Financial Market Weekly

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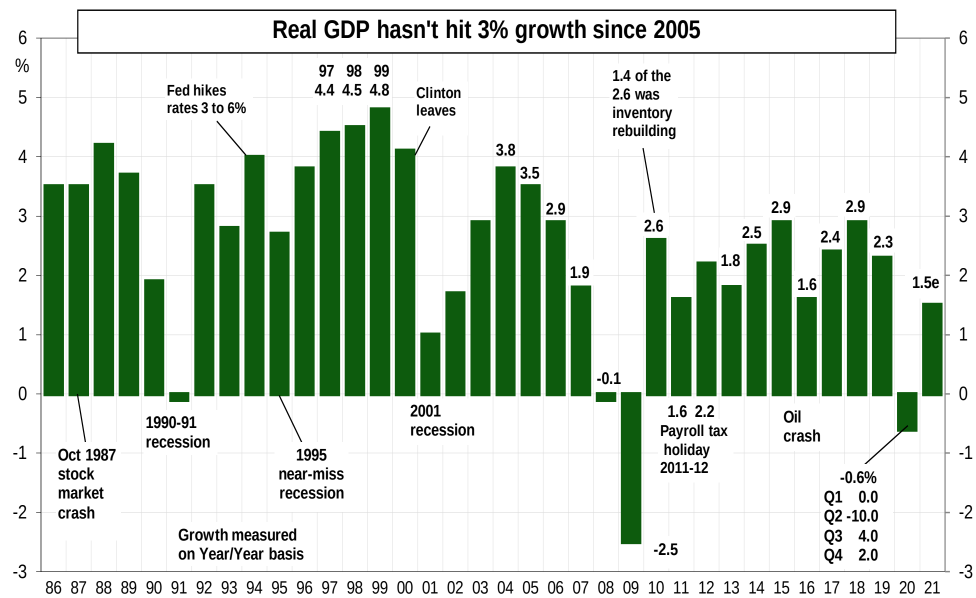
IF A RECESSION IS COMING WHAT'S GOING TO HAPPEN TO THE ECONOMY?



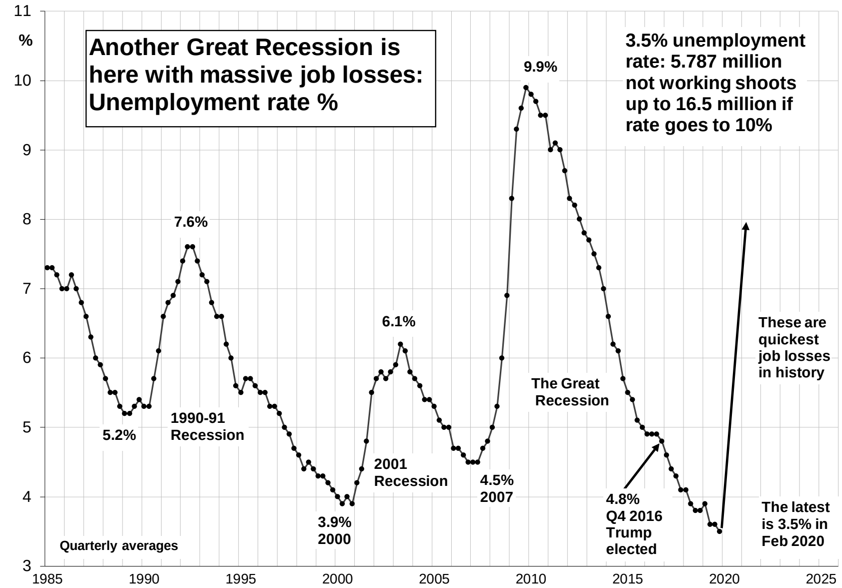
The government has sent much of the country home to stop the spread of the deadly coronavirus, so economic activity will decline sharply in the second quarter. Spending from businesses and consumers only has to drop 2%, then annualize it, to get an 8% drop in Q2 2020 real GDP. This week we got the third look at the fourth quarter numbers. The economy has steadied with 2% growth the last three quarters of 2019. The first look at the first quarter will come on Wednesday, April 29, but the first look at the second quarter won't come until Thursday, July 30. A long time to wait to see if we are doomed. Probably too much is being made of how low the economy goes in the second quarter as this recession is still man-made with the government sending people to their homes to stop the spread of the deadly virus. It's a coronavirus recession. It's temporary, right? It wasn't caused by the Federal Reserve raising interest rates too high to slow the economy and cool inflation like every other recession in modern economic history since the 1970s. (Although we did read on the internet so it must be true that the Fed raised interest rates too high in December 2018 to 2.5% and that was the cause of this recession we find ourselves in.)

