Ameriprise Audiocast
Midyear insights: What may be next for the markets and economy?

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Speakers:
Marcy Keckler
David Joy
Russell Price

Marcy Keckler:
Hello and welcome. I'm Macy Keckler, vice president of Financial Advice Strategy at Ameriprise Financial. Our conversation today is one in a series of audiocasts and you can hear more at Ameriprise.com/marketvolatility.

As we approach the end of June, midyear is a good time for us to take a look back as well as a look ahead at the markets and at the economy, and so joining me today to discuss a midyear assessment of the landscape are two of my colleagues. First is David Joy, who's the chief market strategist. Welcome, David.

David Joy:
Hello, Marcy. Nice to be here.

Marcy Keckler:
And also Russell Price, who's our Chief Economist. Welcome, Russell.

Russell Price:
Hi and thank you, Marcy.

Marcy Keckler:
So Russ, let's start with you. How would you summarize the major economic developments that we've seen so far in 2020?

Russell Price:
Well certainly, Marcy, this has been an unprecedented situation for the economy in the modern era. We've always had pandemics to contend with but we've never really had to intentionally shut down activity as a means to confront and contain an outbreak. The most notable impact as a result of the shutdown has been the number of jobs lost. From both a personal and a national perspective, employment is certainly key to healthy economic conditions. So we've had probably more than 25 million Americans lose their jobs as a result of this situation, we started to see employment recover, but we still have a long way to go. This may be the shortest recession in history, but we've also entered this downturn with relatively solid economic fundamentals, which should help support the recovery on the other side.

Marcy Keckler:

I mean, it's interesting, Russ, it probably is an unprecedented time to be an economist and, and, you know, I'm sure although you've already had a long career that in future years, when you look back, this will probably be a, a period that you'll always remember.

Russell Price:
For better or for worse, that's correct.

Marcy Keckler:
That's right. So David, let's turn to you and talk a little bit more about markets. We have seen choppy markets, at least earlier this year, and as we all experienced, market volatility. What are some of the big observations you would share as you look back in the rearview mirror on 2020 so far?

David Joy:
Well, Russ used the word unprecedented. I'm going to echo that. In, in my mind, the most notable aspect of the first half of the year was the unprecedented speed with which markets reacted to the changing conditions that Russ just outlined. You might recall, although it seems like a long time ago, the markets began the year in a relatively strong uptrend, but then in the middle of February in response to the economic lockdown, they reversed direction dramatically. And we fell into a bear market or a 20% decline at an unprecedented rate of speed. It only took us 16 trading days; that had never happened before. But then we reversed course all over again in response to the stimulus efforts by the government and we began a new uptrend and in fact, began a new bull market in a matter of just a handful of days, 13 to be exact. Again, that had never happened, an unprecedented rate of speed. So that's the big takeaway in my mind. But the point I think that's worth noting is that the patient investor who stayed focused on the longer term has by and large been rewarded for staying the course. As markets have rebounded and have recaptured more than 90% of what they lost from the peak to trough during the bear market downdraft.

Marcy Keckler:
That's a great reminder, David, that in this relatively compressed timeframe, we have seen in really vivid detail the importance of sticking with a long-term focused asset allocation strategy that is aligned to your goals, aligned to your risk tolerance, and being able to really ride out the storm can allow you to participate in the recovery when it comes, and as you said, it came rather quickly. And so maybe let's talk about why that happened. We know that both the Federal Reserve and the Federal Government played big roles in stabilizing financial conditions in the first part of the year, a number of actions taken both by the Fed in terms of ensuring liquidity in financial markets but also by the federal government to provide some relief payments and other provisions. And so interesting in hearing from both of you, Russ and David, on your main takeaways about that federal activity that we saw. And Russ, we'd love to start with you.

Russell Price:
Sure, Marcy. You know, David mentioned the speed in which the markets suffered their downturn and just how rapidly digested all that information, but certainly, the speed of

both the Federal Reserve's policy response and the support programs offered by the federal government. The speed and magnitude of those adjustments have been really remarkable through this period as well. The stock market hit its peak on February 19th and the, the federal government, Congress passed the CARES Act before the end of March. So far, the federal government has provided close to $3 trillion in policy support and that equates to approximately 15% of US economic activity on an annual basis. So the Federal Reserve's primary function has been making sure the financial system continues to function properly and certainly, the banking system was in healthy condition before we moved into this period, but systems have been working well and with the Fed support, they've also lowered interest rates, which should continue to support economic activity as the recovery starts to take hold. Now, of course, the downside, particularly with the federal government's programs has been the significant increase in government debt. As we all know, the federal government had high debt levels coming into this situation and protections were that the debt was going to grow in the years ahead. Now with the incremental spending, that 3 trillion that I mentioned, certainly makes that dissolving that debt situation much more challenging, but we do think that the current level of debt relative to the size of our underlying economy is currently manageable for the federal government. And that is clearly reflected at least in our view with the help of the Federal Reserve and today's very low interest rates. So we do think that the policy response has been very strong but also the, the appropriate response throughout this period.

