CORBETT ROAD

MACRO MUSINGS

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THE FOG OF THE PANDEMIC

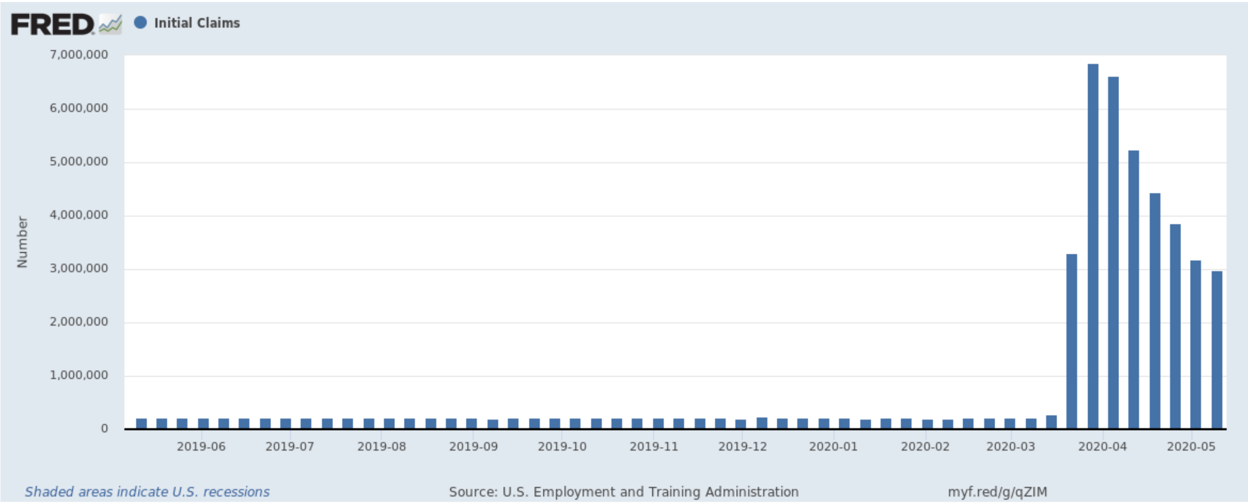
SUMMARY

- **We are getting more economic data from the COVID-19 fallout, and it is as lousy as expected. We expect GDP data for the second quarter to be the worst on record.**
- **The Federal Reserve responded to the crisis faster and more aggressively than any time in history. Recent comments by Fed Chairman Powell suggest they will continue to do everything in their power to avoid another financial crisis, but they are limited in how much they can help the broader economy.**
- **In April, the market had its third best month since 1950. Historically this has led to better than average returns a year later.**

THE COLLAPSE IN THE ECONOMY IS AS BAD AS IT HAS EVER BEEN

The contraction in the economy over the past two months is unprecedented, with key economic barometers collapsing.

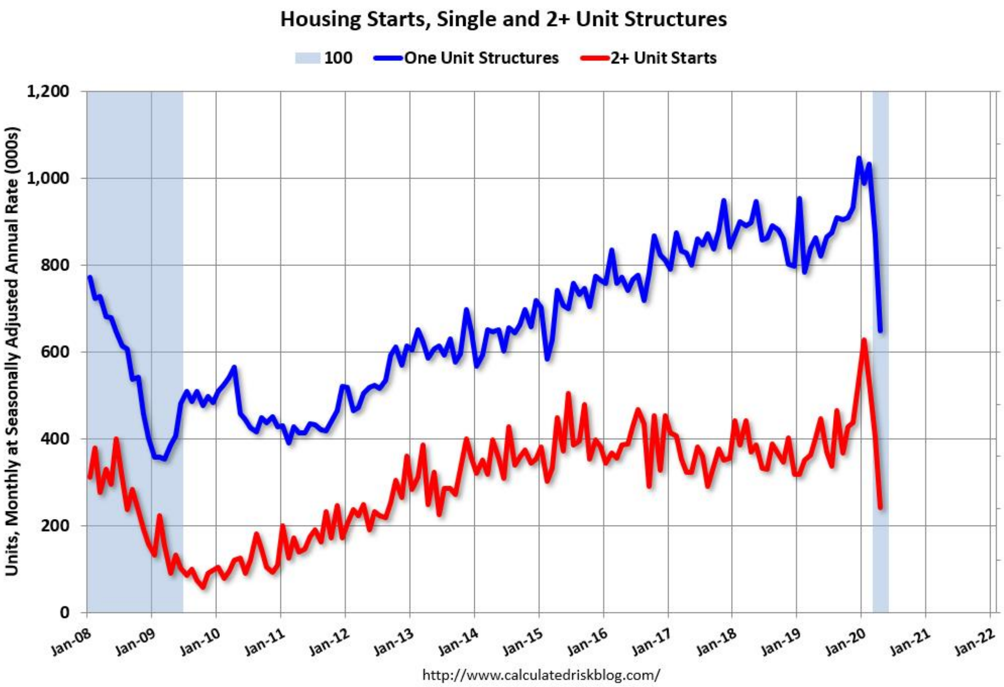
This is apparent in initial claims for unemployment. Lockdowns across the country led to a record surge in jobless claims never witnessed in history. This is the most frequently published indicator we follow, and the jump in mid-March was so drastic, we cannot even use a traditional line graph to illustrate it:



