

In this issue

What Will It Look Like?

The data is in. The U.S. economy hasn't just slowed down, much of it has come to a complete halt. Investors now want to know if it will get worse and how long it will take to recover.

April 3, 2020

Standstill

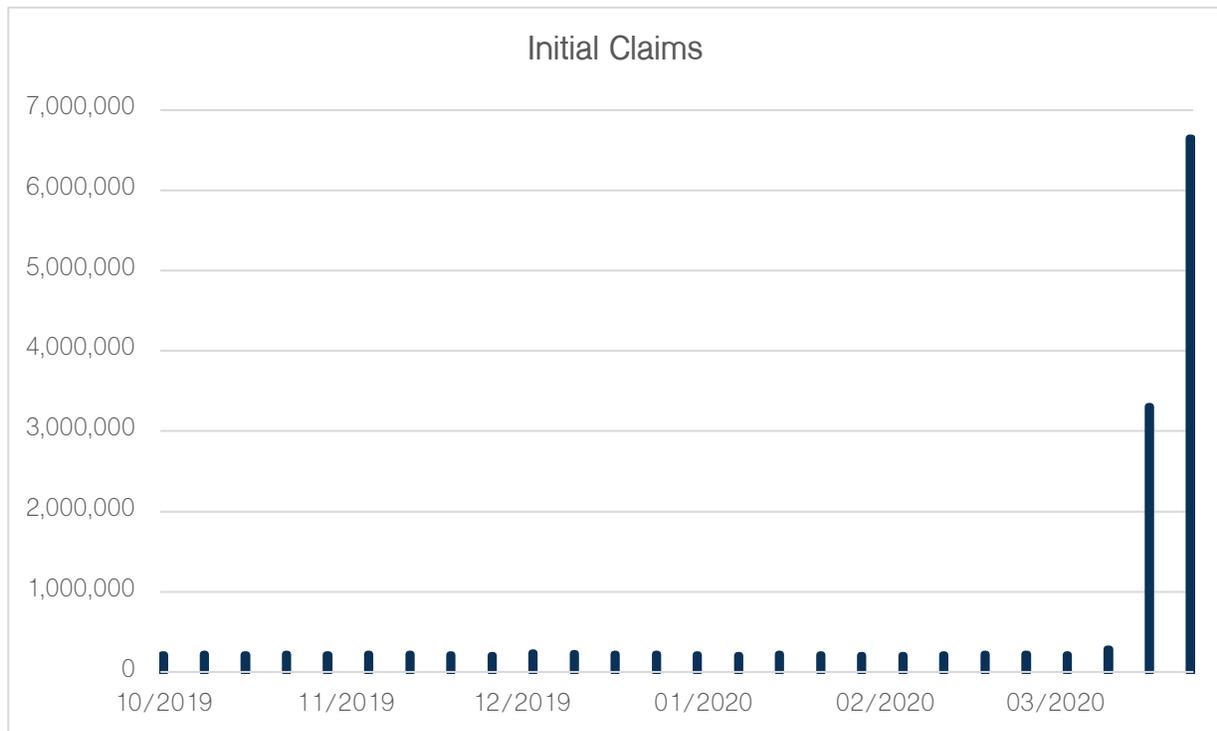
The data is in. The U.S. economy hasn't just slowed down, much of it has come to a complete halt. Union Square Hospitality Group, which owns several restaurant brands including Shake Shack, laid off 80% of its workforce¹. According to the Transportation Security Administration (TSA), 136,000 people went through a TSA checkpoint on Wednesday. On the same day last year, the number was 2.15 million. That's a drop of over 93%.

The chart below shows that in the last two weeks, jobless claims in the U.S. spiked from 282,000 to 6.65 million. Prior to last week's number of 3.03 million, the next largest print was 695,000 back in October 1982². These numbers are staggering.

The government has responded in a big way. The \$2.2 trillion stimulus package combined with the Federal Reserve's bold moves to keep the plumbing of our financial system moving have helped to alleviate much of the panic.

