TRANSCRIPT: Perspectives on Economic Reopening: A Conversation with Jason Jackman, CFA, President and Chief Investment Officer, and Brandon Zureick, CFA, Director and Portfolio Manager

Wednesday, June 10, 2020

Jason Jackman: Hello and thank you for joining us today. As states begin to open up across the nation, we wanted to get in front of you and provide our thoughts and perspectives on what this means and maybe what it doesn't mean for the economy in the markets. My name is Jason Jackman. I'm President and Chief Investment Officer of Johnson Investment Counsel and I'm joined today by Brandon Zureick, Director in our Asset Management division and Portfolio Manager critical to our bond strategy and overall economic outlook

Brandon, it's certainly been a challenging time for the nation with civil unrest and demonstrations across the country for racial justice. At the same time, we had COVID-19 deaths, surpassing 100,000 mark in the country and really even just the fits and starts of economic reopening as states are on different timelines and rules. It certainly doesn't feel like an optimistic time in the country. But if you look at the stock market, you wouldn't know it at all. The stock market has come roaring back from its March 23rd lows and now is basically break-even for the year and within five percent of its all-time high on February 19th. This market rally has been driven by significant Federal Reserve and government stimulus and plateauing data on new COVID-19 cases, hospitalizations, and deaths. But more and more lately, it's been driven by optimism about economic reopening and what might that might mean for the market. But even though the market's up, the economic toll of coronavirus has been very real.

The policy response that mandated shutting down large swaths of the economy and even the voluntary response from consumers as they work to stay safe and secure have significantly pressured meaningful segments of the economy. Think about restaurants, airlines, travel and leisure, hotels, retailers, the energy segment and the list goes on and on. We've seen many bankruptcies already. Companies like J.C. Penney's and Hertz, and we're likely to see many more, both large and small businesses. All of this is setting up for some of the worst economic data we've seen really since World War Two or even the Great Depression, yet with incremental signs of improvement like Friday's surprising labor market report. Brandon, can you walk us through this economic data, what impact reopening is likely to have on the economy and how all this is shaping our outlook for the year?

Brandon Zureick: Sure. Thanks, Jason. Widespread economic shutdowns and national orders to stay at home have caused the collapse in economic activity like we've really never seen before. In fact, since late March, over 40 million Americans have filed for unemployment insurance, which led to the single largest monthly increase in the unemployment rate in history. And despite the surprisingly strong jobs report in May, the unemployment rate still stands north of 13 percent, which is a full three percent higher than the peak in the financial crisis.

So as consumers stayed at home and many of them were left without reliable employment or income, it's no surprise that consumer spending plummeted. As a result, estimates for second quarter GDP at this point are looking pretty dire. In fact, according to Bloomberg, the media and economists now expect second quarter GDP to contract by roughly 36 percent. If that forecast proves accurate, that would be the single largest quarterly decline in economic activity in history, including periods like the financial crisis and even the Great Depression.

So I think it's a fair question to ask, what then is the stock market so optimistic about? Well, it's important to understand that economic data is often released with a one or even two month lag. So the data that we're getting today is painting a picture of economic activity throughout April and May. And I think it's probably safe to say that investors at this point are fairly well aware of the virus related fallout over the course of the past few months.

So in many ways, the economic data we're getting today are really yesterday's news. Instead, investors are turning their attention to the gradual reopening of many parts of the economy and are fairly optimistic that economic activity may quickly rebound. But here's where you really need to be careful, because the economic data was so bad throughout the spring that even a modest improvement over the coming months might appear like a very large bounce in percentage terms. But it's probably a more realistic way to gauge the economic recovery by comparing what's happening today versus the same period one year ago. That helps to smooth out some of the month to month noise and volatility.

But even after accounting for economic reopening, it's likely that we end the year roughly 10 percent below the levels of economic activity that we reached at the end of 2019. And there are a couple of distinct reasons why it could take up to two years for us to fully recover that pre-virus level of economic output. So first of all, there are still significant preventative measures in place to slow the spread of Corona virus. Think of the many employees that are still working from home. Large gatherings like conferences and concerts and sporting events that have been postponed or canceled. And even many families choosing to do things like delay those summer vacation plans.

Second, it's simply tough to see such a severe economic disruption without more longer lasting impacts. For examples, companies that were struggling under heavy debt loads before this year may be unable to continue servicing that debt going forward, which could really turn into a more traditional economic recession where we start to see bankruptcies and defaults begin to rise. So at the end of the day, there's really plenty to be thankful for and optimistic about as our country gradually starts to reopen. But we're still tempering our expectation that the economy fully recovers to pre-virus levels really anytime soon.

Jason Jackman: Thank you, Brandon. The markets are definitely responding to some of this incremental improvement from economic reopening. On top of positive trends we're seeing in the coronavirus and the tremendous stimulus the government's provided. But as we look at the market today, it’s priced for near perfection. If everything goes really, really well on the health front and the economic front, these levels may sustain. But if we have a second wave of infection either caused by reopening or more traditional flu season later this year, or if it just takes longer than expected to progress towards a normal economy, get back to those pre-virus levels you talked about, we're likely to experience further volatility. But rest assured, your wealth management plan and the portfolio structure we put in place for you incorporates difficult and volatile market and economic environments like the one we're experiencing today. As we assess the totality of this landscape and everything we talked about today. Our investment position is to be invested, yet conservatively postured.

I hope this overview of economic reopening was helpful for you today. If you have any questions about this topic, the economy, the markets or your specific investment portfolio, please reach out to your Portfolio Manager.

Thank you, and have a good day.

Disclaimer:
Johnson Investment Counsel cannot promise future results. Any performance expectations presented here should not be taken as any guarantee or other assurance as to future results. Our opinions are a reflection of our best judgment at the time this interview occurred, and we disclaim any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise.