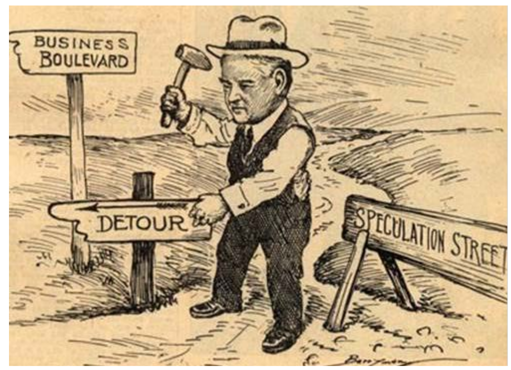
July 2020

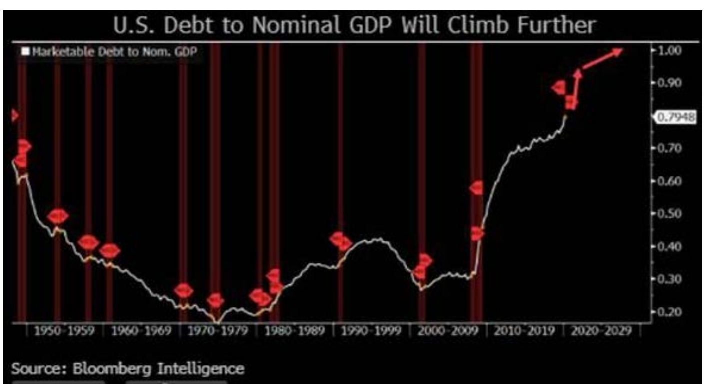
The Disconnect of the Raging Bull Market and the Hoover Economy in the Era of the The *New* New Deal

"Blessed are the young for they shall inherit the national debt."
~ Herbert Hoover

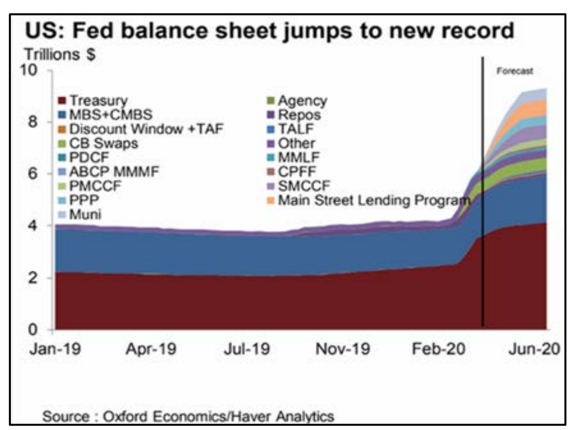


On March 12, 1932, two and a half years after the start of the Great Depression, the unemployment rate in the United States stood at 23.6%. According to the 1940 *Census of Agriculture,* the more than 25% of Americans living on farms did not fare much better as some 750,000 homesteads were lost between 1930 and 1935 through bankruptcy and foreclosure. GDP would decline that year by 12.9% and the stock market would close down 90% from its 1929 high later that summer. But that night, Secretary of the Treasury Ogden Mills informed the nation on public radio that there was no more important issue before the country than balancing the Federal budget. His sentiments were repeated by President Herbert Hoover only two weeks later who said a balanced budget was "the very keystone of recovery."[1] Today, while economic statistics emanating from the current crisis are eerily reminiscent of the 1930s, the 2020 fiscal and monetary responses are decidedly different.