Wall Street is counting positive COVID-19 cases in NYC

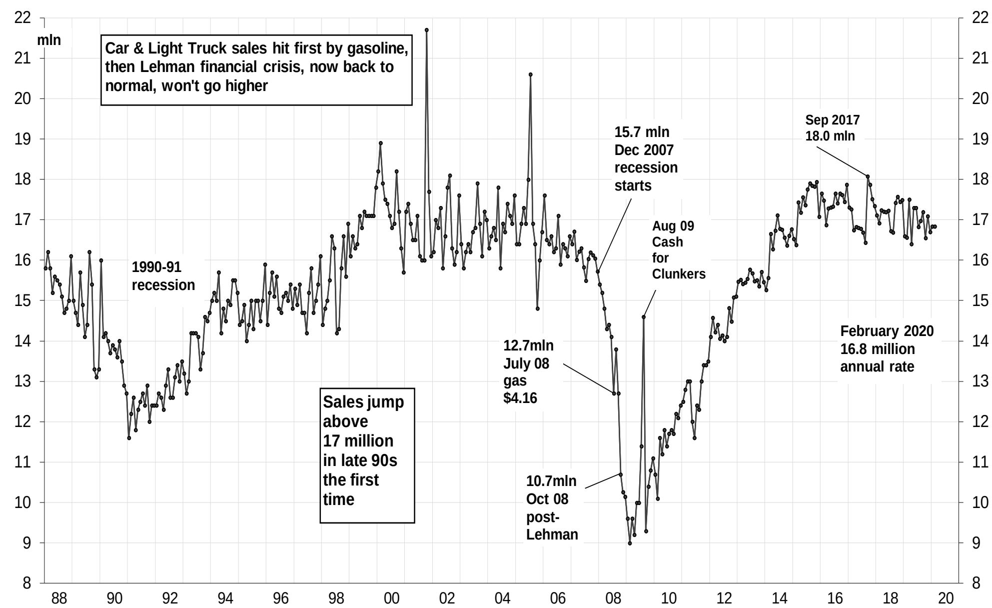
Mar 18 1,339	Mar 23 12,305
Mar 19 2,469	Mar 24 14,904
Mar 20 4,408	Mar 25 17,856
Mar 21 6,211	Mar 26 21,393
Mar 22 9,045	Mar 27 25,398

Is this a two-week or 12-week shutdown? Length is critical for 2020 U.S. economic outlook.

Two consecutive negative quarters of growth is one definition of recession regardless of how far that economic activity falls. It doesn't always fall two quarters, and we put the decline in Q2 2020 at 10% before rebounding. If this is the (optimistic) case as we have graphed above, year/year real GDP will decline 0.6% in 2020. The Great Recession GDP decline was 2.5%, GDP didn't decline at all in the 2001 recession on a full year basis, and in the 1990-91 recession it fell just 0.1%.



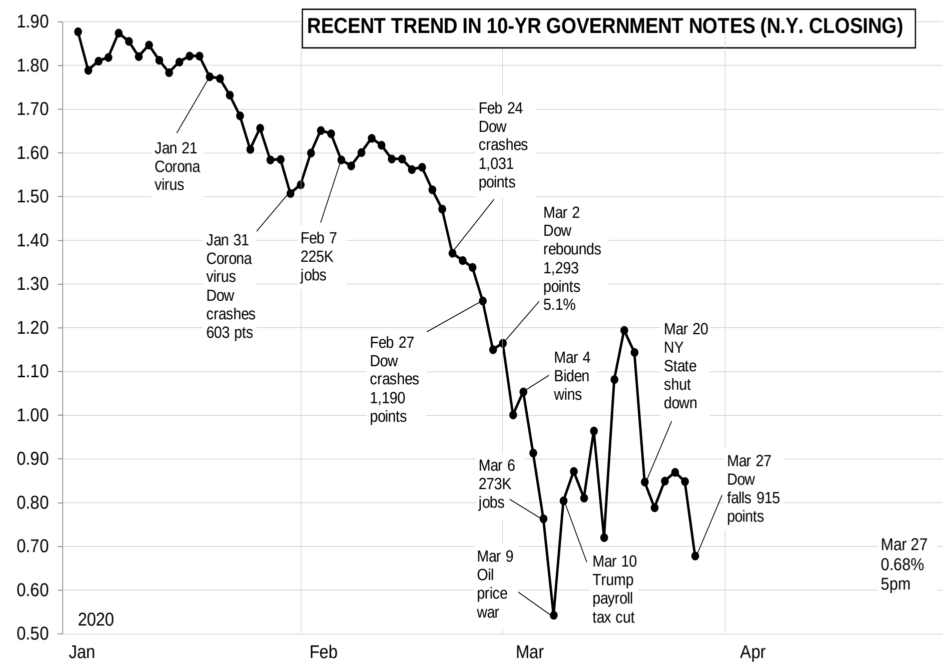
The economy is going to have to take on a lot of debt to get out of this unprecedented drop in spending and revenues, and ruined balance sheets may slow the eocnomy's revival. The Federal government has the Federal Reserve's QE purchases of Treasuries to bail them out although this has yet to be tested as the Fed's balance sheet soars into the stratosphere as it prints money like a third world country. States and local governments cannot recover from debt loads as easily assuming the markets are open for them and investors are willing to buy their paper. Companies that take on too much debt, well this often ends badly based on the experience from other business cycles. We want to forecast a V-shaped recovery to be patriotic, go USA. But these



