CONWAY• JARVIS LLC
Investment Outlook

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Update

The Economy Surprises

Within the context of bleak economic data and civil unrest, stocks continued their advance this week going into Friday's employment report. The numbers were expected to be grim with estimates of unemployment at nearly 20%. Instead, we saw 2.5 million jobs ADDED to the rolls in May and the jobless rate drop to 13.3%. That proved to be the green light for traders to jump in and take the DOW up almost 1000 points (+3.5%) and the S&P 500 (+2.85%) to levels not seen since late February.

This week's activity has capped a more than 12% advance of the S&P 500 since mid-May and left that index just a little more than 5% off its record high. The real news of the week is the NASDAQ posting a new record high. That's hardly the stuff of looming recession. Heightened optimism regarding the reopening of the economy is abound and fears of a second wave of the virus are receding. But for how long? Current estimates of negative GDP growth foretell of a US recession in the making, one that could persist through year-end.

What could explain this rally off the March low to current levels? Perhaps it's the certainty that the economy will return to robust growth at some point that's inspiring investors. In recent days, the yield curve has steepened by virtue of long bonds selling off a bit. It could be assumed that those dollars would migrate to the shorter end of the curve. That's a good sign for the long-term economy. In addition, breadth has widened in the stock market this week as capital has migrated to a number of the have-not stocks that had been beaten down. Airlines, Travel/Leisure, and most importantly the Financials, have led this stage of the relief rally.

For us, it's not a matter of "if" the economy rebounds nicely but of "when." The impending recession, defined as two consecutive quarters of negative GDP growth, doesn't come with the structural impediments that burdened us in 2008. The current contraction was a by-product of measures taken to combat the coronavirus. It was accompanied by massive fiscal and monetary stimulus to soften the blow to consumers and business. For those reasons, we don't doubt the economy will bounce back to positive growth. We just don't share the market's apparent belief that it will be this year. We'll expand on that next week in our upcoming Outlook.

While certainly pleased with the continuation of the advance in portfolios, we're remaining cautious as we head into Q3. We're looking for a consolidation of recent gains as earnings disappoint and the slower "careful" economy emerges from the current crisis.

Next week we'll dispense with an update and post our Quarterly Investment Outlook.

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