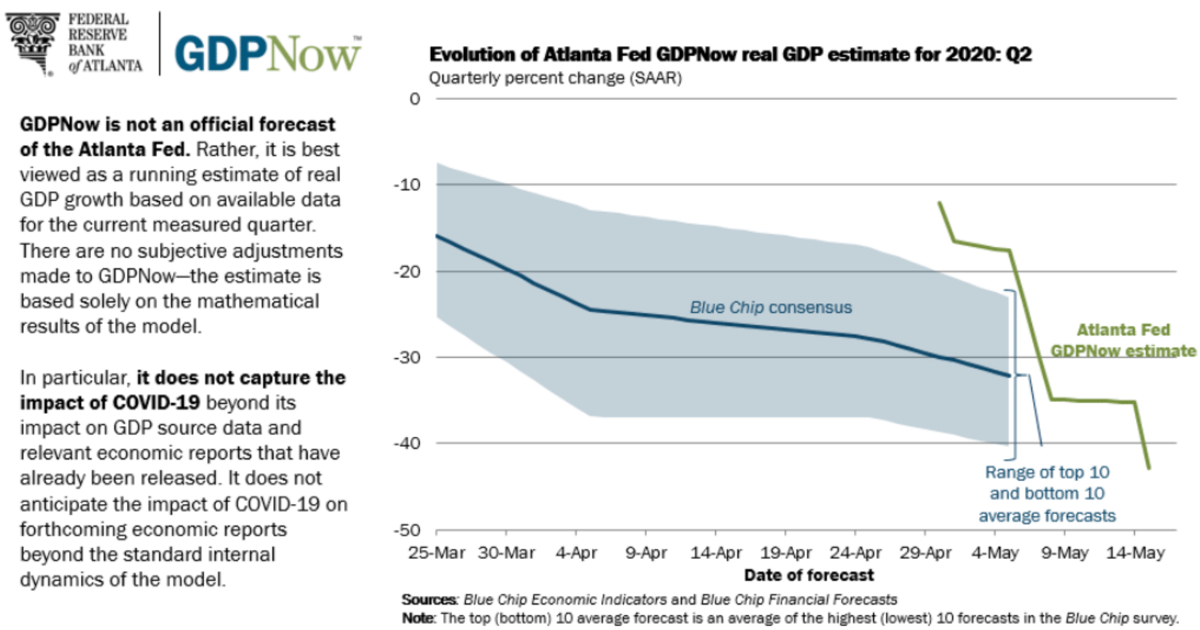
Retail Sales, which typically peak a year before a recession begins, fell off a cliff:

And the damage was broad based. **Sales declined in every industry except food and online retail**:

Housing starts also fell back to 2013 levels in March and April:



All of these factors feed into GDP, where the second quarter of 2020 will go down as the worst in history. The Federal Reserve Bank of Atlanta has a model that tracks GDP in real time, and currently projects a decline of over 40%. Comparatively, in the fourth quarter of 2008, in the depths of the Great Recession, GDP dropped 8.4%.