The COVID-19 pandemic and government response should continue to impact the U.S. economy and financial markets over the coming months. What investors want to know now is how long it will take to rebound. Will the recovery look more like a "V" or a "U"?

The two shapes describe the depth and duration of an economic downturn and stock market selloff. The former tends to be quick (matter of months), while the latter can take a while (a year or longer).



Source: Source: U.S. Employment and Training Administration

If we use history as a guide, the chart below shows that every pandemic in the last half century created a “V-shaped” pattern in stocks because they were mostly fueled by panic. The economic impact in each was minor. This combination created attractive opportunities for patient investors (depicted in the embedded table).

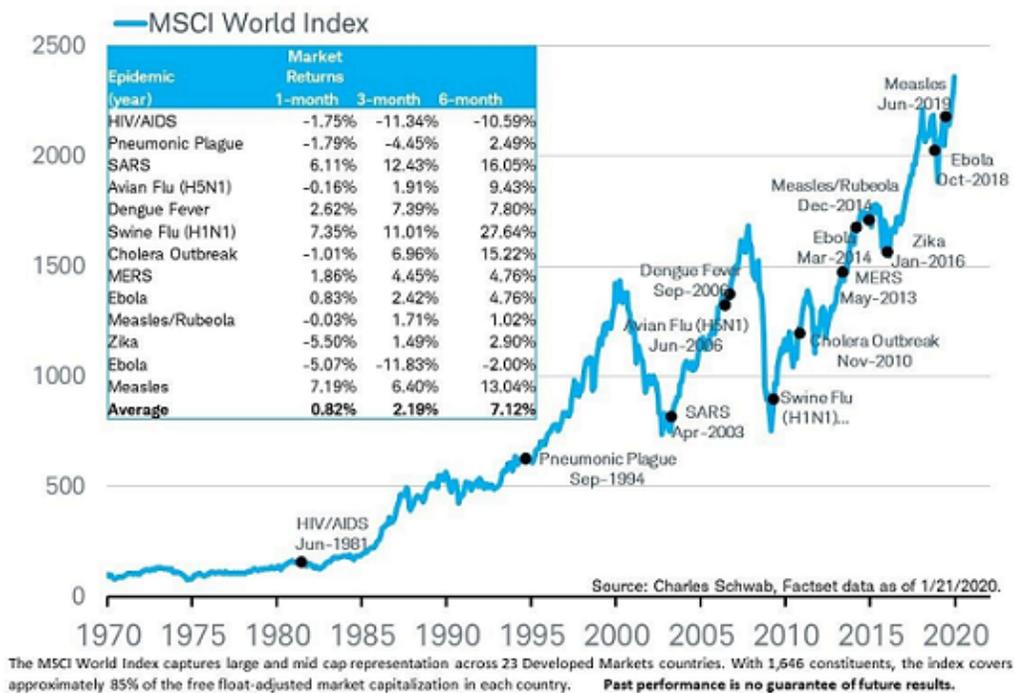
However, none of these prior pandemics were met with a government-mandated shutdown of the economy, so this time could be different. Even if the government were to open the economy next week, we’ve already lost activity. First Trust estimates 3–4% of businesses will not survive through Easter³. Those displaced will need to find work elsewhere, so history may not be a perfect guide.

What will determine the shape of this recovery, more than anything else, will be the length of this shutdown. If we can get the economy up and running in a few weeks, it’s likely that we will see more of a V. If it persists into the summer, the more businesses we will lose, and the more likely the recovery extends out into a U.

What Will It Be?

I usually avoid making bold predictions on the future because I will either be lucky (less likely) or wrong (more likely). I don’t have a crystal ball, nor could I ever feel confident about forecasting a future that is so heavily dependent upon government action. But I do spend a lot of time thinking about the range of outcomes, and if pressed, I’d

Immune: world epidemics and global stock market performance



wager that the recovery will look more like a V for two reasons.

