

The Great Adaptation, Black Swans and What's Next?

April 1, 2020 UMB Investment Management Economic Call Summary

Black swans are unforeseen and have a meaningful impact. COVID-19 (coronavirus) and oil prices are at lows we haven't seen since the early 2000s. These two black swans will cause a recession and could change our spending habits for months to come. The duration of the recession now depends on how we handle a public health crisis. In light of this, UMB's forecast for U.S. real GDP quarter by quarter is as follows:

- Q1: 0.8%
- Q2: -15.5%
- Q3: -0.3%
- Q4: 3.2%

We anticipate GDP to be negative at -1.8% for 2020.

Economic Forecast

We started the year on a firm foundation. Now we are searching for a "foundation formation" process needed to stabilize the market. Historically, that process includes:

1. Federal Reserve monetary stimulus
2. Aggressive fiscal stimulus
3. Improving fundamental economic data, including firmer oil prices

And in this crisis, we need additional variables:

4. The curve needs to flatten globally with the number of new COVID-19 cases declining in the U.S.
5. A vaccine for COVID-19

One of the most important variables is the number of new COVID-19 cases and that number continues to rise in the U.S. This has significant parts of the economy shut down for at least a third of the second quarter. A recession now is all but certain.

The recent economic data supports our forecast:

- Initial unemployment claims posted a historical 3.3 million workers filing for unemployment benefits, beating the previous high of 695,000 in 1982 and 665,000 in 2008.
- We expect the number of unemployed to increase by at least six million, taking the unemployment rate from 3.5% to 7.2%.
- Consumer confidence dropped by 6.8 points to 89.1 in March based on the University of Michigan's preliminary reading.

Assumptions

There are several assumptions we make in our economic model:

1. The COVID-19 virus will have a similar reproduction rate as in China.
2. The quarantine effort in the U.S. will have a similar impact on flattening the curve as in China.
3. Consumer confidence will return once the virus is contained and the consumer will increase consumption.
4. Oil prices rebound close to \$50 a barrel.

Remaining Risks

The major risk in our assumption is that the reproduction rate of COVID-19 will be similar to China. There are vast differences:

- China locked down cities and quarantined millions of people eight days after the spike.
- The U.S. had a soft lockdown 25 days after cases spiked and the process was fragmented as the decision to lock down was left to each state to handle.

Another risk is that the massive fiscal stimulus doesn't entice consumers to consume anytime soon. The recovery may take longer and be slower than expected. We could also see corporate earnings drop, ratings downgrade and if oil prices stay low, there may be bankruptcies in the energy space.

Conclusion

- The economy in 2020 will contract in range of -0.7% and -2.2%
- The second quarter of 2020 will see the most impact as the U.S. attempts to contain COVID-19
- Vast amounts of monetary and fiscal stimulus will be pumped into the economy and could provide a launching pad for economy activity later in the year and into 2021

For questions, and if interested in receiving a recording of this call, please contact your UMB representative. During this uncertain time, we want to assure you that UMB remains committed to providing the customer service that you have grown to know, while helping to ensure the health and safety of our associates and clients.

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