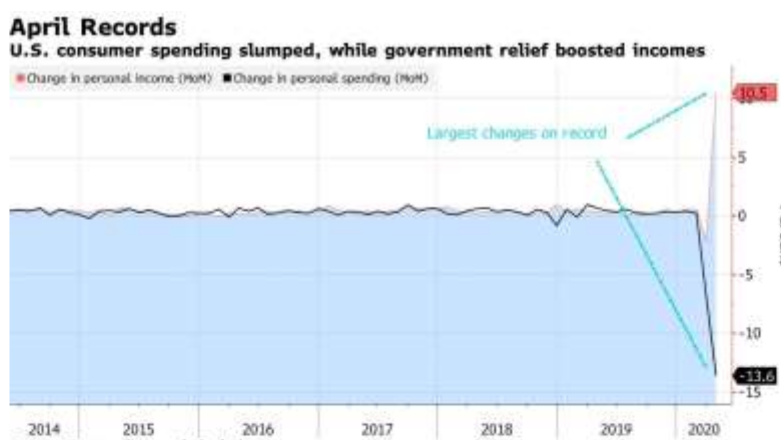
COMMENTARY

June 2020

The month of May saw a continued recovery in markets, as stocks looked through grim economic data to see "green shoots" of optimism as economies begin to re-open. Around the country, and the world, governments and businesses alike have begun to detail their recovery plans. Fear of a second wave of infections is abating, with encouraging results from states that have begun to reopen. Continuing unemployment claims data, which tally on-going unemployment benefits received in state programs, fell for the first time since the crisis began last week, although remaining at very high levels. Over the past month, corporate executives have highlighted the ways in which their businesses "troughed" in late March and early April and have steadily improved since. At the current moment, investors are looking through the recent past and current present to imagine a return to normalcy. As we noted in our previous Commentary, the main battle in the markets remains the unprecedented monetary and fiscal policy response against the broad economic deterioration of the last few months. The good news is that, at least for the month of May, the policy response appears to be winning.

This battle was encapsulated well by a Commerce Department report released this past Friday. The report showed that U.S. household consumer spending fell nearly 14% in April, the largest drop since records began in 1959. Wages and salaries fell 8% amid layoffs, furloughs, and pay cuts, however U.S. incomes actually rose nearly 11%. This record increase in income alongside a record decrease in wages was driven by the one-time checks going out to affected individuals as part of the massive CARES Act passed by Congress in late March. In fact, at the current moment, many unemployed workers are now generating more income than they were pre-COVID. With incomes rising and spending falling faster than ever before, the savings rate rose to 33% versus a 6-7% rate seen for most of the past decade. The CARES Act stimulus is undoubtably helping consumer balance sheets and spending during this crisis, but big questions remain. What happens when the stimulus checks stop? Will consumers more broadly regain the confidence to start spending at their pre-crisis level anytime soon?



On the monetary policy side, swift Federal Reserve actions in March and April have helped calm fixed income markets. Corporate credit spreads, the borrowing cost above benchmark U.S. Treasury rates, have dropped meaningfully in the last few months. As intended, the

Fed's bond-buying program has had a "multiplier" effect on the health of the bond market; while the Fed's purchases helped ease liquidity in the market when needed, the primary benefit of this program is the confidence boost that comes from the Fed "backing up" markets. This boost in confidence, and subsequent lower borrowing cost, allowed Corporate America to issue more than $1 trillion in new bonds this year. Much of this borrowing was done to raise cash levels to help weather the recession. Without Fed actions, it is not clear that these companies would have been able to raise this cash at all, let alone at the attractive rates that they have been able to during this difficult environment.

This coordinated effort by the Federal Government and the Federal Reserve has likely taken the worst-case scenario off the table for the economy. However, just because the next Great Depression has become much more unlikely, this does not mean that a "V-shaped recovery", in which COVID-19 is simply a small short term blip on the radar, is necessarily in the cards. Moving forward, risk remains heightened in numerous areas. In our last Commentary, we highlighted the risks related directly to COVID-19: a second wave as states reopen or a second wave in the fall. There is upside and downside risk depending both on their progression, and on the progression of therapies and vaccines. The level of unemployment and future Congressional response remain large unknowns. Unemployment rates will almost certainly plummet into the summer as temporary layoffs are reversed as the economy reopens but it is very uncertain to what degree recent layoffs are permanent versus temporary.

The speed at which we return to some semblance of an "open" economy, with broad consumer and business confidence, will likely determine the resilience of this market recovery. The economy, and by extension the stock market, will not be supported indefinitely by Congress and the Federal Reserve, and at some point there will be a withdrawal of stimulus. While the risks posed by COVID-19 and its impact on reopening are of primary concern, there are other issues for this market to contend with in the coming months, including elections in the fall, the recent mass protests and riots around the country following the death of George Floyd, and the current state of America's relationship with China. These issues are intertwined; protests can influence elections and election results will impact economic and trade policy. With an economy in crisis, Wall Street will be keenly watching the political debates being waged across the country, and the ramifications of the results.

In reference to the COVID-19 pandemic and its economic impacts, Charlie Munger, the sage 96-year-old Vice Chairman of Berkshire Hathaway, recently stated that "nobody in America's ever seen anything else like this. This thing is different. Everybody talks as if they know what's going to happen, and nobody knows what's going to happen." We continue to agree with this sentiment that the current environment demands extreme prudence, but balance that view with the understanding that the Federal Reserve and Federal Government will continue to take extraordinary measures to support the economy, while Corporate America continues to adjust and adapt to produce the best possible outcome to whatever economic and political environment we face.