FEG investment advisors

FEG MEMO ON THE U.S. CONGRESS CARES ACT

News of the Senate's unanimous passing of the $2 trillion "Coronavirus Aid, Relief, and Economic Security Act" or "CARES Act", late Wednesday, drove a historic rebound across risk assets for the 3-day period ending Thursday, March 26, as the S&P 500 Index gained 17.6%, the strongest 3-day rally since 1933. On Friday, March 27, the bill passed in the House of Representatives, sending the bill to the White House for the President's signature.

The Congressional passage of the of the CARES Act comes on the heels of the Federal Reserve's (Fed) Monday morning announcement of open-ended asset purchases, along with other policy support mechanisms, which failed to stem the U.S. equity market's decline through Monday. This week, the White House has also expressed a desire to find ways to restart the U.S. economy, even if only in part.

The combined policy response of unlimited amounts of QE, policy and short-term market rates of interest near-zero, and multi-trillion dollars of fiscal accommodation comes with no true historical parallels. Policy makers have hastily set forth in an effort to counteract looming blows to U.S. economic data, which is likely to reflect a sharp slowdown of unprecedented proportions.

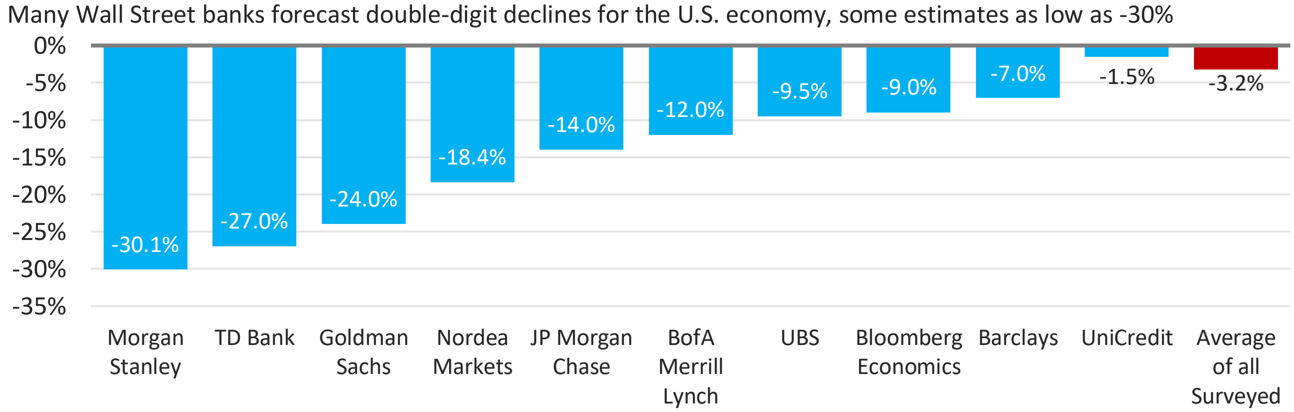
CORONAVIRUS – A SHOCK TO THE SYSTEM

Over the 2-month period of January 21 to March 21, the confirmed number of global cases of novel coronavirus (COVID-19) increased to 250,000. In just the past week alone, this count has more than doubled, to greater than 550,000, with the U.S. case count surpassing both China and Italy this week. The shock to the global economic and financial system, not to mention the devastating impact on the lives of millions of affected families around the world, presents immense challenges to policy makers.

The impact of the halted economy appears immense and the Senate's passage of the CARES Act late Wednesday evening represents the policy action aimed at "filling the gap" in the vast growth decline facing the U.S.

A FORECAST OF DECLINE FOR SECOND QUARTER U.S. GDP

Many Wall Street banks forecast double-digit declines for the U.S. economy, some estimates as low as -30%



Data source: Bloomberg, L.P. Data as of 3/26/2020.

For historical context, the steepest quarterly real GDP decline during the height of the Global Financial Crisis was -8.4% in Fourth Quarter 2008. In the history of the data dating to 1947, the economy has only experienced one single quarter where real GDP growth declined double-digits, falling 10% in 1958.

At an estimated $2 trillion in size, or nearly 10% of nominal GDP, the Senate's Bill includes key pillars such as loans to large and small businesses, expanded unemployment benefits, aid to the overwhelmed healthcare industry, and direct cash payments to most Americans. The payments are to be up to $1,200 per single filer and $2,400 for joint filers—based on certain adjusted gross income limits—in addition to $500 per qualifying child.