output losses tend to be permanent, at least this was the experience after the 2007-09 recession. If the economy was running 3% before a recession and growth slows to -3%, the next couple of years don't often run faster than the 3% trend to more than make up for losses. If car sales drop in half to 8 million at an annual rate they are not going to jump back to 24 million. If we are lucky, this assistance from Washington will push us back to 2% growth and keep us there. That's the hope. Time is important. If self-isolation shuts down the American economy through May, this could lead to more permanent job losses where there is a period of "stubbornly high unemployment." It isn't just GDP growth that defines recessions, it is job losses. Our optimistic scenario for unemployment in this recession is modeled on the 1981-82 recession even if you may not call it optimistic. The optimistic scenario is unemployment goes from 3.5% good times in February 2020 to a 10 to 15 percent peak in September 2020, then takes a year to come back down to 4.5% in September 2021. Be well.

MARKETS OUTLOOK

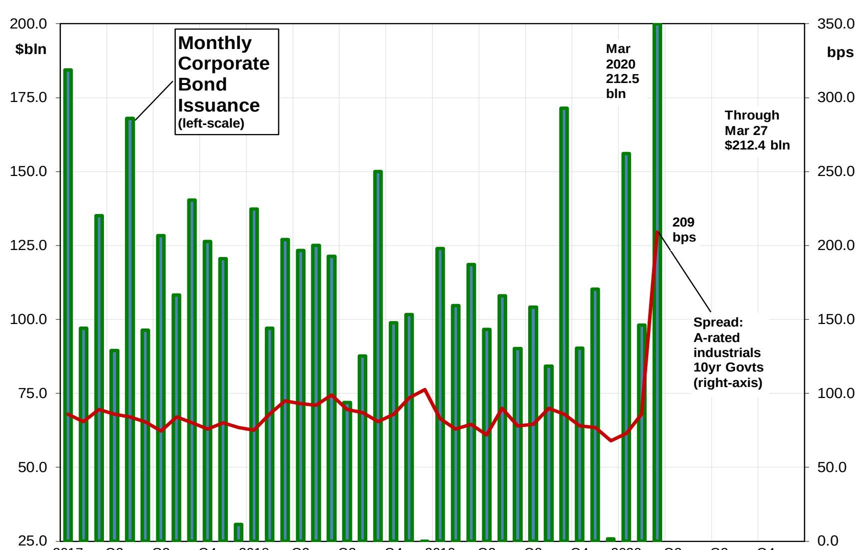
	29-Mar 2019	28-Jun 2019	30-Sep 2019	31-Dec 2019	27-Mar 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021
30-Yr Treasury	2.81	2.53	2.11	2.39	1.27	1.20	1.10	1.20	1.20	1.30
10-Yr Note	2.41	2.01	1.67	1.92	0.68	0.70	0.70	0.80	0.90	1.00
5-Yr Note	2.23	1.77	1.55	1.69	0.40	0.40	0.50	0.60	0.70	0.80
2-Yr Note	2.26	1.76	1.62	1.57	0.25	0.30	0.30	0.30	0.40	0.40
3-month Libor	2.60	2.32	2.09	1.90	1.45	1.10	1.00	0.80	0.60	0.50
Fed Funds Rate	2.50	2.50	2.00	1.75	0.25	0.25	0.25	0.25	0.25	0.25
2s/10s spread	15	25	5	35	43	40	40	50	50	60



10-year Treasury yields were back to a tighter range until Friday: the 10-year closed at 0.68% versus 0.85% a week ago. The $2 trillion stimulus package was passed by the House and signed by Trump on Friday. After buying $358.9 billion this week, the Fed announced Friday afternoon it would scale back somewhat to $75 billion next Monday through Wednesday and then buy $60 billion on Thursday and $60 billion on Friday. That would put Fed purchases at $976 billion since the Sunday night March 15 announcement it would resume doing QE and yet 10-yr yields are barely changed from 0.96% on Friday, March 13. Stay tuned. Story developing.

CORPORATES: PROCTOR & GAMBLE, GENERAL DYNAMICS, NIKE, NVIDIA, HOME DEPOT, CVS, COMCAST, LOWE'S, MCDONALD'S, TOYOTA, TARGET

Corporate offerings were $109.9 billion in the March 27 week versus $62.7 billion in the March 20 week. On Wednesday, 3M Company sold $1.75 billion 5s/10s/30s. It priced a $600 million 3.05% 10-yr (m-w +35bp) at 225 bps (A1/A+). The diversified technology company will use the proceeds for general corporate purposes. Corporate bond yields (10-yr Industrials rated A2) were 209 bps above 10-yr Treasuries Friday versus 269 bps last Friday.



