Hamilton-Bates
Market Update

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Is Peak Bad News—A Bottom in Stocks?
Enough of the US population is on 'lock-down' and mandatory closure that some 80%+ of US GDP is affected. Naturally this means the upcoming round of earnings and economic numbers will be dreadful. That much is known, We are also seeing welcome signs that the above mentioned lockdowns and social distancing have in fact 'bent the curve', and many of the extreme estimates of hospitalizations and deaths have proven much too high.

Stocks often peak when things look the best—when things can't seem to get any better they usually don't; and bottom when things look the worst–the night is darkest before the onset of dawn etc. That pattern looks to have held up once again. Early April has been the 'peak' so far in bad Covid Virus news, and this peak in bad news has come with what looks like the bottom in stocks.

Earnings and Economic Data
The upcoming data for the foreseeable future will be bad. The weekly unemployment claims have skyrocketed to levels not seen since the 1930's. The economy is on lockdown and GDP figures are expected to show declines of 7 to 25% for the second quarter, and an annual growth rate of 0% to –8%. When you shut down your economy you get a recession.

We are now coming into earnings season. The first quarter will only partially reflect the shutdown that began in March, but analysts are still expecting pretty poor results. For Q1 revenues are expected to be flat and earnings down -7.5% (according to data firm Refinitiv). Second quarter earnings are expected to be the trough with an –18% decline. From there analysts expect the economy to gradually improve as (hopefully) the virus fades and the economy comes back online. For now though, investors should expect bad news over the next few weeks. Some quite large companies may not have any earnings to speak of — rather steep losses as the coronavirus blows through their earnings. Second, in some cases dividends and stock buybacks will be cut back as companies head into cash preservation and restructuring mode.

None of the data coming out over the next few weeks offers much when making predictions about where equity prices are likely to go. The pace of the virus spread and containment depends on our actions. What we can go on is what we see, what we do know, and whether the policies put in place seem sensible. We know for a fact that global economic numbers will be horrid. We just don't know for how long and to what lasting effect.

Based on the data we can evaluate, and the present rates of Covirus 'curve bending', the second quarter (April-June) seems like the likely trough point for economic activity.

The Market Has Friends in High Places
In a world with many 'unknowns', we do now know one thing for **sure**—the **market has friends within the halls of the central banks.** The speed, massiveness, and extent of the new programs rolled out to combat the market's decline in the face of the virus has been unprecedented. Its clear the Fed and the other Central Banks care about the level of asset prices. The recent programs say the Fed is 'all-in'.

The market's big problems originated in the bond market—and that is what set stocks tumbling in mid-March. The 'boring' bond market has always been the driver of the financial markets (even though the 'sexier' stock market gets all the attention), and the Fed moved quickly and decisively when the bond market started to show signs of strain.

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Now Fed intervention doesn't always work out and, not necessarily in a straight line. But the Fed's track record at arresting declines is proven enough that it's worth factoring it into your calculus. Once again the Fed wants risk asset prices higher, and you don't fight the Fed.

The Stock Market and the Economy Diverge

Most of time what is good for the economy is good for stocks, and vice versa. As a result the economy and stocks tend to move together, reflecting changes in the business cycle. Many times the stock market leads the economy, anticipating the economy rolling over after a long expansion or anticipating the economy turning up after a recession.

<u>We could be in one of those periods where what stocks are doing seems to have little correlation with most of the day-to-day news going on in the economy</u>.

The stock market has rebounded from the March lows with gusto, thanks to the 'all-in' moves by the Fed. But the strength of the move goes beyond just an oversold snap-back. The Fed has essentially back-stopped the entire bond market—even high-yield bonds. It appears the Fed was once again a game changer, and the stock market is signaling that while the upcoming news will be bad, there will be an ultimate recovery. The stock market found a grasp on the Corona virus shock, and that limit was the March lows. That does not mean it will straight up from here. A return to normalcy is many months away. But the stock market's action does tell us that the very worst in terms of stock market damage is probably over.

Managed Accounts

Our managed accounts by and large faired MUCH better than the market during this period of turbulence. Managed portfolios as a group fell 1/3 to 1/2 as much as the market. We added to risk assets on the way down, and portfolios have gone from being DEFENSIVE to being positioned 'Moderately Bullish'. The market is now in the bottoming-rebuilding phase. While we certainly welcome the market's improving footing, we would not jump in with both feet. <u>We are buying incrementally on weakness for accounts where we'd like to increase equity exposure</u>.

Investors on the sidelines can begin to make plans for the upcoming bull market, because there will be one. **After every bear market comes a bull market.**

The technology sector has acted very well throughout the decline, losing less than the broader market and rebounding faster. Large-cap technology companies tend to have strong balance sheets and lots of cash on hand. Most have little debt and not a lot of 'infrastructure' to fund. They are also more adaptable to the current 'work where you can' environment. Holding up through the selling well, and showing early strength lets us believe this sector will lead the way as the next bull starts. Large-cap growth stocks in general should be among the leaders. Chip stocks, as in semiconductors, also looks like an interesting sector. An index we like for the months ahead is the NASDAQ 100-Index, which holds many of these big-cap technology and growth leaders.

Take care of yourself and family. If anyone has any questions –anyone, they can direct email me at abates@hbir.com.

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