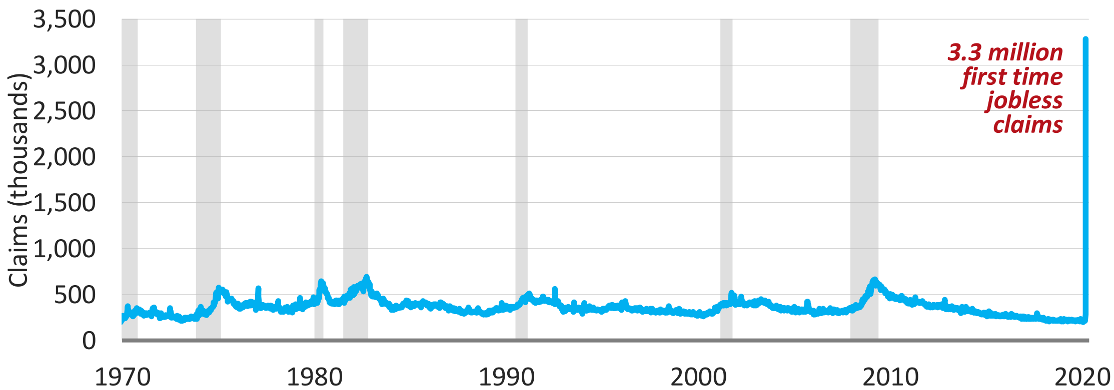
Some highlights, in addition to the direct payments, include:

- Expansion of unemployment benefits for Covid-19 related causes, such as caring for loved one or the closure of a day care facility
- Eliminating required minimum distributions from retirement accounts, so investors are not compelled to "lock-in" losses if funds are not needed
- Allows the U.S. Small Business Administration to extend loans under the paycheck protection program, with special considerations for restaurants and hospitality businesses, and with portions of loans used for payroll to be forgiven if certain terms are met
- Loans and guarantees segments of the economy hardest hit by the outbreak, including passenger airlines, cargo carriers, and the hotel industries
- Support for the healthcare industry, including addressing supply shortages, access to healthcare for Covid-19 patients, and support for the healthcare workforce

The direct cash payments into the pockets of millions of Americans cannot come soon enough for many. The *Department of Labor* reported on Thursday for the week ending March 20, first time filings for unemployment benefits surged to the highest level in modern records, at a staggering 3.283 million persons. The weekly jobless claims print nearly doubled the Bloomberg median consensus estimate that called for a 1.7 million reading.

HIGHEST LEVEL OF UNEMPLOYMENT CLAIMS SINCE THE GREAT DEPRESSION

And nearly five times larger than the peak of the Great Financial Crisis in March 2009 of 665,000



Data sources: DDL, Bloomberg, L.P., NBER. Data as of 3/20/2020.

The sharp reversal in the U.S. labor market, which entered the year with the lowest unemployment rate in 50 years and strengthening payrolls growth momentum, may propel broad unemployment to levels not seen since the Great Depression. On Monday, St. Louis Fed President James Bullard noted the unemployment rate may reach 30% and GDP growth may decline by 50% as a worst-case outcome.[1]

The development of positive stimulus news flipped already-heightened equity volatility to the positive over the course of Tuesday through Thursday of this week. The news resulted in the strongest 3-day gain for the S&P 500 Index (+17.6%) since the 3-day period April 20, 1933 (+19.8%). This strength failed to carry through into Friday's trading, with U.S. equities experiencing another sizable decline through the trading day.

CONCLUSION

The rapid, positive market reaction to news of the stimulus measures and desires to restart the economy likely illustrates what might be expected when greater clarity develops around the global pandemic. Although the actual implementation of the stimulus is yet to come, the incremental removal of the fear of the unknown helps calm investor angst about economic activity and the reliability of future cashflows.

This is not to imply that health concerns will not remain, employment will immediately rebound, and the economy will necessarily experience a "v-shape" recovery. Rather, it speaks to the market's desire to understand the severity of the crisis and how as a nation we will address the impacts, both short-term and long-term.

As investor sentiment improves and the fundamental outlook brightens, we expect further positive market reactions. In the interim, however, recovery from the shock of the economic slowdown, the duration and scope of which remains impossible to forecast with accuracy, will take time, with the pace of recovery likely dictated by the duration of the economic slowdown. Markets, however, have shown that historically, the market bottom occurs prior to clarity of resolving the turmoil and before the end of weakness.

FEG has worked to provide ongoing updates surrounding the impacts of the COVID-19 pandemic. You can find those materials at https://www.feg.com/news/coronavirus-updates.

More importantly, we are focused on ensuring our clients' needs are met and as opportunities develop in these trying times, that we help our clients benefit from opportunities most suited to each client's unique needs.

FOOTNOTES:

[1]https://www.stlouisfed.org/on-the-economy/2020/march/bullard-expected-us-macroeconomic-performance-pandemic-adjustment-period