FEDERAL RESERVE POLICY

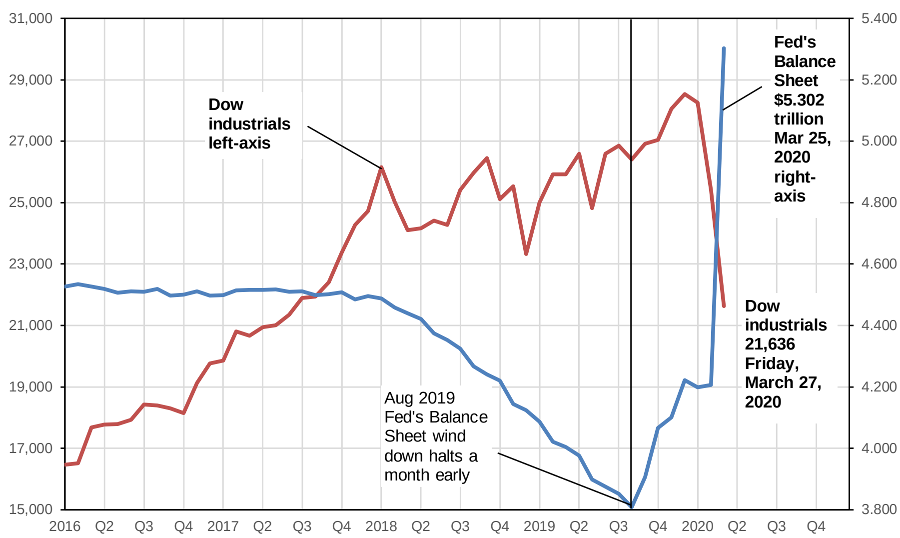
Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	25-Mar	18-Mar	11-Mar	4-Mar	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2978.372	2640.771	2523.031	2502.624	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1384.563	1366.676	1371.846	1371.846	0.000
Repurchase agreements	352.355	441.945	242.375	195.000	126.750
Primary credit (Discount Window)	50.768	28.224	0.011	0.001	23.455
MMLF	30.634	0.000	0.000	0.000	
PDCF	27.718	0.000	0.000	0.000	
Central bank liquidity swaps	206.051	0.045	0.058	0.048	62.000
Federal Reserve Assets	5302.6	4716.5	4360.0	4289.3	961.7
3-month Libor %	1.27	1.12	0.77	1.00	2.82
Factors draining reserves					
Currency in circulation	1872.242	1843.254	1818.957	1810.269	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	97.411	0.477	1.325	5.025	0.000
Reserve Balances (Net Liquidity)	2347.747	1945.393	1779.990	1735.005	24.964
Treasuries within 15 days	44.037	35.806	21.427	22.679	14.955
Treasuries 16 to 90 days	221.051	211.429	221.961	213.281	31.549
Treasuries 91 days to 1 year	430.067	387.117	378.403	367.820	69.272
Treasuries over 1-yr to 5 years	1111.145	966.762	915.101	914.339	170.807
Treasuries over 5-yrs to 10 years	436.318	357.666	327.906	326.323	91.863
Treasuries over 10-years	735.754	681.991	658.232	658.181	101.337

**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08

MMLF: Money Market Mutual Fund Liquidity Facility: loans secured by assets bought by banks from money market funds

PDCF: Primary Dealer Credit Facility: o/n and term funding with maturities to 90 days

The Fed meets April 28-29, 2020 to consider its monetary policy. Do they even need to meet? They skipped the March meeting this year. After Monday morning's surprise 8am ET Fed announcement, it looks like they have done just about everything humanly possible that a central bank can do to support the economy and financial markets. QE is unlimited now and the Treasury purchase amounts are simply staggering. It's hard to guess at what the long-term consequences to the financial markets will be from the Federal Reserve's extraordinary intervention. No one knows, but certainly the Treasury market will never be the same again. It sounds like the 10-year Treasury yield will never go above 1.0% in the years ahead if Fed policymakers could control the long-end of the curve more than economic theory would suggest they should be able to. We're sure they are going to try. Buy it all, money market yields are somewhat elevated with credit concerns and with the $2 trillion fiscal package more Treasury debt is coming. $631 billion Treasury securities bought over the last two weeks is a good start. Keep it coming.



