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THE ALOOF/MATTOS REPORT

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COVID-19: Turning the Corner

"Life is 10% what happens to you and 90% how you respond to it." — *Lou Holtz, Hall of Fame football coach*

As the battle against the COVID-19 pandemic continues, how we respond to it will determine how we beat it. Continued sacrifices range from everyone in the medical community working on the front lines to the thousands of truck drivers across our country keeping goods flowing, parents who have become homeschoolers, and folks missing their family events to help stop the spread of this terrible outbreak. As Lou Holtz said, we can't control what happens, but how we respond to it is what matters. Our response to this crisis has shown the resolve and strength of the human spirit, which is why we will overcome.

The response from the economy and stock market, however, has shown a disconnect between the two. Tragically, 22 million people have filed for unemployment in the past four weeks, nearly wiping out all the jobs created during the record 10-year economic expansion. Historic drops in consumer confidence, retail sales, industrial production, oil prices, and housing starts have shown how quickly our economy has gone from solid growth to virtually stopping in its tracks. Yet, stocks have been soaring the past few weeks. Remember, stocks tend to weaken before the economy, and they tend to lead before the economy turns around. Stocks see light at the end of the tunnel before the economy feels it, and the big move recently may be a sign the economy could turn around later this year.

Small businesses have been impacted the most by the economic crisis, and the government and Federal Reserve actions to bridge the gap to better times are unprecedented. The combined stimulus from fiscal and monetary policy is more than 20% of the value of the entire US economy, as measured by gross domestic product, greatly mitigating the economic hardships. The hurried roll out of the small business loan program wasn't perfect, but it is helping those businesses.

This recession—though not officially declared yet—is unlike any other. It wasn't caused by the virus itself, but by the government telling people to stay home in an effort to flatten the curve. The government can't simply turn on a switch to get

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things back to normal, but with all of the stimulus making its way through the system, it's possible this could be one of the shortest recessions ever. First quarter earnings season has begun, and it will be interesting to learn how quickly corporate America anticipates the slowdown ending. Estimates for earnings in 2020 have reduced drastically, but there is still hope that a strong second-half economic rebound could help support a recovery in corporate profits.

More than 2 million people worldwide have been infected by the virus, and we all have been impacted in some way. There are drug companies all around the world working nonstop to find an effective treatment, while Boeing, one of the hardest hit companies during this crisis, said it might start building planes again soon. We aren't out of the woods yet, and the economic data and headlines may get worse before they get better, but our response to this crisis reinforces our confidence that the future remains bright.

Please stay healthy, and please contact us if you have any questions or concerns.

Light at the End of the Tunnel

Special Guest Columnists:
Brian S Webury—Chief Economist
Robert Stein, CFA—Deputy Chief Economist
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When the employment report for April is released this Friday, the economic damage from the deepest of the Coronavirus shutdowns will become clear. We estimate that nonfarm payrolls will be down roughly 22 million versus March, and the unemployment rate will skyrocket to around 17.0%, the highest reading since at least 1948.

To put that in perspective, during the subprime-mortgage panic of 2008, payrolls declined 8.7 million over a 25-month period. Now, it looks like we lost almost three times as many jobs in just one month. The highest unemployment rate since the wind-down from World War II was 10.8% at the end of the 1981-82 recession. The jobless rate peaked at 10.0% after the Great Recession.

Unfortunately, we expect the unemployment rate to be even higher in May, and it is very difficult to believe that $2.5 trillion in government spending offset more than 50% of the damage. We hope we are wrong about that, but promising money to companies for payroll expenditures - but then not allowing them to open or letting them open at only 25% capacity - will not save many restaurants or bars.

While the economic damage is horrific, there are some positive signs. While 30 million workers filed for unemployment benefits in the past six weeks, those currently receiving benefits (what are called "continuing claims") are up a smaller 16 million in the first five weeks of that period and will be up around 20 million for the full six-week period. Yes, that's still awful, but it tells us that the Payroll Protection Plan and areas of actual job creation, such as online retailing and delivery services, are offsetting some of the damage.

This kind of job destruction will be accompanied by a very large decline in GDP. We're estimating a contraction at a 30% annual rate in the second quarter. But everyone already knows that.

We won't get that data until late July, and by then we expect the economy to be expanding, albeit from a low base. In fact, we already see some light at the end of the tunnel. During the week ending Saturday May 2, 939,790 passengers went through TSA checkpoints at airports. That's up 26% from the prior week and up 40% from two weeks ago. The amount of motor gasoline supplied has grown three weeks in a row, and is up a total of 16%. Hotel occupancy and railcar traffic are both up from a month ago. These high-frequency data will give a clearer read on the pulse of the economy as we gradually reopen.

Yes, activity is still down substantially from year-ago levels, or even those in January, but we are beginning to see signs of life. It's a sign that the animal spirits are not dead.

Anyone who ventures outside will notice more cars on the road and more activity, including in businesses that are still required to be closed to the public but are preparing for clearance to re-open. Many researchers are using cell-phone location data to track the movement of people. For example, Apple looks at "routing requests" on map applications. In mid-April, both walking and driving requests were down roughly 60% from January 13th . As of Saturday, walking and driving requests were only down 29% and 16%, respectively.

We will continue following "high frequency data" like those above. This recession will be brutal, the worst of our lifetimes. But it is not a normal recession, and it will also be short. Investors should keep in mind that, although the weeks ahead will be tough, there are better days beyond them.

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