Federated Hermes

You can′t quarantine me!

A lot of unknowns but in the end, Linda expects consumers will save the day.

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Can you? .... I was in the office all week after a trip cancellation (unrelated to the virus!). All well and good, but if the company forbids all "unnecessary travel" and it affects my plans for the foreseeable future, I will be crushed! Conference calls and local Pittsburgh meetings this week finds the virus at the top of concerns, followed by fears of zero interest rates in the U.S. I was up with the sun today to be on "Mornings with Maria." I said I thought we will get a V-shaped recovery but from much lower levels as the market really hasn't reacted to the virus proliferating here. From a technical perspective, up moves haven't been accompanied by confirming breadth. If last Friday's low fails to hold, the S&P 500 at 2,700 (20% off the Feb. 19 record high) will be the next important support level to watch. The retail investor isn't scared enough—AAII bears were tracking at 39.6% this week, still below recent years' moves into the mid-40s that were common before bearishness topped out. More and more travel and events are being canceled and inventories are running off, further threatening global supply chains already suffering from

China's actions. Why do you suppose China shut down, Milan shut down and schools continue to be closed when 81% of virus cases are mild, even compared to winter's Type A flu? Could it be that there is no evidence the virus will die out in the warmer weather? Analysts and managements have yet to slash earnings-per-share (EPS) estimates; our Wall Street resources are all over the board trying to guess what will happen to EPS growth this year. (The market hates uncertainty.) Personally, I figure we'll lose a year of earnings growth. (It's always about earnings.)

All last year my biggest fundamental concern was a recession in China irrespective of tariffs. Isn't that what we have in 2020? While a number of high-frequency indicators such as traffic congestion and emissions suggest China is getting back to work, it's not "back to growth," says Leland Miller of the China Beige Book. February data gleaned from the monthly survey reportedly was the worst he's ever seen. Evercore ISI separates virus worries into two camps. The optimists expect China supply to come back on line fairly quickly, with stimulus making its data unusually strong by late spring. With the central banks aggressively easing all over (*more below*) and mortality rates relatively low, investor sentiment should improve, particularly if Covid-19 is just a bad flu that gives governments an excuse to spend more. (Stocks love stimulus.) The pessimists think hospitals will be overrun, supply chains will be impaired and U.S. economic activity will decelerate sharply as thousands get the virus, schools close, sporting events are canceled and travel restrictions intensify, similar to what is happening in Italy. Under that scenario, Fed easing will prove ineffective, a prolonged recession with 10-year Treasury yields approaching 0% (Whoa! What am I and my fellow baby boomers supposed to do for conservative income?) may occur and markets would have a lot more downside. With sentiment, not macro variables, driving volatility and quants enhancing the move, expect continued volatility as the debate over these two scenarios intensifies.

In the end, the behavior of the U.S. consumer may determine the outcome. Key data to watch will be mortgage/home sales/starts activity and jobless claims/job growth. Are lower mortgage rates helping (they did this week, *more below*)? Are consumers losing jobs or is the labor market still healthy (data this week favored the latter, *more below*)? Housing and employment are, in this consumer-led economy, much more important than manufacturing PMIs, which we know will be ugly (*more below*). While spending on discretionary items such as traveling, hotels, restaurants and cultural events are likely to fall, two key factors suggest spending won't collapse. First, financing conditions are easy, tax refunds are in full season, inflation is low and household balance sheets are strong (debt-to-income is at an *18-year low* and the broader financial obligations ratio measuring debt burden to disposal income is near *a record low*). Second, consumers rarely react much to negative sentiment shocks. Investors are stuck in a blind spot until the evolution of the virus and its impact on the economy plays out. Until there is a peak in the daily new infection rate outside of China, more downside is likely. Maria asked me how the "now-punished saver" should invest. With ballast: gold, U.S. municipal bonds, high-quality dividend stocks. I'm an optimist, and there are some very important positives to remember as the market finds its low. The second-largest economy in the world, and the epicenter of the virus, is getting back to business. And here in the U.S., consumer and corporate balance sheets have rarely been so flush with cash. I have my money on Main Street, and the American consumer! And now, if you'll excuse me, I'm off to the mall.