Commercial Paper	
30-day Rate	
AA financial	
Day	%
Mar 26	2.21
Mar 25	1.93
'Mar 24	2.30
Mar 23	--
Mar 20	2.06
Week	
Mar 27	2.15
Mar 20	1.24
Mar 13	1.09
Mar 6	1.21
Feb 28	1.55
Feb 2020	1.58
Jan 2020	1.57
2019	2.18
2018	1.90

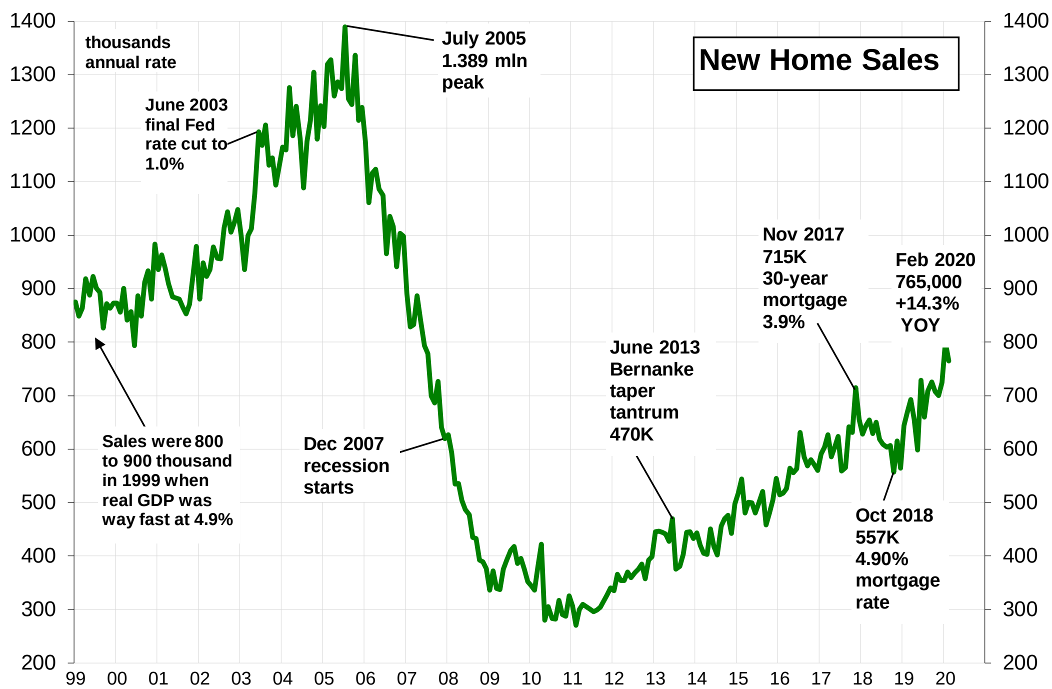
FED QE Govts Purchases		
Week	Daily	
358.91	Mar 27	71.500
	Mar 26	73.680
	Mar 25	70.948
	Mar 24	68.953
	Mar 23	73.829
272.137	Mar 20	72.122
	Mar 19	74.998
	Mar 18	45.007
	Mar 17	40.006
	Mar 16	40.004

OTHER ECONOMIC NEWS THIS WEEK

No recession for new home sales yet (Tuesday)

Breaking economy news. New home sales fell 4.4% in February to 765 thousand at an annual rate. Sales were really unchanged from where we thought they were a month ago because January was revised higher to 800 thousand. Big declines out West of 17.2%, and the Midwest of 7.3%, were offset by a warm-weather 38.9% jump in the Northeast. The biggest market for new homes down South rose 1.0%. Home prices are still rising and not falling like they did over a year before the last recession. The median sales price rose 7.8% the last year to $345,900, and the average price of a new home rose 5.3% to $403,800 from year earlier levels.