Marcy Keckler:
Great. Thank you, Russell. David, any highlights you would mention around activities that both the Fed and the federal government took in the earlier party of the year?

David Joy:
Well, one of the things I think is extremely important and unnerved investors during this period was the fact that market volatility had risen to unprecedentedly high levels and the actions of both the fiscal and monetary authorities was able to bring that down. It remains somewhat elevated compared to its longer-term history but it is down significantly from where it was, so that's one point. The second is, and Russ has alluded to this already, the Federal Reserve has lowered interest rates. The overnight rate, the Fed Funds Rate, is now in a range between 0% and one quarter of 1% and they've also indicated recently that they are likely to leave that, the rate at that level through the year 2022. So that goes a long way towards stabilizing the economy, sending a signal that interest rates will be stable over that period of time, makes mortgages more attractive for those looking to buy a home, it makes auto loans more attractive, and it makes stocks more attractive in the long run, and especially so compared to bond yields, which have come down in this environment as well. So very supportive action by both the fiscal and monetary authorities and likely to remain so for the foreseeable future.

Marcy Keckler:
Great. Thank you, David. So with that as a helpful look sort of in the rearview mirror, let's turn to the windshield and talk about what we think is coming in the future. Would

love to start with you, David, on the indicators that you think investors really should be watching in, say, the next three to six months.

David Joy:
Well, one of the important ones is obviously going to be related to the path of the coronavirus. We've seen at the present time flare-ups in a number of states. Those bear watching and its in fact on the local economies where that's occurring bears watching as well. But I think it's important to note in that regard that we don't expect by any means that the entire economy will need to be locked down as it was earlier in the spring. It's more of a regional impact we think at this point in time but that certainly bears watching.

It also bears watching some of the flareups that we're seeing overseas in places like China and in Europe, the global economy is important to our own, so that bears watching as well.

And of course, important in both of these is what's the, you know, response of the, of the citizenry. Are they practicing social distancing? Is there discipline there? Or is that starting to recede. We're seeing some evidence of the latter more recently.

The other thing that's important to watch is developments in regard to the development of treatments and vaccines. We have nothing yet, it's very early days, but important to note that according to the World Health Organization, there are over 100 development projects underway to develop a vaccine, some 10 of them are already in human clinical trials, so there is some optimism that perhaps towards the end of the year, if all goes well, or if not, hopefully in the first half of next year, there will be a safe and effective vaccine. So those are just a couple of things to monitor on the healthcare front.

As far as markets are concerned, one of the big impacts in the first half of the year was a significant decline in earnings among corporations. We saw roughly a 15% decline in the first quarter of this year compared to the first quarter of last and although the second quarter is not yet complete, it looks as though earnings compared to the second quarter of last year will have declined in excess of 40%. So over the second half of the year, as the economy begins to reawaken, we would like to see a moderation in that rate of decline in earnings on its way towards the resumption of actual earnings growth at the beginning of 2021.

Marcy Keckler:
Thank you, David. And, and one quick follow-up question for you, one of the things that we've certainly talked about in prior conversations is that to some degree, the markets already expect those decreases in corporate earnings relative to, you know, second quarter of a year ago, and so interested if you have any quick thoughts on how we might expect market activity or market response to look as we enter the next sort of corporate earnings announcement season.

David Joy:

Yes. Well, of course, you're absolutely right, Marcy, markets are a discounting mechanism, and by that, I mean that they tend to look forward, not backward, and absorb what the anticipated conditions are likely to be, anywhere, let's say, from 6 to 12 months into the future, and given the recent strength in stocks that we've enjoyed over the last month or so, that's telling you that the market is saying we expect conditions to be better, we expect the brunt of the impact of the virus on the economy to be somewhat transitory, and that earnings growth will in fact resume. And so that's allowing investors to a certain extent to look past the decline in earnings that we'll see in 2020.

Marcy Keckler:
Great. Thank you, David. And so Russ, what's your perspective given the Fed's role so far this year? What do you envision from them in the second half and what might that mean for the economy overall?

Russell Price:
Sure, Marcy. You know, I think we all hope that the virus does not come back in the second half of the year but health officials indicate that that's very likely and it certainly it's best to prepare for, for that situation. But the Federal Reserve has certainly mentioned that regardless of where the virus come back, but until the economy is able to more fully recover, that they will remain very supportive of economic conditions. So that support is very important and here the early stages of the recovery, which speak to how strong we might expect the recovery to be in the second half of the year. Interest-rate-sensitive sectors such as auto purchases and, and housing market have both been recovering quite well based on initial indications, so that's been encouraging.

