Eagle Strategies LLC

The Eagle Edge

Quarterly

MARKET & ECONOMIC OUTLOOK

July | 2020

On the Radar Screen

1. **The continuing swell in new case counts across the Sun Belt** needs to be monitored. Broad lockdowns are unlikely, but consumer behavior will respond with adverse impacts.
2. **Support for the economy remains critical.** We anticipate another fiscal stimulus package before the August congressional recess and would not be surprised to see further monetary policy accommodation as well.
3. **The corporate earnings reporting season will shed significant light on the damage already inflicted upon profitability.** Hopefully management will provide guidance to investors on what they anticipate for the second half of the year.
4. **The upcoming election will have a growing impact on markets** as we move through the summer and into the fall. Prospects of a Democratic sweep appear at present to be growing, and their tax and regulatory proposals are unlikely to be viewed as market friendly.
5. **Geopolitical tensions remain elevated**, and the status of U.S. trade relations with China are particularly concerning.

Insights from Multi-Asset Solutions' Portfolio Managers

"I tell people there are two rules to investing: Stocks only go up, and if you have any problems, see rule No. 1." – Dave Portnoy, Barstool Sports

In for a penny, in for 5 trillion dollars" — Cameron Crise, Bloomberg. Pick your superlative: extraordinary; unprecedented; eye-watering; unimaginable. They all apply, both to the economic consequences of the pandemic containment policies and to the government's response.

Through the winter months, with evidence gathering that the SARS-nCov2 virus was circulating freely within some of our communities, policy makers hesitatingly implemented many of the recommendations offered by epidemiologists. Business closures were mandated, and stay-at-home orders issued. The economic costs were predictably catastrophic. Bringing a wide range of businesses to a full stop precipitated a tsunami of job losses, a growing swell of bankruptcies, and a collapse in aggregate production. Incoming data painted a picture of a Great Depression-like environment, and capital markets reacted in predictable fashion with equity prices plunging and credit spreads blowing out.

Enter stage right our headliner acts. First came Jay Powell, Chairman of the Federal Reserve Open Market Committee, to do his best impersonation of David Copperfield, a master of the art of illusion. Through a mix of near zero interest rates, unlimited quantitative easing, and a hodgepodge of lending facilities, the Federal Reserve reversed a developing liquidity crisis and ensured credit was both inexpensive and widely available to a broad range of borrowers, creating a fantastic impression of normally functioning markets and healthy economic activity. Congress followed, further enhancing the mirage through direct fiscal transfers, creating an impression of rising personal income and sustained corporate cash flows. And thus, the notion of a "V-shaped" recovery was born. Market pricing obediently fell into line, snapping back near prior peaks.

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The concern is that absent policy intervention, actual economic conditions look terrible relative to pre-pandemic readings. Will monetary and fiscal support be sufficient in scale and duration to bridge the gap to a more normally functioning post-COVID economy? That remains to be seen, but you can put us in the camp of the skeptics.

"History has not dealt kindly with the aftermath of protracted periods of low risk premiums." —Alan Greenspan. Whereas underlying economic activity remains dire and corporate profits remain well below levels anticipated just a few months ago, equity pricing has staged a rather remarkable recovery. For some, this is justified by the efforts of the Fed to change the rules of the game. In a world in which the discount rate is near zero, what's a fair price to pay for equities? Earnings growth becomes almost infinitely valuable. To our ears, that smacks of the grandiose theories bandied about through the tech bubble of the late '90s. We're back to rationalizing the irrational (assuming you share the argument that PEs in the mid-20s are irrational).

More worrisome still has been the behavior of retail investors. A huge number of new brokerage accounts have been opened in recent months and become home to some aggressive risk taking. Volumes in near dated options are surging, or so we have read. Stock prices in already bankrupt firms like Hertz and JC Penney surged even though those securities are almost certainly worthless. The zero-emission vehicle designer Nikola has been granted a market cap roughly equal to that of Ford even though they have yet to produce a functional prototype of the pickup truck they are making available for advance order. And then there is that quote above from David Portnoy, self-proclaimed leader of a merry band of small investors on the Robinhood trading platform. If that doesn't harken back to the day-trading boom of the late '90s, what does? Those of us who were in this business back then, and can recall the speculative fervor of the time, find plenty of reason for concern in the similarity to today's environment. If the game is to end in similar fashion, we'd rather not play.

"The saddest aspect of life right now is that science gathers knowledge faster than society gathers wisdom." — Isaac Asimov. The forward demand curve will be heavily influenced by the trajectory of the pandemic. It's highly unlikely that government entities will mandate broad April-style lockdowns but rising new case rates are nevertheless likely to severely inhibit personal consumption as swaths of the population will elect to continue social distancing rather than put themselves at risk. Restoring normal economic activity will require containment of the virus or a medical solution. Progress is being made on the latter front, but efforts to contain the spread have thus far proven inadequate.

When SARS-nCov-2 arrived on our shores earlier this year, we knew relatively little about the virus. That has changed in the weeks and months since. We now have a much clearer idea as to how it spreads and what steps can be taken to slow that process. Numerous developed and emerging countries—like Germany and South Korea—have demonstrated effective policy in containing the virus.

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Unfortunately, the science has been tinged by politics here in the United States. Measures that could help reduce new infection rates, allow activity to normalize, and reduce the burden on the healthcare system are in many cases being flaunted. As we move toward November's election, it seems unlikely that the partisanship will abate in favor of unity in combating the virus. As such, we are fully prepared to witness the continued spread of COVID-19, the concomitant destruction of economic output, and persistent pressure on corporate earnings. We anticipate that markets will eventually follow.

About Risk

All investments are subject to market risk, including possible loss of principal.
Stocks and bonds can decline due to adverse issuer, market, regulatory, or economic developments. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer's ability to make such payments may cause the price of that bond to decline. A bond's prices are inversely affected by interest rates. The price will go up when interest rates fall and go down as interest rates rise.

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