Market analysis

At a glance

April 6, 2020

Markets pulled back from recent gains as economic news in the U.S. reflected the initial impacts of social distancing. We maintain a cautious investment bias, with social distancing measures continuing to grow.

TERM OF THE WEEK

Consumer confidence – A measure of consumers’ feelings about current and future economic conditions, used as an indicator of the overall state of the economy.

9.96 million

Americans who filed for unemployment in the past two weeks.

“Economic data last week signaled the duration of the current economic challenge may exceed expectations.”

- Robert Haworth, Senior Vice President, Senior Investment Strategist, U.S. Bank

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[1] Important disclosures provided on page 4.
Global economy

Quick take: The global economy has likely entered a deep contraction as a result of social distancing policies in response to COVID-19.

Our view: Economic data signaled the duration of the current economic challenge may exceed expectations. Loss of business confidence, sharply rising unemployment and disruptions to supply chains are not easily fixable in the near term. The length of time until recovery depends on how long distancing policies stay in place.

- Nearly 10 million Americans claimed unemployment in the past two weeks, far more than what has ever occurred in history. Friday’s jobs report showed the economy shedding 701,000 jobs and the unemployment rate rising to 4.4 percent.

- Consumer confidence fell at the fastest monthly pace in years across multiple surveys. The housing sector also suffered from the decline in confidence, with mortgage applications declining at the fastest pace since 2011. We expect even greater drops in April as consumers adjust to increasing labor market slack and lockdowns spreading nationally.

- Eurozone economic confidence deteriorated at the fastest pace in history, led by unprecedented weakness in the services sector surveys. A current epicenter of the COVID-19 crisis, Europe also looks to be one of the hardest-hit regions economically.

- China’s business activity stabilized, but did not really improve, compared to February, when the country was locked down. This non-recovery, along with increasing evidence of the coronavirus’s resurgence in China, bodes negatively for a near-term global recovery.

Equity markets

Quick take: The cost of COVID-19 to human life, jobs, markets and businesses is extreme and unprecedented, thus serving as the basis to maintain a cautious near-term bias.

Our view: We expect volatility to remain elevated until the number of COVID-19 cases peak or is contained.

- Falling oil prices are hurting profits. Low energy prices add stress to highly-leveraged energy companies and banks with significant exposure to the oil industry.

- Earnings estimates for the S&P 500 are trending lower. Consensus estimates for 2020 earnings are approximately $154 per share, below the $178 level estimated at the start of the year, according to Bloomberg, FactSet and S&P Global. Valuations based on current earnings estimates may be misguided if estimates continue to be reset lower.

- First quarter earnings reports are slated to begin next week with the release of results from several money center banks. At present, consensus is for revenue growth of 2.4 percent over year-ago levels, with earnings declining 5.2 percent, according to FactSet. Investor focus undoubtedly will be on tone and mindset around how companies may operate during the remainder of 2020.

- While the near-term is unsettled, opportunities are forming when looking toward year-end and beyond. The dividend income profile of equities is compelling, with nearly 80 percent of S&P 500 offering dividends that yield above the 10-year Treasury yield. Digital transformation is changing how we live, work and play. Select companies focused on e-commerce, video conferencing, artificial intelligence, machine learning and cloud computing, seem well-positioned for future growth. Additionally, the recent drawdown presents an opportunity to upgrade holdings and capitalize on tax-loss strategies.
Bond markets

Quick take: U.S. Treasury yields declined last week and remain just above the all-time lows experienced in March. Corporate bond spreads (corporate bond yields compared to Treasury yields) remain wide, signaling cautious sentiment and deteriorating fundamentals.

Our view: We are cautious on lower-quality bonds until we see signs of stabilizing economic activity, despite rising yields and signs of improved liquidity. We favor high-quality bonds, particularly U.S. Treasuries, to preserve capital as economic activity slows.

- The Federal Reserve (Fed) continues to implement new policies to encourage lending, including large bond purchases. Liquidity has improved in the fixed income market as a result. We expect strong demand to offset a rapid increase in Treasury supply to fund emergency spending measures in the near term.
- Corporate bond prices were relatively stable last week. Yields compared to Treasuries remains much higher than normal, but elevated debt levels, ratings downgrades and defaults among weaker companies remain key risks.
- Municipal bond yields remain higher than normal relative to Treasuries and comparably rated corporate bonds. However, a significant portion of the municipal bond market relies on revenues that are vulnerable to an economic contraction. Lower-quality municipal bonds are also vulnerable and current yields are unlikely to provide sufficient compensation compared to their risks.

Real assets

Quick take: A 40 percent jump in oil prices grabbed headlines and boosted energy company prices. However, meaningful hurdles remain for an oil agreement between Russia and Saudi Arabia. Other real asset sectors performed poorly due to concerns about revenues.

Our view: We remain cautious about assets, despite much cheaper valuations, because future revenue streams lack visibility.

- News of retail tenants not paying rent are increasing. The market is attempting to discern if this trend will become more widespread or if retail tenants will close permanently.
- President Trump’s declarations of a crude oil production cut agreement appear premature. Hurdles to an agreement still exist, and it is questionable if any party is willing to make cuts large enough to balance supply and demand.
- Given low interest rates and the Fed essentially providing unlimited liquidity to many market sectors, there is price support for gold. Companies that mine gold may be well positioned, because their cost of production falls with the decline in energy prices. However, market risks remain meaningful.
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