Bulls, Bears and the Albatross

April 14, 2020 UMB Investment Management Economic Call Summary

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This week, public health care officials are announcing that the worst of the COVID-19 outbreak is most likely behind us; however, the duration of the economic recession will largely depend on how quickly local economies are able to open back up and how swiftly consumer confidence returns. UMB's 2020 forecast for the fundamentals of the U.S. economy is as follows:

- **Real GDP:** -0.7 to -2.2%
- **Unemployment:** 5.0%
- **Fed Funds:** 0.25%
- **10-Year Treasury:** 1.00%
- **S&P 500:** 3000

Daily Changes in COVID-19 Cases

As the confirmed number of cases globally surpassed 2 million, the U.S. can look at other nations' recovery measures as case studies. We expect the U.S. to closely resemble Italy, peaking with a slow recovery.

When we look at Japan, we can see what happens when stay at home orders are relaxed across the board. Japan went on lockdown in late February/early March. When they reopened work and schools early April, there was a second wave of the outbreak. Now, many areas are back on lockdown.

Current Economic Conditions

Each recession has unique components, but all have common features. We expect the economic recovery to be an upward sloping "L" shape. We had a sharp drop from the impact of the virus, and it will be a slow recovery.

Some factors to consider:

- **Initial unemployment claims:** Unemployment in the Great Recession peaked at a 10% rate. Currently, the unemployment rate is at its highest level since then. Jobless claims now exceed 17 million and the unemployment rate could go up to 15-20% in the second quarter.
- **"Jobless" recovery:** There's no doubt this pandemic will change the economy and we will be adjusting to a 'new normal' as the recovery starts. We could see a jobless recovery where the economy recovers from a recession And unemployment remains stubbornly high.
- **Consumer confidence:** Confidence is driven by the labor market and asset prices. While consumer confidence and small business started to wane before the last two recessions, it was increasing before COVID-19. Confidence has experienced a waterfall event, falling sharply.

The Stock Market – S&P 500

The uncertainty of earnings is creating volatility in the marketplace and we can expect that this uncertainty is here to stay for the immediate future. In late February, we saw panic selling as the stock market started to crash. In late March, there was a period of panic buying from the large fiscal stimulus pumped into the economy and aggressive monetary policy.

Fed Programs

The Federal Reserve acted quickly in an effort to bring on a swift recovery. The Fed started out initially focusing purely on stabilizing the banking and credit markets, pumping $2 trillion dollars into the economy. Since then, the Fed has expanded their recovery effort to include small companies, High Yield and Municipal issuers. They have expanded the balance sheet to at least $4.5 trillion and there is perhaps another plan in the works.

U.S. Debt/GDP

There will be a large amount of debt at the Federal government level: We are predicting 120% of GDP, if not higher. The last time we saw a high like this was WWII. Many leaders are dubbing this a war against a virus and an economic war at that.

Risks That We are Watching:

- When the economy re-opens, which will ultimately be driven by the availability of testing and treatment
- If consumers will have confidence once the economy opens
- How many businesses will be permanently damaged and how this virus will change consumer behaviors

Continued

- A second COVID-19 wave
- Oil and if the low prices will lead to bankruptcy in the sector and the impact of the high-yield bond market
- Corporate earnings risk
- Share buyback risk, which leads to a discussion of whether the practice should be more heavily regulated
- Consumer, corporate and sovereign debt mushrooms

Unintended Consequences:

- How we will pay for this? Looking at corporate and individual taxes
- Consumers changing their consumption behavior and perhaps consuming less
- How will we unwind stimulus? Never?
- De-globalization

Conclusion

- The economy in 2020 will contract in range of -0.7 and -2.2%
- 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. A full recovery, however, will be slow and in an upward sloping "L" shape.
- Between stimulus at an unprecedented level and low interest rates, once we get to recovery, it will sow the seeds to an inflation push

For questions, and if interested in receiving a recording of this call, please contact your UMB representative.