First, we went into this crisis in far better shape than prior ones. Companies have spent years improving their operations through cost cuts, inventory management, and better technology. These efficiencies have driven record-high margins and more consistent profitability. They can endure far more today than in prior crises.

Financial markets are also stronger, and regulatory changes since the 2008 crisis have strengthened the firms that transact in them. The combined effect is analogous to a strong immune system that affords better odds of a swifter recovery.

Second, the power of the U.S. government cannot be overstated. We are a wealthy nation, and the government's ability to throw money at this problem has only just begun. Rainy day funds exist for a reason, and it's time to *temporarily* loosen the purse strings.

But wealth is not enough on its own. The willingness and knowing *how* to spend effectively is paramount. There is no substitute for experience, and the power of hindsight may have already paid off. Actions that were taken after months of deliberation during the last financial crisis were rolled out in a matter of days after COVID-19 spread. The decisiveness today appears to be a direct result from having been here before.

Add it all up, and this “closer to V” recovery might be in full effect by year end. Since stocks are anticipatory and have a history of moving 3–6 months before the start of an economic recovery, that already puts them in the window for a potential rebound (to be abundantly clear, this is in no way a “market bottom” call).

The Bottom Line

What if I am wrong? What happens if the government drops the ball? What if the economy is shut down for too long, too many people lose too many jobs, and we must stomach a U recovery?

If this happens then so be it. There's an old saying that “you make the most money in bear markets, you just don't know it at the time.” Whether the economy and stock market recover this year or next, it's still going to recover. Nothing about this crisis leads me to believe that it is a precursor to a zombie apocalypse. If so, history will depict this time period as more of an opportunity for patient investors than a trap.

Our nation has endured a lot, and when challenged to rise up, we are undefeated. There simply has never been a time when the U.S. has failed when faced with adversity, and there is nothing that tells me this is going to be any different.

Entrepreneurship and innovation are the bedrock of the U.S. economy, and these are immune to something 12 microns in size.

COVID-19 is not going to stop the brilliant scientists in Boston from curing cancer, nor will it derail the technology revolution currently underway in Silicon Valley.

Think about it this way. Few countries exist where one can be rewarded for fixing problems like they can here (more than just money too). The world had never heard of COVID-19 back in November because it didn't exist. Today, multiple U.S. drug companies are testing legitimate vaccine candidates. I seriously doubt scientists are working so hard to kill this virus so they can secure bonuses.

The bottom line is that nobody knows for sure how long the economy will remain on sick leave, but it will recover. For now, focus more on your own health and try to stay sane while sheltered in place.

Sincerely,



Mike Sorrentino, CFA
Chief Investment Officer

Three Key Points

1. The data is in and it's not good.
2. Investors are asking if we will see a V or U-shaped recovery.

3. The U.S. has never failed when faced with adversity.

Sources

1 <https://www.businessinsider.com/hospitality-layoffs-danny-meyer-ushg-lays-off-80-percent-workforce-2020-3>

2 Bureau of Labor Statistics

3 <https://www.ftportfolios.com/blogs/EconBlog/2020/3/30/recovery-v-shaped-or-u>

Disclosures

Investment Advisory Services offered through Harwood Advisory Group. Insurance products and services are offered through the Harwood Insurance Group. Harwood Advisory Group and Harwood Insurance Group do business collectively as Harwood Financial Group, DBA. Securities investing involves risk, including the potential for loss of principal. There is no guarantee that any investment plan or strategy will be successful. The foregoing content reflects the opinions of Harwood Financial Group and is subject to change at any time without notice. Content provided herein is for informational purposes only and should not be used or construed as investment advice or a recommendation regarding the purchase or sale of any security. There is no guarantee that the statements, opinions or forecasts provided herein will prove to be correct. Past performance may not be indicative of future results. Indices are not available for direct investment. Any investor who attempts to mimic the performance of an index would incur fees and expenses which would reduce returns.