Graybill, Bartz & Associates, Ltd.

COMMENTARY

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While the COVID-19 pandemic continues to inflict pain on society and the economy, the financial market panic of March has subsided during the month of April, with the S&P 500 index rallying nearly 13%. Investors are currently trying to gauge a titanic struggle between the largest stimulus in history and the largest economic downturn since the Great Depression. On one side you have the Federal Reserve and the Federal Government, who have responded to the crisis with actions that are both enormous and swift. In late March, the President signed a $2 trillion economic relief bill, the CARES Act, which included direct cash payments to individuals affected by the economic fallout, loans and grants to small businesses such as bars and restaurants, and numerous other initiatives. On top of the fiscal stimulus from the Federal Government, the Federal Reserve has continued to push forward programs to help stabilize financial markets, announcing $2.3 trillion in new programs on April 9 that have been described as "game changers". While the details are a bit technical, the Fed is sending a direct message to financial markets that they will "do whatever it takes" to ensure financial stability. The drastic action has calmed credit markets that were in chaos and may be what ultimately prevents a credit crisis on top of a health crisis. On the other side of the coin is the global economy, which is contending with a first-of-its-kind voluntary shut-down. With businesses closed and consumers staying home, U.S. GDP for the first quarter of the year fell 4.8%, its largest contraction since 2008, driven by the steepest drop in consumer spending since 1980. This drop is anticipated to be only the beginning, with 2nd quarter GDP expectations ranging anywhere from down 20% to down 50%. The six-week total of Americans filing for unemployment has now passed 30 million as of April 30, a staggering sum that dwarfs any previous recession. The battle between unprecedented stimulus actions (with more to come) and the painful economic reality will continue to play out well into the future.

Against this tug of war between stimulus and shutdown, there has been growing optimism in the fight against COVID-19, causing market sentiment to shift from worst case scenarios to best case scenarios. New cases have been falling in the hardest hit areas of the country such as New York, and states are starting to release detailed plans around how and when they will "reopen" their economies. In recent days, pharmaceutical giants such as Pfizer have announced promising vaccine candidates that may be ready for emergency use by the fall, and results from a trial of Gilead's drug remdesivir suggest it could be an effective treatment to fight the virus. Dr. Anthony Fauci, the White House health advisor, described the remdesivir results as "quite good news" and as having a "clear cut positive effect in diminishing time to recover."

Despite the strong rally from the March lows, we remain cautious about the pace at which markets have "priced-in" economic recovery. While we wrote in our last quarterly letter that markets hate "uncertainty", we are now faced with the question of whether or not a gradual reopening of the economy, and hopes for a medical breakthrough, provide enough "clarity" to justify the market recovery we have experienced. The level of remaining "uncertainty" has been evident during the current earnings season, as a record number of public companies have "pulled their guidance", which means that the detailed annual financial forecasts are no longer relevant and they have no revised forecast to share. Right now, companies and their executives are sending the message that they have no ability to project how their businesses are likely to perform over the coming months. And how could they? While states and businesses may begin to re-open by late Spring and early Summer, it remains unclear how consumer behavior will differ in this new world. Will many people continue to avoid restaurants, public transportation, and other crowded areas? How long is air travel likely to remain depressed? Sweden, as the only Western European country not to close their economy, offers some insight. Despite never being required to close, there was a record jump in bankruptcies of hotels and restaurants in March, as tourists all but vanished and large percentages of citizens decided to stay at home. In China, first hit and first to recover, the consumer rebound in the early stages of re-opening has been uneven at best, weak at worst. Along with uncertainty around re-opening, there is also uncertainty around the path of new infections. Will re-openings create an uptick in new cases almost immediately? Will there be a new spike in cases in late autumn, as weather across the northern hemisphere begins to cool again into the traditional flu season?

The current, on-going earnings season is starting to show exactly how the economic shut-down is impacting Corporate America in varying ways. While airlines and hotels are the poster children of industries that have been severely impacted, many others are demonstrating their ability to persevere in these difficult times, albeit with much reduced clarity. The recent relief rally has given us the opportunity to eliminate some holdings that no longer offer the level of "predictability" that they did in a different economic environment, while adding to those that do. At the same time, we have allowed portfolio cash levels to become elevated as bond maturities roll off, as we expect continued volatility and further investment opportunities to arise through the remainder of the year. While this cash provides the benefit of optionality and safety in an uncertain world, we continue to maintain equities near target weightings to ensure clients will participate in a recovery should stimulus continue to overwhelm markets and best case economic and health scenarios play out.

Ultimately, a return to economic normalcy will require the fear of the virus to decline significantly, driven by discovery and mass production of a vaccine, effective treatments for those infected, and/or widespread testing giving us further clues into the true spread and mortality rate. With the brightest minds and immense resources behind the effort, we are confident that one or all of these will be achieved. Never before has the entire world been so focused and unified on solving the same problem. While the road ahead remains perilous, it has never paid to bet against human ingenuity.