations. Some policy-makers at the state level have prioritized mortality over the monetary, assuming the Fed and the Treasury will ride to the rescue of their budgets. That has set the stage, in an election year, for politicizing policy among the states as it affects those living on Main Street.

In our previous Outlook, we cautioned that many restrictions in response to COVID-19 held the potential to do more actual damage to the economy than the virus itself. We think hindsight will point to that being the case. However, when looking at the decline in the rate of transmission that resulted from these measures, it was a necessary step toward defining acceptable losses and learning to live with the virus much as we have with the flu. Some states will reopen with that perspective in mind, others won't. That's why we see any rebound from this self-imposed shutdown being uneven and lengthy rather than the V-shaped recovery touted by some market-watchers.

What's Next for Main Street?

When talking about the economy, we place *extremely* long odds on a V-shaped recovery occurring. The average duration of eight post-war recessions is 11 months so returning to positive GDP growth in the fourth quarter might qualify as one. While some see the stock market messaging that, the economic data indicates otherwise. Despite some big gains in dining and hospitality staffing in May, unemployment came in at minus 13+% amid speculation that a data anomaly understated the actual number by 3%. While that's an improvement from the prior month, reduced capacity in those sectors due to ongoing restrictions makes it likely it will be a long, slow return to normalcy.

Manufacturing and industrial production should revive in the second half, but at a diminished level due to health and safety considerations. Service companies, being more adaptable to working remotely or at a distance, will fare better. Switching the economy off took a matter of weeks. Switching it back on will take months and perhaps years in the event a second wave of the virus occurs. We'll revise our opinion if and when testing becomes widely available and an effective vaccine is developed.

The Message from Wall Street

Following the March 23 bear market low, the major indexes have rallied to levels at or near their February record highs. The question is whether this secondary trend will persist and prove to be the start of new bull market or become a footnote as the greatest bear market rally (+44%) in history. Illustrating the divergence among companies that can quickly adapt to the crisis, we've seen the NASDAQ blow through its record high of February to establish its own bull market while the S&P 500 and DOW still trade well off their highs.

The Tech, Consumer Discretionary, and Healthcare sectors were clear winners at the onset of this rally. Only in recent weeks have laggards such as Energy, Financials, and Industrials joined in the advance. Underlying stock prices of the latter groups are many companies that aren't earning a profit, paying a dividend, or investing for growth as they were in prior years. Revenues, cash flows, and earnings have been hollowed out these past few months and we suspect that will be reflected in the data for months and quarters to come. That makes valuations suspect as P/E multiples expand because of a deteriorating "E". It's hard for us to believe that a reality check isn't coming soon. If it doesn't and this rally becomes, by definition, a new bull market it will indeed have been different this time.

Here's a look at the risks to the economy we monitor:

COVID-19: Globally, the spread of the virus has been reduced to varying degrees. Restrictions remain in place but are being gradually phased out. Reopening of the economy in the US varies state-by-state. Capacity will be reduced for a lengthy period of time. **Significant**

The Fed: Where would we be without them? They've opened the toolbox and are supporting the credit markets and increasing the money supply. A mighty tailwind for the economy that the stock market has noted. **Benign**

Trade War: China's management of the crisis has sparked a backlash. The truce in trade with the Phase One agreement is at risk in an election year. Phase Two likely to be stalled until next year. **Moderate**

Global Economy: Global recession began in the first quarter. The Fed led with aggressive measures to stimulate. The ECB followed in May. China remains behind the curtain. **Significant**

The Election: Not surprisingly, the COVID-19 crisis has been politicized in Congress and among red and blue states. Civil unrest has created a new narrative. The potential for a shift away from current fiscal policy has increased. **Moderate**

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