POSITIVES

- **Jobs strong—old news?** Employment is holding up so far, with February nonfarm payroll growth came in well above expectations, pushing the 3-month average growth to its highest level since September 2016! ADP business payrolls surprised, too, while Challenger's monthly hiring and layoff tallies showed job cuts fell and hiring plans rose. Weekly jobless claims, a key current indicator, edged down this week.

- **Housing is a key indicator of consumer strength** The Mortgage Bankers Association weekly survey showed refinancing applications spiked to a 7-year cycle high. With mortgage rates set to fall to all-time lows, half of the home builders in Evercore ISI's proprietary sales survey and two-thirds of real estate firms described the current season as "very strong" or "strong." Furthermore, Quicken Loans, the nation′s largest mortgage lender, said Monday was the busiest day for mortgage applications in its 35-year history.
- **Services aren't sick—yet** The ISM gauge of non-manufacturing activity accelerated to a 1-year high last month on increasing orders and employment. Markit's separate survey was bleaker, and the Fed's Beige Book conveyed concerns from firms about the virus, though the actual effects were limited: outside of discussion of supply chain delays and declines in travel and tourism, activity was a touch firmer overall than the January report.

NEGATIVES

- **The Fed's 'surprise' cut was not well received** Perhaps this is because markets are looking for a concerted effort by central banks around the world. Cornerstone Macro says historically, inter-meeting half-point cuts by the Fed happened only at times when the economy was headed into recession.
- **Manufacturing's budding recovery is old news** The virus stopped it in its tracks, with the Markit Global Manufacturing PMI falling to almost an 11-year low in February. China drove the contraction, which is spreading to other countries. The eurozone PMI was in contraction for the 13th consecutive month (shouldn't it get worse before it gets

better?) In the U.S., ISM and Markit surveys here softened but remained, barely, in expansion territory.

- **Second-half earnings estimates will be key** Yardeni joined Goldman Sachs in dropping its S&P earnings growth forecast to zero for the year as it expects warnings to surge in the next few weeks to levels not seen since the global financial crisis. Cornerstone Macro posits this week's collapse in long yields was driven by deteriorating global growth concerns, not lower term premium and inflation expectations that pushed down yields in prior weeks.

WHAT ELSE

I should check out Venmo China destroyed banknotes that have been circulating in high-risk areas for the Covid-19 virus on concerns the human flu virus has been found alive and infectious for up to 17 days on banknotes. Deutsche Bank thinks recognition of this infection risk is almost certain to accelerate the push toward digital payment systems worldwide.

You've just got to watch the next debate! The biggest risk to the ascendant Biden candidacy may be Biden himself and the March 15 debate. Until Bloomberg entered the debate stage, Biden's debates hurt his standing with voters. Bernie has issues, too. The map of future primary contests becomes a lot less favorable for him moving forward, and he no longer will enjoy his significant cash advantage as moderate donors will make sure Biden has at least as many resources, if not more. Popcorn!

What am I and my fellow baby boomers supposed to do for conservative income? High quality dividend stocks are looking ever more enticing compared with a 10-year yield at 73 basis points and falling. 70% of stocks have a dividend yield greater than the 10-year. Income-seeking investors have not had more incentive to turn to the stock market since 1972.

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Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

The American Association of Individual Investors (AAII) Bulls Minus Bears Index is a measure of market sentiment derived from a survey asking individual investors to rank themselves as bullish or bearish.

The Eurozone Purchasing Manufacturers Index (PMI) of manufacturing is a monthly gauge of the level of manufacturing activity in the euro zone.

The Global PMI is compiled by Markit Economics and is derived from surveys covering more than 11,000 purchasing executives in 26 countries.

The Institute of Supply Management (ISM) nonmanufacturing index is a composite, forward-looking index derived from a monthly survey of U.S. businesses.

The Markit PMI is a gauge of manufacturing activity in a country.

The Markit Services PMI is a gauge of service-sector activity in a country.

The prices of gold and other precious metals may be subject to substantial price fluctuations over short periods of time and may be adversely affected by unpredictable international monetary and political developments.

There are no guarantees that dividend-paying stocks will continue to pay dividends.

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