



THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – APRIL

U.S. Markets and Economy

The brutal stock market collapse in March was followed by a strong rally for almost the entire month of April, which cut bear market losses by more than half. This rally took place amid economic reports that ranged from bad to worse. Such a disconnect often happens during a recession because the financial markets can turn around in an instant, while the real economy, like a supertanker, takes much longer to turn around. What the stock market is saying is that the economic decline will bottom out by the end of this year, with growth resuming next year. Because the stock market often leads the economy by as much as six months, this is a plausible outcome but by no means guaranteed.

The economic data, however, will continue to get worse: the monthly report on April employment and unemployment, due out on May 8, will be one of the worst ever for the U.S., with a stupendous drop in employment and an unemployment rate well into the double digits (most likely the highest since the Great Depression). There is no sugarcoating the numbers: in a matter of weeks, tens of millions of Americans have lost their jobs outright or are on indefinite layoff. Coronavirus (COVID-19) has closed the restaurants, emptied the malls, and grounded the airlines. The knock-on effects of the layoffs and shutdowns then reverberate through the economy.

It is also likely that second quarter GDP will show one of the worst declines in modern history. Corporate earnings will fall this year, and the extent of the fall will probably not be clear until second quarter reports are released. The only good news is that the unprecedented actions by the Federal Reserve (trillions of dollars in quantitative easing, including purchases of corporate and municipal bonds), in addition to trillions in new government spending and forgivable loans, should slow the decline. But almost none of this spending can directly end the COVID-19 epidemic; we are still many months—if not years—away from a vaccine, and we have yet to find a drug that will “cure” the disease, in spite of a massive worldwide race to uncover such a magic bullet.

World Markets and Economy

Most of the world's stock markets followed the U.S. down in March and back up in April. In Europe, where the economic news may be even worse than in the U.S., the main blue-chip index (the EUROSTOXX 50) fell 38% from peak to trough, then rallied in April by almost 23%. Spain and Italy have been hit especially hard by the virus, and their markets reflected this: both countries witnessed 40% drops in stocks followed by only tepid rallies of 10%–20%. Japanese stocks also fell, but not as sharply and they recovered more. This was in spite of the postponement of the 2020 Olympics, an event that Japanese leaders had been hoping would help restart a sputtering economy. Chinese GDP may have fallen less than that of most other large economies, but Chinese statistics are among the least reliable in the world. China has been gradually reopening its economy, and it will be an excellent laboratory test showing if reopening can be managed without a spike in COVID-19 infections. Chinese stocks had a smaller fall than most in March, as by that time it seemed that China's brutal lockdown had stopped the virus in its tracks.

Outlook

While the U.S. is starting to gradually reopen the economy, much will depend on two interrelated factors: how quickly Americans will return to their pre-coronavirus behaviors (consumption is 70% of GDP) and whether the virus is planning a comeback just as—or because—Americans have gone back to the malls, airports, and restaurants. A second spike in infections (and deaths) as a result of reopening, or a second wave next fall and winter (as was the case with the “Spanish flu” a century ago), could nip any economic recovery in the bud.

The battle between the optimists, who see recovery coming, and the pessimists, who see a second wave of infections coming, will be played out in financial markets over the next few months. Investors who braved the dramatic fall in March must be prepared for powerful rallies and sharp selloffs until it becomes clear which path the virus (and the economy) will take. If history is any guide, though, patient and disciplined investors will win out in the end. As Warren Buffett has said, “Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold. When downpours of that sort occur, it's imperative that we rush outdoors carrying washtubs, not teaspoons. And that we will do.”