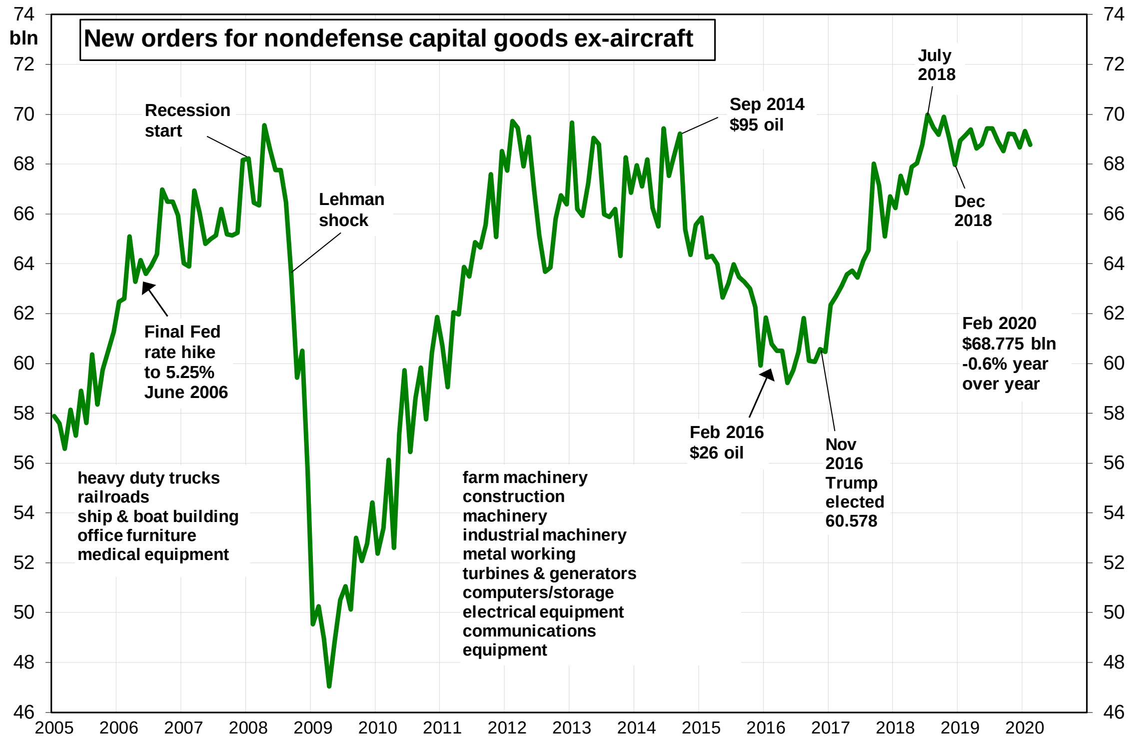
Net, net, new home sales will likely plummet in the next few months not because of a recession per se, but the reality is the public has been told to stay in their homes and not come out except to get bread and water. Of course, new home sales are going to plummet. A recession is coming? Fear not stock market investors. This is going to be a very special recession that is the result of a temporary social-distancing experiment sending people to their homes in order to stop the spread of the deadly virus. We can write off the second quarter with its GDP doom estimates of a 15, 20, 30 percent drop, anyone, anyone, want to guess. Everyone does. The million dollar question is not how hard we fall, it is how quickly the economy will come back to life after the coronavirus isolation of consumers and businesses ends. There are some longer term challenges, but the economy is likely to recover faster than you think. Bet on it.



Durable goods orders for capex fall in February as shutdowns begin (Wednesday)

Breaking economy news. Durable goods orders. New orders rose 1.2% in February to $249.4 billion. Our proxy for business investment is the subset of orders called nondefense capital goods ex-aircraft and these fell 0.8% to $68.8 billion in February which reverses January's 1.0% increase.

Net, net, in February, businesses were not canceling orders yet to any significant degree, but that's going to change in March as the coronavirus will take a toll on factory production in many states which have shelter-in-place rules. Today's drop in orders is likely to be just the first warning shot across the economy's bow as factory after factory appears to be turning out the lights on production in March. Business investment is the key swing factor in every recession and right now the pendulum is swinging the wrong way with declining orders likely to drag the economy over the cliff and down into recession in March. Orders remain near peak levels today, but with the last factory foreman turning out the lights, orders will tumble in the next couple of months making a recession a recession.



Powell says we may be in a recession. He's got that right. (Thursday)

Breaking economy news. Jobless claims jump by a record amount in the March 21 week and most certainly would have been much, much higher if the websites for filing hadn't blown a fuse. Millions have lost their jobs from the coronavirus shutdown of the economy and all that is left to do is record the number of workers that have been sacked by no fault of their own. It doesn't look like the government's $2 trillion fiscal package is going to be enough. We hope the stock market doesn't go down on the reports of job layoffs because millions more will lose work if the virus doesn't stop its deadly spread that is keeping millions of Americans trapped at home.