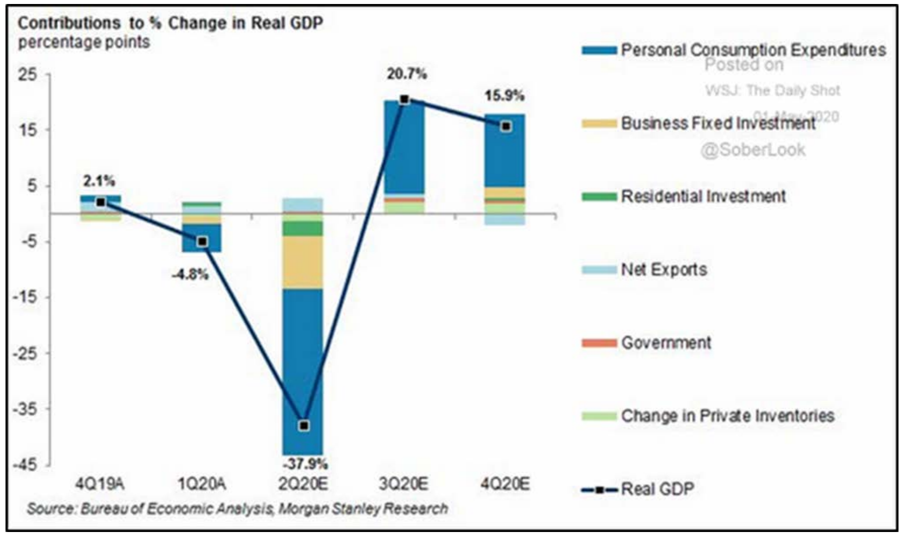
The *New* New Deal



The U.S recently went from a financial system highlighted by a 50-year low in unemployment with healthy GDP growth to one that will likely reach its highest unemployment rate and lowest GDP growth rate since the Great Depression in the second quarter. But in sharp contrast to the early 1930s, once it was clear the healthcare crisis had turned into a full-fledged economic crisis, the Federal Reserve and the U.S. Treasury stepped into action. Total U.S. Government debt has increased by $2.75 trillion while the Fed balance sheet has expanded by $2.5 trillion since mid-March. A veritable alphabet soup of stimulus initiatives have been funded in an effort to keep the financial markets running and the economy stabilized. To put these figures into perspective, economists estimate the government response for the entire New Deal was $41.7 billion or about $775 billion in today's dollars[2] and $840 billion for the American Recovery & Reinvestment Act (AARA) passed in 2009 during the Great Recession. So far, the results from the stimulus initiatives are mixed. The resurging bull market on Wall Street would suggest a recovery is just around the corner, but the depth of pain and suffering by Main Street and the real economy would suggest otherwise. Can they both be right?

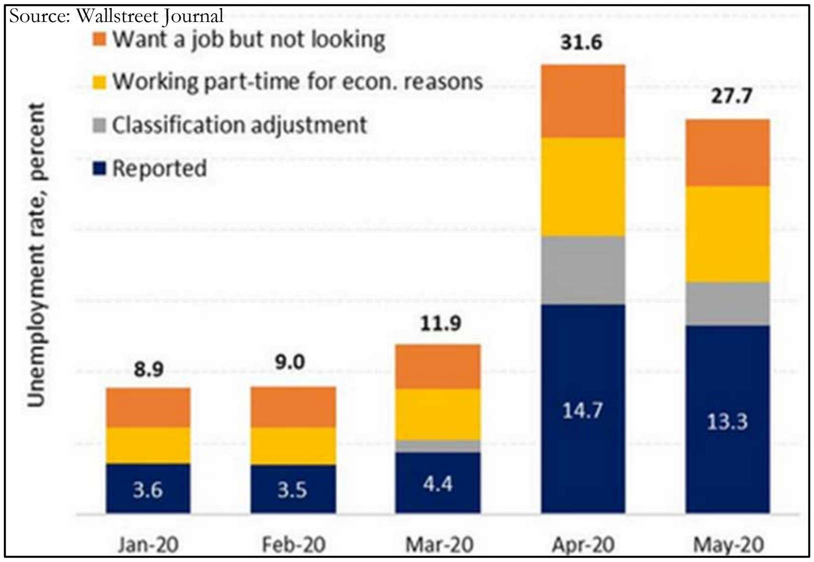


Covid-19 *Raw* Deal



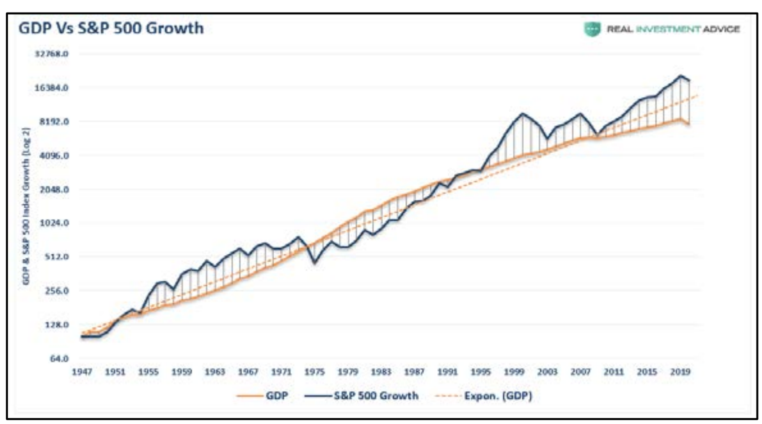
U.S. GDP was down 4.8% in the first quarter and is expected to plummet by a record 35% in the second quarter. The good news is, as businesses have begun to reopen, economic indicators across the board are gradually improving. A group of economists, recently polled by Bloomberg, suggest this momentum will continue through the second half of 2020. However, 'all bets are off' if a second major wave of Covid-19 surfaces.