And also, consumer activity has been recovering stronger than expected as well. In the month of May, total retail sales jumped double the rate that forecasters such as myself were expecting, and a good part of that is because of the added cash that the federal government has provided to both people that are out of work because of this situation but also people that just sending, sending money to people in support of their financial situations throughout this period.

So will another round of federal government stimulus or fiscal policy be required in the second half of the year? Well, that remains to be seen just how the voracity of the outbreak, should we have one, in the second half of the year will be and the impact on the economy, but we do believe that the federal government also has indicated that additional policy actions could be forthcoming, coming, if we find ourselves in that situation. And considering that both policies from the Fed and federal government have generally shown very good results thus far here in the early stages in the first half of the recovery, we're hopeful that the same would be the case in the second half as well.

Marcy Keckler:
Thank you, Russ. David, what are your thoughts on what you see ahead, you know, with the Fed and the possibility of further whether we want to call it relief or stimulus actions from the federal government, what do you see that might be on the horizon to expand on what Russell just shared?

David Joy:
Yeah. The first thing I would say is it seems to be a general willingness in Washington to consider another round of stimulus. The two parties seem to be fairly wide apart in terms of potential size of such a possible piece of legislation. They're also fairly wide apart in terms of what programs would be supported by that, but I, I would say the bottom line is that there is at least I think the groundwork to suggest that a, a second round of stimulus is, you know, a real likelihood. But that remains to be seen and I don't think that they'll be in any hurry to do it. There seems to be willingness to wait and see how the economy performs during the summer months, so that's the first thing.

Second thing is I, I would like to reiterate the fact that interest rates are at rock bottom and likely to stay that way and the Fed has shown itself very willing to continue to support the smooth functioning of capital markets. That's certainly likely to stay in place as well.

So, you know, one other thing I think that's important to mention in addition the Fed's, you know, support works hand in glove with the fiscal support that the market has enjoyed and just recently, the Federal Reserve Chairman Powell in testimony to Congress made the point that he encourages the fiscal authorities to pass an additional stimulus package, that the marketplace has responded well to the first round of support, the economy seems to be reawakening with the better data points that Russ has alluded to, and that stimulus would be quite timely at this point to allow the economy to really gain the traction and the sustainability that it needs in order to reaccelerate into a sustainable expansion. So those will be some important benchmarks to monitor throughout the summer.

Marcy Keckler:
Thank you, David. It's a great reminder that the Federal Reserve, which is managing monetary policy for us, and the federal government, which manages fiscal policy for us, are independent but certainly keeping an eye on each other, and that the indicators that both kind of both processes look at are going to become an indicator, so I appreciate your helping us think through how those things relate to each other.

I do have one final question for you, David, and that is about a sort of a third thing I say, I'd say we're seeing in the news. We are certainly seeing lots of information about the global pandemic and developments in treatment and potential vaccine, which we've talked about, we're seeing lots of important information about economic and market conditions that we've talked about, but the big third theme that we see today is news about politics and the upcoming presidential election. And so interested, David, in what you think investors should consider as we look toward our presidential election in the fall and, and really what that means from an investment standpoint.

David Joy:
Well, I guess the first thing I would mention is that each election year is a little bit different. Markets and the economy are focused on, you know, economic fundamentals

and that's the primary determinant of their ultimate direction, even in an election year, but as we get closer and day by day, we edge a little bit closer to the ultimate election, investors increasingly begin to pay attention to what the election landscape looks like. The market is a discounting mechanism and as we get closer to the nominating conventions in August, investors will really begin to pay attention, and you'll see that, perhaps, reflected in market activity.

As a general statement, markets don't like uncertainty and as a result, it might come as no surprise that when an incumbent is ahead in the polls at around Labor Day, that's generally something that the market takes comfort in because it doesn't like the uncertainty of a possible change in the policy outlook. But that's a generalized statement. I think overall, at least from today's vantage point, it's a little too early to be truly focused on it. Markets will remain focused on the fundamentals I think in the near term, but as I said, as we get closer to those conventions, the upcoming election will be increasingly on the radar screen of investors, and we can take a second look at it at that point.

Marcy Keckler:
Great. Thank you, David. Appreciate those thoughts on what the upcoming election means, and, and thank you to both Russell and David. I appreciate both of you sharing your thoughts as we look in the rearview mirror at what we experienced in the first half of the year and then as what we anticipate in the coming part of the year. We certainly know it has been a challenging year and we do have the potential for challenges ahead. But we also heard that there's good reason to see economic improvement that's beginning now and on the horizon, and so your advisor is here to help you make sense of the situation and, and what you ought to do about it. Your long-term plans, staying focused on your goals, having an appropriate investment strategy that has an asset allocation with the exposure to the right asset classes for you and takes into account your risk tolerance and timeframe, that's also important to help you address the future with confidence, so your advisor is here to help and thank you for joining us for our conversation today.

Finally, before we leave, I'd like to share some important disclosure information.

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