

ECONOMIC OUTLOOK

Summary

Over the past seven weeks, nearly 33.5 million Americans have filed for unemployment benefits, representing more than one in five of the overall working population. So if you're wondering how the May non-farm payroll report only shows a loss of 20.5 million jobs and an unemployment rate of 14.7%, you're probably not alone. The answer is two-fold, it's an issue of timing and classification. The survey that is conducted by the Bureau of Labor Statistics (BLS) occurs during the calendar week that contains the 12th day of the month. When considering that more than seven million people filed for unemployment benefits after the week of April 12, that helps narrow the gap. Additionally, as noted in the BLS report, there was also a large increase in the number of workers who were classified as employed but absent from work because employers whose business were closed due to coronavirus failed to classify them as unemployed on temporary layoff. Regardless of the details and the official totals, with so many individuals unemployed it's fair to think that as soon as companies begin rehiring, prospective employees will be knocking down their doors. Unfortunately, that may not be the case. After receiving their first unemployment benefit payment, a statistical majority of the newly unemployed will be pleasantly surprised that their income for remaining at home is now more than it was when they were working.

Surprised? The national average unemployment benefit as of the end of 2019 was \$371.88 per week. Due to the CARES Act of 2020, that has now been increased by an additional \$600 per week across the board. This will create a juxtaposition between potential consumer trends. On one hand, a high percentage of the population will be unemployed but possibly earning more than they have in their lives. This will likely only add to

the pent up demand from the consumer to spend once the economy opens back up. On the other hand, the government has incentivized remaining on unemployment for as long as possible for many individuals. This could create delays in getting the economy back up and running at full speed if companies are understaffed in a post-lockdown world. While many continue to hope for a "V" shaped economic recovery, it is factors such as these that will set the stage for how quickly we recover.

Positives

Congress approved the Interim Coronavirus Relief Bill allowing additional relief funds for small businesses

The Federal Reserve expanded the scope and eligibility of the Main Street Lending Program and Municipal Liquidity Facility

Conference Board U.S. Leading Index decreased less than expected month-over-month (-6.7% vs -7.2%)

Negatives

GDP for the first quarter of 2020 dropped more than estimates (-4.8% vs -4.0%)

Personal consumption slowed drastically during the first quarter (-7.6% vs -3.6%)

Pending home sales plummeted -20.8% month-over-month and -14.5% year-over-year

EQUITY OUTLOOK

Summary

Global equity markets rebounded in April following the worst opening quarter since 1938. Investor's focus quickly shifted away from the COVID-19 virus and deteriorating economic fundamentals toward a more optimistic outlook. The three factors most likely driving the market recovery are the successful flattening of the virus curve in many regions, the swift and massive response by the Federal Reserve and other central banks around the globe and the prospect for slowly reopening the economy in certain states.

The S&P 500 rebounded 12.8% making April the best performing month since 1987. The rally was broad in terms of company size and style. The Russell 2000 index, comprised of small domestic companies, up 13.2%. Growth stocks continue to lead value stocks with their respective Russell 1000 Growth and Russell 1000 Value indexes rising 14.7% and 11.0%.

There is clearly a debate to be had about the pace and practices of reopening the U.S. economy and both sides can present valid concerns weighing public health against economic health. The fragile conditions concerning both sides of the argument speak to the ongoing risks that remain.

Equity market advances in April clearly signal investors are looking past weak corporate earnings and uncertain guidance and instead focusing on the eventual recovery. We share the market's optimism for the long term. However, there are likely to be many fits and starts as we work through the challenges that remain ahead. Stocks may have gotten a bit ahead of themselves in the near term.

Positives

Aggressive and historic government and central bank response

Health care and pharmaceutical industries continue to make COVID-19 breakthroughs

Capital markets are functioning with seemingly no liquidity issues

Negatives

The number of new coronavirus cases and fatalities are still rising in many areas and testing still needs to expand further

Corporate earnings results have been mediocre many companies have expectedly presented poor guidance or withdrawn guidance altogether

Unknowns

Outcome of the staggered reopening of the economy

FIXED INCOME OUTLOOK

Summary

A U.S. recession is all but officially under way as of the beginning of April and the speed at which the economy has ground to a halt has rendered most traditional economic data outdated before it's even published. The deterioration in almost all measures of economic activity has been nothing less than shocking. Still, after plunging to historic low yields in March, the bond market has had little reaction to the data when it's actually been released in April.

For the month, U.S. Treasury bonds had a solid return of 0.64% as yields declined by a few basis points (bps). The 2-year Treasury note declined 5 bps to end April at 0.20% as the 10-year and 30-year bonds dropped about 3 bps to end at 0.64% and 1.29%, respectively. Combined with the first calendar quarter's return, the Treasury bond market has now returned 8.89% for the four-month period. Measuring bonds with maturities less than 10 years, intermediate maturity Treasury notes still delivered an outstanding 5.54%.

To fund a budget deficit that is expected to be upwards of \$4 trillion, the U.S. Treasury will issue a record amount of net new debt over the next few months. For example, the mid-May refunding will be a record \$96 billion split among 3-year, 10-year and 30-year maturities. As if that's not a lot to absorb, the following week the Treasury will issue \$20 billion of 20-year bonds, a maturity not seen since the mid-80s. In spite of the supply, with short rates anchored for the foreseeable future, the yield curve has only steepened modestly. Given the global demand for the security of U.S. government debt, we do not expect that longer maturity interest rates will increase much even with the onslaught of supply. We are maintaining our full duration position.

After trailing the Treasury market return by almost 12% in the first quarter, investment-grade corporate bonds improved significantly with credit spreads declining about 70 bps across the sector as a whole. The April return of 5.24% brought corporate bonds to the positive side of the ledger for the year with a return of 1.42% for the four-month period. Within the corporate bond universe, returns have varied widely based on credit quality, industry and maturity. Representing about 50% of the universe, BBB-rated bonds had the greatest return in April (+5.93%) but are still negative year to date (-1.89%). With oil prices plunging below zero, energy company bonds underperformed all other sectors.

Like overall Treasury market yields, corporate credit spreads appear to have found a fairly stable clearing level of about 200 bps on average, with wide variances across quality, industry and maturity spectrums. While liquidity remains a challenge for the trading of corporate bonds in the secondary market, the door is wide open for new issuance of debt. In early May, new issuance of investment-grade corporate debt crossed over \$800 billion, which is almost double the level of the past few years for the same time period. Given the record level of new issuance in this market, one might expect spreads to increase significantly, but like the Treasury market, demand remains ample. With spreads approximately twice the level at which we began 2020, we agree that high-quality corporate bonds appear attractive and we have maintained an overweight to the sector.

Positives

Corporate bond yields remain attractive relative to Treasury debt

Federal Reserve's rate policy unlikely to increase for many years to come

Inflation to remain below target due to demand destruction caused by the virus

Negatives

Fed policy already at the zero bound and unlikely to go negative

Record level of Treasury and corporate debt issuance

Investors could sell bonds as they rebalance if virus fades

Unknowns

Ability to contain the spread of the coronavirus

Whether fiscal stimulus will create future inflationary pressures