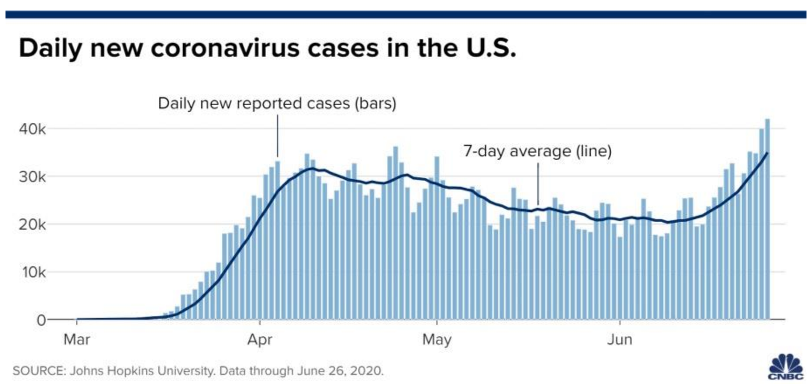
Why Are Stocks Appreciating During the Pandemic?

By Bob Deitrick and Justin Braun

You have heard Steven and I often say that: "strong markets climb walls of worry." That proverb could not be truer than it has been over the past 3+ months. This market has been remarkable – for those who have been invested. Fortunately, we have been, and our results speak for themselves. The question is: Will this trend continue moving forward? As the economy moves into the second half of 2020, we expected this bounce to continue as money on the sidelines moves back into the market. However, the resurgence in COVID-19 to record levels in our southern states threatens to make that rebound less potent than expected even a week ago. Florida reported 15,300 confirmed COVID cases on Sunday, the highest single daily total for any U.S. state since the pandemic began.

- ***The surge brings Florida's total cases to 275K - higher than the totals of several major nations with much larger populations such as Spain, Italy, and France.***
- ***45 people died on Sunday in Florida from the virus, bringing the statewide death toll to 4,346.***
- ***Florida remains set to host the RNC convention in Jacksonville in August and Governor Ron DeSantis is requiring all public schools re-open in August.***
- ***Disney had a very uninspiring re-opening of its theme parks in Orlando this past Saturday.***



After conducting a thorough investigation into the fiscal and the monetary policy responses to the economic contractions created by the Great Recession of 2008/09 and the COVID-19 pandemic of 2020, it is clear the COVID response has been far more expansionary and expensive.

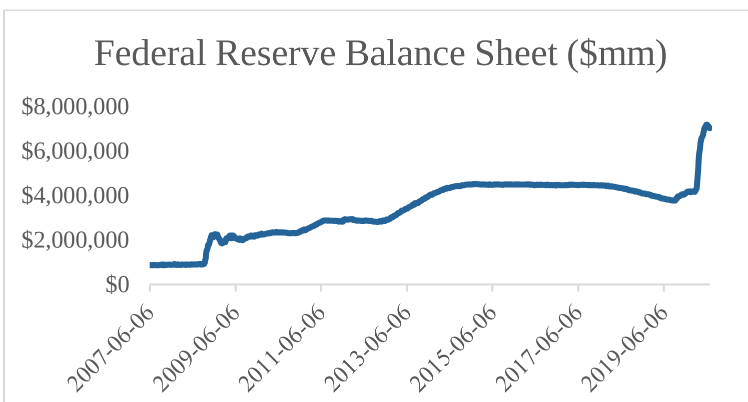
There has been a striking difference between the Fed's response to the contractions of 2008/09 and 2020. Both responses were expansionary, but the COVID response has been more aggressive than 2008 by double! So far, the Fed has increased its balance sheet by 2.8T in less than 4 months!

Our states have been inundated with unemployment claims with COVID. To date, 35 million Americans are collecting unemployment benefits today – <u>5x more than The Great Recession.</u>

The first move during any economic contraction is to lower interest rates to create easy access to capital. One way the Fed accomplishes this is by lowering the fed funds target rate. The Federal Reserve added a new expansionary measure in 2008 called quantitative easing or QE. This involves

purchasing long-term treasury debt to lower interest rates and to increase the money supply. The Fed started QE in 2008, but this year it announced unlimited QE to lower rates and increase the money supply. This year, the Fed enacted another concept in response to the COVID mess by purchasing investment-grade bonds via investment-grade bond ETF's and through the Primary Market Corporate Credit Facility. This was done by Fed Chair Powell to shore up the markets - and it has worked.