Obviously, the key to improving GDP is getting people back to work. A recent *Wall Street Journal* article pointed out that 88% of job losses reported in April (and a similar percentage in May) were *temporary* in nature and would reappear once the economy reopens. June brought some welcomed news as 2.5 million more people were employed in May than in April of this year. According to Bloomberg, "the Labor Department's May payroll report showed unemployment fell to 13.3% from 14.7% when economists were predicting an increase to 19%." However, while directionally positive, even the Labor Department recognized the flaws in their numbers. In a partially shuttered economy, those workers who are underemployed (or simply became discouraged and quit looking for work) have likewise increased. According to the *Wall Street Journal*, this number may have risen from about 8.9% in January to a staggering 27.7% at the end of May. It is stats like these that help highlight just how much employment needs to improve before the economy can return to return to pre-coronavirus levels.



Source: Wallstreet Journal

Roaring 20s in the Hoover Economy

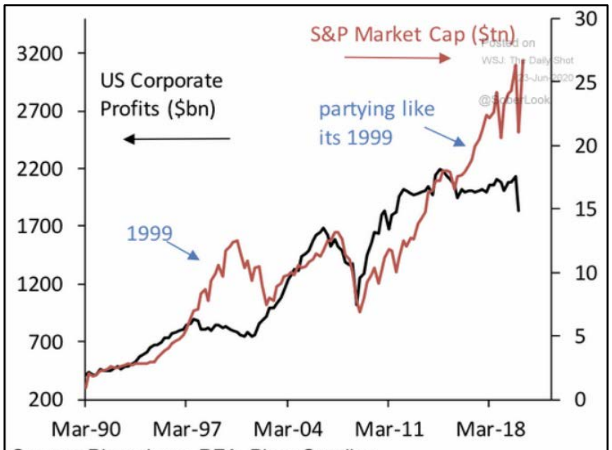


At a time when there has been a dark cloud over economic data, the stock market has been a 'beacon of light' as prices have soared over 40% from their March lows. Ed Yardeni of Ed Yardeni Research believes the recent buoying in stock prices augurs well for a V-shaped recovery and a quick return to healthy corporate profits is in the offing. In a recent interview with CNBC, he suggested "the economy may very well be catching up with the stock market rather than the stock market going off on its own." After all, the stock market attempts to anticipate a coming economic change or adjustments in corporate earnings whereas lagging indicators, like unemployment and GDP, simply give investors a snapshot of what has occurred in the past.

Unfortunately, not everyone is as sanguine about the prospects for the U.S. economy as Mr. Yardeni. Debates abound about whether the recovery will be V, W, U, L, or Nike Swoosh-shaped. The S&P 500 would imply there will be a 'V'-shaped recovery in the short term. But is the stock market an accurate predictor of future economic activity? According to *Advisor Perspectives*, "since 1947, earnings per share (of the S&P 500) have grown at 6.21%, while the economy has expanded 6.47% annually." Due to outside influences like investor psychology, fiscal and monetary *stimulus*, or the narrowing breath of the S&P 500 Index, "the stock market often detaches from underlying (economic) activity."

Conclusion: Party Like its 1999?

What is imminently clear to everyone is the longer Covid-19 remains a threat to human lives, the more challenging (and expensive) any economic recovery will be. Most pandemics in world history, including the Justinian Plague, the Bubonic Plague, the Spanish Flu and dozens of others, came in waves. Unless there is a cure sooner than later, Covid-19 will not likely be an exception to the rule. As the population begins to reassimilate, infections will likely rise. In this scenario, a 'W' versus a 'V'-shaped recovery is much more likely. This would add a level of uncertainty for both consumers and businesses alike which could result in some of the temporary layoffs of April and May becoming permanent layoffs in August and September.



Source: Bloomberg, BEA, Piper Sandler

For now, record liquidity in the financial system, near-zero interest rates, and multiple layers of stimulus have helped propel the markets to multiple levels not seen since 1999 and put a temporary floor in on the real economy. But the longer it takes to stem the tide of Covid-19, the less likely it is that corporate earnings rise to support current stock prices. Certainly the Fed and the Treasury will continue to play their part in the recovery, but this continued level of stimulus is not sustainable. If relief in the form of increased economic activity does not come soon, this *New* New Deal could become the New *Raw* Deal.

Sincerely,

Chris L. Doucet

Chris L. Doucet, CEO

Footnotes

[1] Forbes Magazine, Martin Fridson, "Four Major Reasons Why the Covid-19 Recession Isn't Likely to Evolve Into a Repeat of the Great Depression," May 18, 2020

[2] Fishback, Price and Kachanovskaya, Valentina. *The Journal of Economic History*, Vol. 75, Nov. 1, 2015, pp. 125-62

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