However, it is not all bad news. Despite the historic drop in GDP, the worst is probably behind us. While the unemployment rate is likely to climb in the months ahead, the stock market is forward looking and tends to correlate better with initial claims, and the worst readings for claims look to be behind us. There are also signs that the housing market is picking back up thanks to lower mortgage rates, but we will need to wait a few months to see how quickly housing activity rebounds.

HOW MUCH CAN THE FED HELP?

Having already taken extraordinary action since the beginning of the crisis, the Federal Reserve claims there is still a lot more it can do. On the most recent episode of *60 Minutes*, Chairman Jerome Powell was asked if there was anything else the Fed could do, and he responded with the following comments:

*"I will say that we're not out of ammunition by a long shot. No, **there's really no limit to what we can do with these lending programs that we have. So there's a lot more we can do to support the economy, and we're committed to doing everything we can as long as we need to**."*

Powell made it clear that the Fed will do whatever it can to prevent a financial crisis, but he also cautioned that there is little the Fed can do to help the real economy. In a speech last week, Powell said that it's up to Congress to help support the economy now:

*"The recovery may take some time to gather momentum. **Additional fiscal support could be costly, but worth it if it helps avoid long-term economic damage** and leaves us with a stronger recovery."*

In our view, the biggest known risk to the market is if Congress refuses to pass more stimulus legislation *should the economy need it.* If the economy is slow to reopen or there is a second coronavirus wave, Congress may need to enact additional spending packages for testing, unemployment relief, and small business support. Any hesitation from lawmakers in this scenario could be met with another sell-off in the market.

HAS THE MARKET ALREADY LOOKED PAST THE CRISIS?

As we mentioned last month, the rally of the March lows surprised even us. Despite the depression-level economic backdrop, by the end of April, the S&P 500 had registered its 3rd strongest month since 1950 (table from LPL):

10% Monthly Gains, What Happens Next?

Historic S&P 500 Index Gains Have Led To Continued Strong Returns

Date	S&P 500 % Change	Next Month	S&P 500 Index Return 3 Month	6 Month	12 Month
October 1974	16.3%	-5.3%	4.2%	18.1%	20.5%
January 1987	13.2%	3.7%	5.2%	16.3%	-6.2%
April 2020	12.7%	?	?	?	?
January 1975	12.3%	6.0%	13.4%	15.3%	31.0%
January 1976	11.8%	-1.1%	0.8%	2.6%	1.2%
August 1982	11.6%	0.8%	15.9%	23.9%	37.3%
December 1991	11.2%	-2.0%	-3.2%	-2.1%	4.5%
October 1982	11.0%	3.6%	8.7%	23.0%	22.3%
October 2011	10.8%	-0.5%	4.7%	11.5%	12.7%
August 1984	10.6%	-0.3%	-1.9%	8.7%	13.2%
November 1980	10.2%	-3.4%	-6.6%	-5.6%	-10.1%
November 1962	10.2%	1.3%	3.3%	13.7%	17.6%
	Average	0.2%	4.0%	11.4%	13.1%
	Median	-0.3%	4.2%	13.7%	13.2%
	% Positive	45.5%	72.7%	81.8%	81.8%

Source: LPL Research, FactSet 4/30/2020 (1950 - Current)
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.
The modern design of the S&P 500 Index was first launched in 1957. Performance before then incorporates the performance of its predecessor index, the S&P 90.

The good news is that there were only two historical instances when the market was lower a year later. The next one to three months saw more mixed returns, but there were no alarming drops.

The question remains, of course, whether there are any analogous periods that mirror our current situation. The economic damage today is far worse than any period in the above table, and we simply do not have any historical precedent for the pandemic and its aftermath.

SUMMARY: LIMITED UPSIDE FROM HERE?

The biggest challenge going forward is to balance the lousy economic backdrop with record stimulus and a supportive Federal reserve. The MACROCAST™ score is negative, but not extremely negative. MACROCAST™ has not provided an all-clear signal that would suggest the conditions for risk assets are positive. While the market rally off the lows has been strong and swift, we believe significant gains from these levels are unlikely. At the same time, the current MACROCAST™ score suggests the worst might be behind us, and significant declines from here are less likely.

In our view, risk remains skewed to the downside, and we will continue to monitor incoming data and update our outlook and positioning when necessary.

Thank you for your continued support.