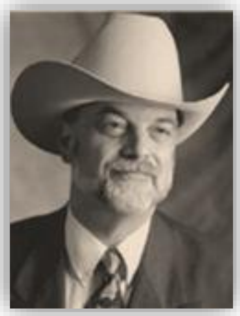

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The week ending May 15th was another one when the negative pronouncements by the market pundits would have traditionally triggered a big move in the S&P 500 Stock Index (SPX) but instead produced a very real but muted response. The Index was indeed down 2.26% for the week but was back to its slow, steady rise by the last two days of the week. That all leaves it down 11.36% year-to-date and about 15% from the top back in February but still up a very substantial 28% from its bottom in late March. It is also still a bit positive, up 0.15%, from a year ago.

One of the greater problems with valuing the stock market right now is that the normal driver of whether the market is over or under priced is the one-year forward price-to-earnings ratio. That ratio compares the price of a stock to its projected earnings over the coming four quarters. If we use that method, the market looks quite overpriced. The problem with that method is that we all agree that corporate earnings are going to look miserable as long as fear of the coronavirus is ruling the day. A more realistic view would be to compare stock prices to what their earnings are likely to be two years out when, hopefully, this pandemic is reduced to a chapter in the history books. By that method the market is fairly or even low priced. Some hedge fund managers are shrieking that this market is wildly overpriced and due for a massive fall, but there seems to be a majority of investors who think that we will have an effective and widely used vaccine in a year or so and that will be followed by a surge in buying as the pent up demand from the pandemic period will kick us into high gear.

The U.S. Treasury 10-year T-note yield, like the stock market, slid downward for the first part of the week but started back up toward the end to close at 0.642%, still well above the 0.109% annualized 90-day T-bill and thereby anchoring a positive yield curve. A surprisingly optimistic sentiment swept over the oil markets this week as West Texas Intermediate crude oil (WTI) closed at $29.35, up a delightful 20.7% for the week as Americans started driving more and companies began to reopen.

The Economy

We usually list what we believe to be significant indicators of where the economy is going here but this time we want to focus on the bigger picture; what this crisis is and, just as importantly, what it is not.

We know exactly what the cause of our problems is. In America, what we are facing is a pandemic that so far is killing about 6% of the people confirmed to have the COVID-19 disease. More, the number of cases confirmed is still growing at about 1.5% per day. So far, it has sickened at least 1.5 million Americans and killed about 86 thousand according to Bloomberg/Johns Hopkins. It appears that less than 1% of the population has been infected, but that number is doubling every six weeks or so. The low infection growth rate appears to be a result of shutting down a large portion of our economy. Based on what we are seeing in places like Sweden, where the economy was not shut down by government decree, the decline in economic activity is likely to be the same whether or not businesses are officially told to be closed. That economic decline appears to be between 25% and 30%. We also can tell when this economic constriction will end. It will go away when we have an effective vaccination program implemented and people feel secure in going about their business.

What we are NOT facing is a repeat of the Great Depression of the 1930s. In fact, what is happening in the markets and in the economy looks far more like the pattern of the recession of 1920-21. The Great Depression started as a market panic that would have ordinarily triggered what we today would have called a "recession"; possibly severe but short. Economists and historians almost uniformly agree that the would-be recession was turned into an economic catastrophe by three actions, all initiated at the federal level. First, the Federal Reserve raised interest rates to fight a non-existent threat of inflation even as deflation was taking root. Second, the Congress and the President cut federal spending at a breakneck speed to avoid running a deficit. Third, Congress passed the Smoot-Hawley Tariff Act of 1930, starting a worldwide trade war that choked off international trade. Just as importantly, in the early 1930s we did not have unemployment insurance, FDIC bank account insurance, Social Security, Medicare, large-scale military or federal pension benefits, federal bank regulation, or any of the myriad of other safety nets and federal guarantees and safety programs we have today. In this crisis, the Congress has massively increased spending with most of it directed to people who need it, the Fed has chopped interest rates to zero, and the economic safety nets and standards for banks are holding up well. There may be room for improvement, but what we are doing is the opposite of what our forefathers did in 1930.

In the 1940s, the Great Depression was defeated by massive government spending and ultra-low interest rates as we entered World War II. This time around we didn't wait for a war to do that. In the 1930s, no one had a clue as to why the economy suddenly shrank by about 30% or when it would end. This time around we know both answers and we know and are applying the medicine that cured it toward the end of that decade. We, as a nation, do learn and we are applying that lesson to today's economy. As a result, it is our opinion that the patient will be well on the road to recovery in about a year or so. Meanwhile we are in ICU and feeling poorly, but the prognosis is good.

We have read an excellent and well researched article on how to avoid being infected by the coronavirus. You can find the article here: https://www.erinbromage.com/post/the-risks-know-them-avoid-them. If you can't use the internet to read the article, let us know and we will send a printed copy.

Until next week we remain alert and on watch to avoid economic pitfalls and find opportunities as we progress through the famous Pandemic of 2020. Keep the emails coming, we love your comments!

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