Market analysis

April 13, 2020

This informational material is provided by U.S. Bank Asset Management Group who provides analysis and research to U.S. Bank and its affiliate U.S. Bancorp Investments. Contact your wealth professional for more details.

At a glance

A $2.3 trillion Fed plan to buy assets from loans to corporate and municipal bonds was cheered by markets last week. However, the economic damage continues, with 17 million Americans filing for jobless claims in the past three weeks — about 10 percent of the U.S. labor force.

10.5%

Increase in the S&P 500 last week, the index's best calendar week since 1933

TERM OF THE WEEK

OPEC+ – The Organization of the Petroleum Exporting Countries (OPEC) is a group consisting of 14 of the world's major oil-exporting nations. OPEC+ also includes 10 OPEC allies, the largest of which are Russia, Mexico and Kazakhstan.

> "The OPEC+ production cut is far too small to offset the demand decline for crude oil, and prices will likely remain under pressure in the near term."
>
> - **Kevin Weigel,** Vice President, Head of Real Assets Research, U.S. Bank

[1] Important disclosures provided on page 4.

Global economy

Quick take: Social distancing measures to combat the COVID-19 pandemic led to nearly 17 million unemployment claims in the past three weeks. The key question for a recovery is the duration of stay-at-home orders.

Our view: Markets are reacting positively to indications that initial COVID-19 outbreaks in the U.S. are near containment. Federal Reserve (Fed) actions providing liquidity also bolstered markets. We remain cautious that the duration of economic damage from COVID-19's response efforts may be greater than expected.

- **Nearly 17 million Americans** claimed unemployment benefits in the last three weeks, the largest three-week rise in history, eclipsing the 1.93 million job losses in the three weeks ending October 1982. Small businesses, which make up about 50 percent of private employment, saw hiring expectations drop precipitously in March. A large proportion of claims are for furloughs, which will likely increase the recovery speed, but the labor market is under substantial stress.
- **Global economic sentiment** fell to its worst point since 2009. Expectations fell only modestly, however, potentially signaling that a recession may be shorter than average. Still, expectations are not yet positive.
- **Inflation metrics cooled globally** since the onset of the COVID-19 crisis. Despite unprecedented monetary action from central banks, consumer price increases in the U.S., Europe and Asia have slowed. The slowing of global demand currently outweighs the increase in new money supply and points to further deflationary pressure if social distancing measures remain in place.
- **Senator Bernie Sanders** dropped out of the Democratic primary race, presumably allowing former Vice President Joe Biden to claim the nomination. Investor focus on the election is low due to the current crisis, but may grow as the November election nears.

Equity markets

Quick take: Equities have trended higher in early April, despite lingering concerns around the duration and impact of COVID-19 and in the absence of earnings visibility.

Our view: We expect volatility to remain elevated until COVID-19 peaks or is contained and the visibility of earnings for 2020 and 2021 improves.

- **Contributing to the strength** of equities so far in April are monetary and fiscal stimulus programs, signs that COVID-19 may be stabilizing in some areas and positive OPEC+ negotiations. OPEC+ is the Organization of the Petroleum Exporting Countries plus several non-members, including Russia and Mexico. These discussions resulted in crude oil production cuts intended to help stabilize prices and help companies in and around the oil industry.
- **Earnings visibility is lacking**, which is a headwind for equities. The first quarter earnings reporting ramps up this week, with 7 percent of S&P 500 companies slated to release results, highlighted by releases from several money center banks. Another 80 percent of S&P 500 companies will release results over the following three weeks.
- **Consensus is for first quarter revenue growth** of 1.4 percent over year-ago levels, with earnings declining 9.5 percent, according to FactSet. First quarter results will be anything but typical and normal. Suspended guidance from company managers, delayed share repurchase programs and reduced dividends are potential outcomes.
- **Consensus earnings estimates** for 2020 have fallen from roughly $175 per share at the start of the year (according to Bloomberg) to approximately $143 at present, with more downside likely.

Bond markets

Quick take: The Fed announced details of its massive stimulus measures, which include municipal and corporate lending and bond buying programs. As a result, corporate and municipal bond prices rose significantly last week, moving yield spreads (corporate bond yields compared to Treasury yields) tighter.

Our view: Stimulus measures are supportive of market liquidity and access to financing, but the economic damage from stay-at-home orders grows by the day. A highly uncertain timeline around normalizing economic activity necessitates a high-quality bias in bond portfolios to ensure ample diversification against more volatile holdings, like stocks.

- **The Fed announced an additional $2.3 trillion** in stimulus measures last week. It allows for buying bonds issued by and providing loans to corporate and municipal issuers, and backs small business loans. Liquidity continues to improve as the Fed ensures borrowers have access to cash to meet short-term needs.
- **Rising inflation expectations** moved Treasury yields higher last week. We expect Treasury yields will remain low as demand for safe-haven assets remains strong and the Fed buys Treasuries to keep borrowing rates low.
- **Corporate and municipal bond yields** contracted last week (prices rose). We believe it is still too soon to increase allocations to riskier, lower-quality bonds, despite rising prices, considering their high sensitivity to the slowing economy.
- **Short-term investment-grade municipal bond** yields offer high tax-adjusted yields compared to Treasuries and corporate bonds. We recommend the same higher-quality bias in municipal exposures.

Real assets

Quick take: Talk of the historic OPEC+ production cut agreement made the headlines, but a 20 percent decline in crude oil prices last week reflect investors' disappointment with the deal. Real estate investment trusts (REITs) posted a 23 percent gain during the week, with the most beat-up real estate sectors — hotels and shopping malls — rebounding sharply.

Our view: We remain cautious about real assets, even though valuations have declined considerably. The lack of visibility into future revenue streams is concerning. The OPEC+ production cut is far too small to offset the demand decline for crude oil, and prices will likely remain under pressure in the near term.

- **REITs were the best performer** across real assets last week, with Utilities next. However, all defensive stocks beat the S&P 500 handily.
- **Hotels and shopping malls** were the largest gainers among REITs last week. However, these subsectors have the least certainty about future revenue streams, and market risk remains elevated.
- **Demand decline estimates for crude oil** of 30 million to 35 million barrels per day are circulating in the market. A record supply glut will fill land-based storage quickly.
- **Fed increases** in liquidity facilities caused a strong gain in gold prices last week. Gold mining companies may be well positioned, because their cost of production falls with the decline in energy prices. However, market risks remain meaningful.