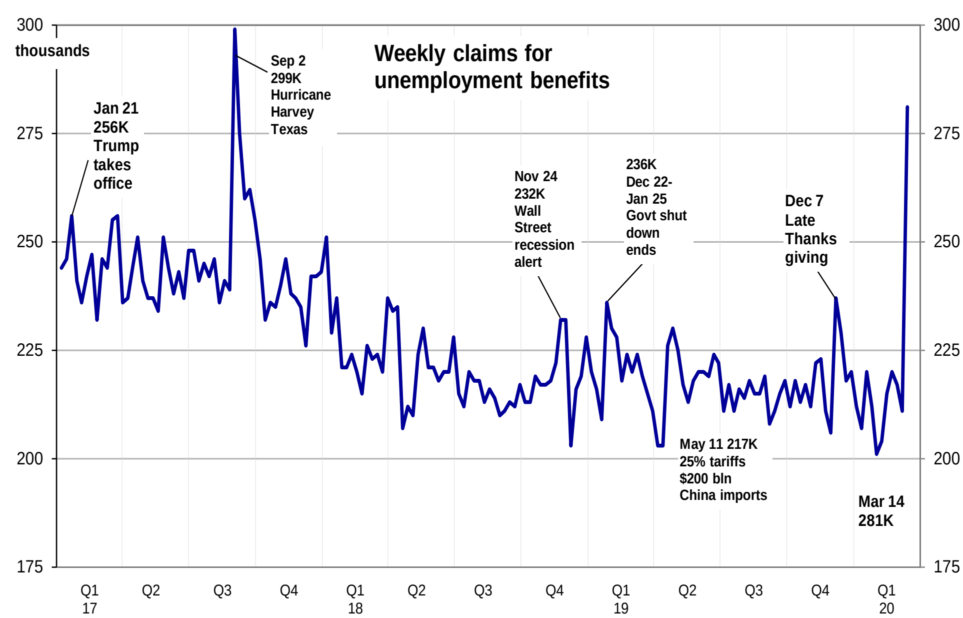
Millions of Americans are filing for benefits and that means the economy is not just staring down at the abyss, it has fallen off the cliff and down into the depths of recession. How far it goes is anyone's guess, but certainly close to ten million people are out of work and this means the official unemployment rate will match the 10% threshold of pain reached in the 1981-82 and 2007-09 recessions. The recession may indeed be temporary as it is the result of the government's policy to isolate Americans to stop the spread of the deadly virus. But the pain felt by the unemployed may be longer-lasting than we think as once they are shut, the shops and factories and malls may be trickier to restart after they are closed. We will see if the economy can be turned off and on like a light switch.

Net, net, if millions of workers losing their jobs and filing for unemployment benefits means a recession, then the Fed Chair is correct when he says the economy may already be in a recession. Let's hope it's a temporary recession that will lift when the government edict to self-isolate expires because the markets know full well the Fed Chair is exaggerating his powers when he says the central bank still has ammunition left. That is not a true statement. They can print money to buy the bonds the Treasury needs to fund the congressional fiscal package, but that isn't ammunition. It is a desperation move when you have no other options and right now the central bank is flat out of options.

Its policy seeks to stabilize the economy, it cannot make the public go out and spend and make companies go out and borrow money to invest in the country's future. The American economy right now is like Humpty Dumpty who had a great fall and all the king's horses and all the king's men don't know what they can do to put him back together again.

Off the Charts

3.283 million initial unemployment claims March 21 week pushes the 3.5% unemployment rate to 5.5%

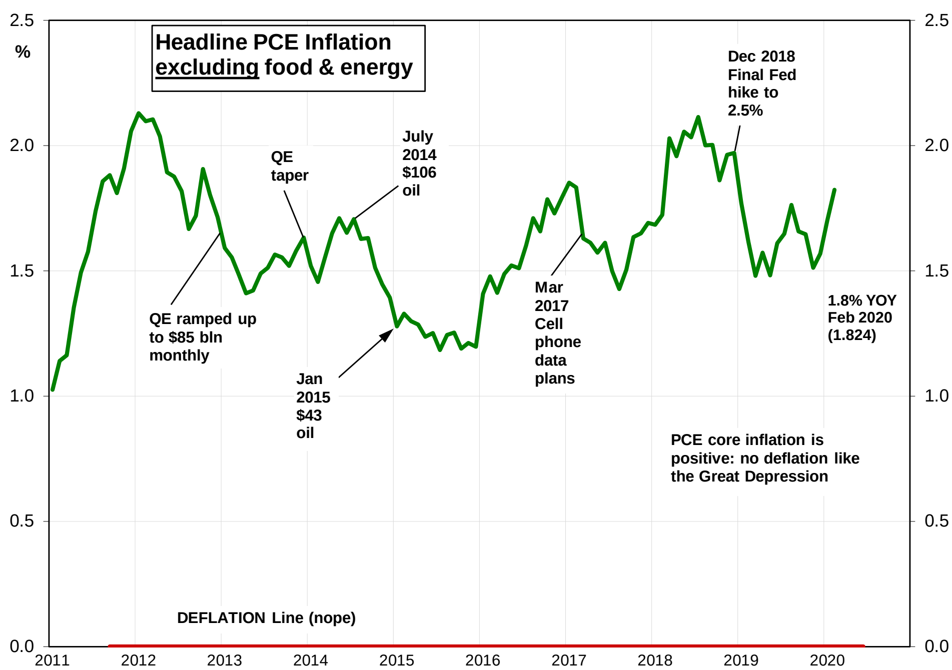


Personal Income report is here today gone tomorrow (Friday)

Breaking economy news. The monthly personal income report for February. It's dated for two reasons: (1) everyone is home and millions are unemployed now due to the coronavirus self-isolation measures, (2) no one cares where the Fed's preferred measure of inflation is because they will be keeping interest rates down at zero for a thousand years "to help the economy recover."

