THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – JUNE 2020

U.S. Markets and Economy

Stocks continued to rally in June, completing one of the best quarters in stock market history. Although the S&P 500 Index and the Dow Jones Industrial Average did weaken toward the end of the month, the NASDAQ Index continued to plow ahead, breaking through the 10,000 barrier to set new all-time highs at the end of the month. Volatility was high, though, with stocks rising and falling sharply even within a single day.

There are several powerful forces behind the sharp rises and selloffs. First, of course, is the pandemic. COVID-19 put the U.S. economy (and much of the world) in lockdown and pummeled stocks in a brief but dramatic bear market early in the year. Since the low in late March, however, stocks have soared on the hopes that the virus could be contained (as it was in New York City), that a vaccine would be developed soon (there are almost 100 candidates in development or testing), and that a treatment for the virus was forthcoming. Every new announcement of an antivirus advance or setback led to a rise or fall in stocks. This was clearly in evidence in the latter part of June, when stocks sold off as the virus made a comeback in the South and West, with new cases in the U.S. reaching 50,000 per day. But the NASDAQ? The mega-cap companies in the NASDAQ seem almost impervious to the virus and general economic weakness; Amazon, Microsoft, Apple, Facebook, and Google are thriving in a virus-induced world of working from home, remote learning, and social isolation.

However, with a widely available, effective vaccine still many months away and a number of states reclosing businesses that have just reopened, the outlook for victory over the virus is cloudy at best. But the second powerful force, monetary policy, has continued to support stocks regardless of the pandemic or economic weakness. The U.S. Federal Reserve (and most other major central banks around the world) has unleashed an unprecedented flood of liquidity designed to offset the economic effects of the pandemic. This tidal wave has rushed into all corners of the financial markets, accompanied by trillions of new spending by the federal government.

Not only have markets returned to normal functioning, with the Fed intervening for the first time ever in the corporate and municipal bond markets, but interest rates have plummeted to near zero. Although short-term rates at zero were achieved while the Fed fought the Great Recession, *long-term* rates have also approached zero: the U.S. 10-year Treasury bond now yields 0.7%, which is less than the current rate of inflation of 1%. The 30-year Treasury bond yields a paltry 1.4%. While these rates certainly punish savers relying on income, they encourage borrowing and spending by consumers and businesses and also make stocks look cheaper. The S&P 500 dividend yield at 2% is nearly triple the yield of the 10-year Treasury bond.

World Markets and Economy

European stocks followed the U.S. higher in June, although the blue-chip EUROSTOXX 50 remains well below its February high. The cloud of Brexit hangs heavy over Europe, with the FTSE 100 showing almost no gain for June. The British have also botched their response to the virus, with the highest death toll in Europe. By comparison, the German DAX Index rose sharply in June. Germany has a larger population than the U.K. yet has 1/5 of the number of virus deaths.

The Japanese economy is back in recession again, although Japanese stocks did manage a small gain in June after much bigger gains in April and May. The Bank of Japan has added nearly $1 trillion in liquidity, with the Japanese federal government spending almost $2 trillion in stimulus measures. This massive stimulus, combined with policies that have severely limited the coronavirus outbreak, may limit the Japanese GDP decline to only 5% in 2020, compared to a U.S. decline that could reach 8%.

Chinese stocks rallied in June then soared in early July, approaching five-year highs. Stocks have been buoyed by signs of economic recovery. The IMF estimates that China will achieve economic growth in 2020, unlike all other major economies. This economic good news has overwhelmed political news as China moves to crush Hong Kong into submission while increasing its threats to Taiwan and other neighbors.

Outlook

For stocks, extreme monetary easing has more than offset the steady stream of dreary economic statistics. Although employment continues to recover, and unemployment continues to fall, many millions of jobs have still been lost this year, and unemployment, at 11%, is still the highest it’s been in 80 years. The U.S. GDP for the second quarter of the year, to be first reported in late July, will likely show a decline of between 20% and 30% at an annualized rate. The reports on corporate profits for the second quarter will also not be pleasant reading, and a string of bankruptcies of household names (Hertz, Neiman-Marcus, JCPenney) will continue.

Europe’s economic growth was already slow before the virus hit, and it will be sharply negative in 2020 even with easy money and new spending by governments. But well-managed economies like Germany are likely to rebound the fastest. German GDP is forecasted to grow at 4.5% next year, even though exports have been hit hard by the worldwide recession. The U.S.-China relationship is deteriorating further, with new sanctions likely against the Chinese and no evidence that China will buy all the U.S. goods promised as part of a tariff-reduction deal. An intensification of the U.S.-China cold war could hurt both the U.S. and China.

While the U.S. economy should make forward progress in the third quarter (July-September), economic weakness, a resurgence of the pandemic, and a looming U.S. presidential election could put a damper on the Fed-induced stock surge. At the very least, the market will remain hostage to developments on the vaccine/pandemic front, meaning further gains will likely be punctuated by sudden and sharp selloffs. Stay-the-course investors will be mightily challenged. But, if history is any guide, the courageous will reap the rewards in the long run.