During the past few months, we have seen a vigorous effort by Congress to borrow money to stave off the economic impact of COVID with aggressive fiscal policy. In four months since COVID began, the National Debt has increased by $3.0 Trillion. During the Great Recession, the National Debt increased by $2.4T over 18 months. This is striking but it does not tell the whole picture. During an economic contraction, the deficit increases. This occurs in a macro-sense because during an economic contraction people and businesses make less money, so they are worse off, and they need to use more government assistance programs (like unemployment) as well. Consequently, they also pay fewer dollars in taxes so the full effects of the COVID crisis have not yet been revealed despite these shocking debt figures through four months. Typically, the National Debt increases during economic contractions because the government spends money trying to jump start the economy. Congress did this in 2008 with $800B in fiscal stimulus. With COVID, we have surpassed $2.4T in stimulus in four months with more debt to follow. The projected deficits for 2020 and 2021 are $3.8T and $2.1T, respectively. This makes the COVID-19 response 2.5 times more expensive than that of the Great Recession. In terms of growth of the FED's balance sheet, which increases inflation - we have already doubled the 2008/09 response.



The economy expands and contracts and businesses sometimes fail. That is the free market working. However, COVID-19 is unique. The government has forced businesses to shut down to save lives and flatten the curve. Small businesses and restaurants, that work on very thin margins to start out, have been stretched to their limits. Many will sadly fail. It is the large cap and well capitalized firms – especially those in the tech sector who are emerging the winners to the COVID pandemic.

When businesses fail during a recession that is unfortunate, but that is the free market. When businesses shut down to save lives to protect our most vulnerable – that is extraordinary. We all want things get back to normal, so businesses can re-open and furloughed employees can get back to work. Aggressive monetary and fiscal response helps, but without a coordinated federal response to the pandemic, a situation that could be under control, so far, is not. The false narrative that the pandemic *would melt away with the summer weather was flawed. It was 118 degrees in Phoenix yesterday. Arizona has reported 44K new COVID cases with over 550 deaths in the first 12 days of this month.*

When I travelled recently out west, I was amazed by how little organization there was from state to state not to mention county to county. In Routt County, the home of Steamboat Springs, the county commissioners were requiring everyone to wear masks – everywhere, even walking across the street. However, in Moffat County just to the west, there were NO requirements to wear masks. None. No businesses had been closed and everything was relaxed. In South Dakota, 300+ workers at Smithfield Foods' Sioux Falls facility tested positive for COVID-19, accounting for half of the statewide cases, making the facility a COVID hotbed. Governor Kristi Noem was one of five governors who refused to issue mask requirements or a statewide stay-at-home order stating that it is "the job of individuals, not government, to exercise their right to work, worship, play or stay at home."

Seriously, one cannot make this stuff up…

There has been no coordinated federal approach to the pandemic; consequently, we are in the state we are in today. We want to see everyone back to work and school; however, this needs to be done thoughtfully and safely as we have done in Ohio, thanks to Governor DeWine and Dr. Amy Acton.

The renewed outbreak over the past two weeks will put further pressure on Congress to extend the fiscal stimulus programs that are set to expire at the end of July. One of those are extended unemployment benefits which provide the unemployed $600 a week on top of their state benefits. Funding to help states cope with the cost of the virus is now pending in Congress also. The Senate approved an extension of the small business Paycheck Protection Program last week.

There are no guarantees to the stock market, but if the fiscal incentives continue from Congress and the Fed continues to keep money cheap - more cash on the sidelines today will find its way into this market, and this rally can continue.

Time will tell… Having said that, we are watching all these events for you with great scrutiny. The key to this recovery is whether we see a 3rd quarter recovery and whether Congress continues to spend, which we suspect they will do in this election cycle... We will remain invested in the HIPR tech growth stocks that are flourishing in this crisis and we will amend that list as needed.

Please feel free to reach out to Steven or me at any time. We will be having ZOOM conferences as well as face-to-face reviews this quarter, so please feel free to call to set up a review at any time. On a creative note, we will not be having our annual Christmas Party at Eddie Merlot's as events remain very fluid and there are too many unknowns to contend with today. In the alternative, we will have a virtual Eddie Merlot's and a Honey Baked Ham Christmas Celebration which will be a lot of fun.

Have a terrific week!!