Personal income jumped 0.6% in February after a 0.6% increase in January, but that is sure going to change. Consumers had so much income they were able to save for a rainy day, and boy is it ever raining hard for the economy right now. Personal savings as a percentage of disposable personal income rose from 7.9% in January to 8.2% in February. Those savings are going to melt away during the coming coronavirus storm for the economy.

In real terms for real GDP, consumer spending is not quite so hot, with spending running slow at 1.1% so far in the first quarter after a weak showing of 1.8% in Q4 2019. With March spending expected to collapse, it will be a close call whether real GDP growth will remain positive in the first quarter.



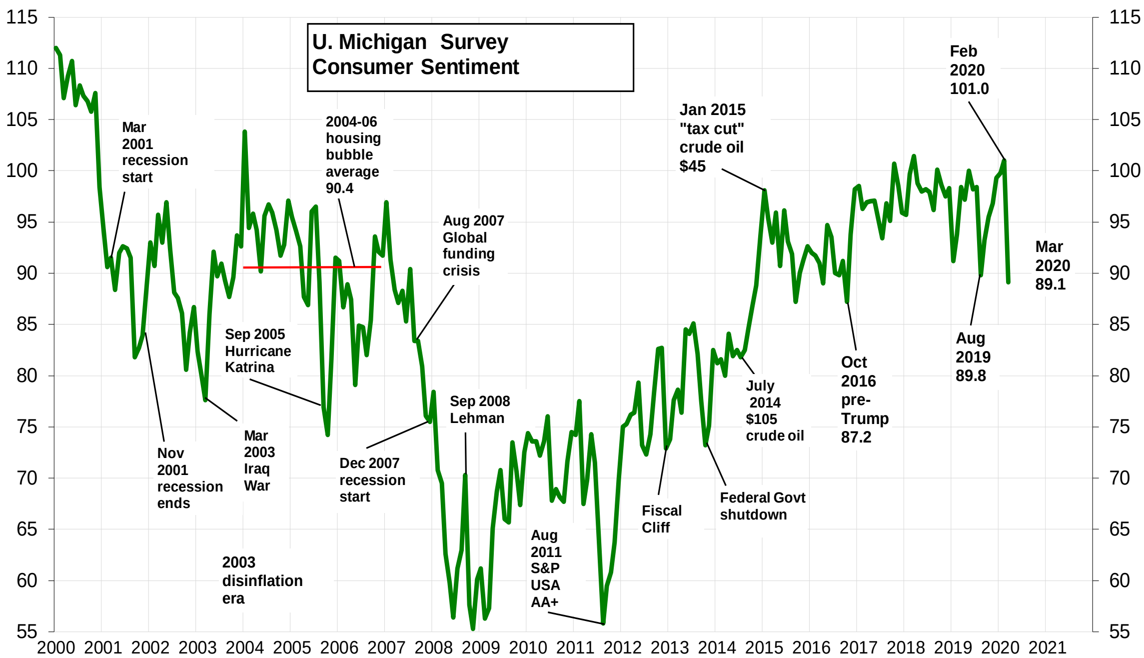
Core inflation rose but it's too late to put a Fed rate hike back on the table. Core PCE inflation was 1.6% year-on-year in January as reported last month, that was revised higher, and now core PCE inflation is 1.8% in February year-on-year which is very close to the Fed's 2.0% target. Inflation is positive and it's a good time to point out that we are not headed for a repeat of the Great Depression no matter how low GDP swings in the second quarter as a depression is when economists lose their jobs, we mean, a depression is when prices fall and that is unlikely.

Net, net, consumers had it all in February before the spread of the coronavirus took down the best economy in fifty years. They had more income and they were spending it and even saving a little for a rainy day, but that is sure going to change with consumer spending likely to plunge in the months ahead. Even if sales made from consumers' smart phones are ringing off the hook it won't offset for the closure of the shops and malls across much of America done to fight the spread of this deadly disease. Stay tuned. Story developing. We will see how quickly the economy recovers, but first we have to wait for a string of monthly reports that are expected to show the economy in freefall with consumers spending barely at all.

Consumer doesn't know what hit him yet (Friday)

Breaking economy news. The Michigan survey of consumer sentiment. It's lower in March but it is nowhere near low enough to give off a recession warning. The consumer is behind in the economic forecasting game where the first economic indicator to flash a recession-warning light wins a prize. The consumer seems to be shut up at home and doesn't know what hit him yet.

Net, net, consumers plainly don't know what hit them yet as the confidence surveys are holding up better than expected given the depression scenarios being floated out there. Consumers must be starting to go a little stir-crazy and are not thinking right because the economy plainly is facing the darkest days ever. No one is flying airplanes. No one is taking vacations. No one is going to the shopping mall. This economy is going to tank and the consumers who took this month's survey are plainly just deers looking into the headlights completely unaware about the disaster that is about to hit them.



Analyst Certification

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