The Meridian Memo

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BIG DISCONNECT: Economy & Markets

Dear Meridian Clients:

Because of the unprecedented nature of current events and how they relate to the economy, the markets and your finances, I wanted to address them. When I take a step back from what is happening in the economy and look at the major U.S. market averages, I see an incredible disconnect. And I'm not alone.

> ***"These metrics don't correlate perfectly with the economy or the large S&P 500 firms…which means there is a lot of risk in the market [at current valuations]."***

U.S. Gross Domestic Product (GDP), which is the broadest measure of the value of goods and services in the economy, fell at an annual rate of 32.9% in Q2 2020, the largest decline on record (U.S. BEA data – quarterly data began in 1947). The prior record, a 10.0% annualized decline, occurred in 1958 and coincided with the Asian flu pandemic.

The contraction can be blamed on the unusually swift decline in the economy that began in March and quickly accelerated in April.

It doesn't take an economist piecing together a complex puzzle to discover the culprit. Simply look at the lockdowns designed to slow the spread of Covid-19. They stifled economic activity and threw tens of millions of people out of work.

In April alone, employment fell by a record 20.8 million (St. Louis Federal Reserve). For perspective, 152 million individuals were employed in February.

However, May and June saw a significant improvement from these very depressed levels. The economy generated a record number of jobs in May and June, erasing one-third of March and April's job losses (U.S. BLS data).

We also saw big gains in retail sales following a record decline in April (U.S. Census),

Meridian embarked on a new venture in May of 2020 where it is partnering with First Source Team to provide career coaching for mid to upper level executives in career transition, helping them find and land that next job. Meridian also helps these executives look at the big picture and create a "Business Plan for Life" thinking about the broader economic impact, doing an analysis of 4 areas that all interrelate, which include:

as businesses began to reopen, furloughed employees returned to work, and stimulus money ($1,200 checks and generous jobless benefits) found its way into the economy.

Still, the economy remains far below its pre-coronavirus state, as evidenced by the steep decline in Q2 GDP.

In February, the unemployment rate was at a 50-year low of 3.5%. In June, the jobless rate stood at 11.1% (below April's 14.7% peak).

Yet the major market averages tell a different story. As July came to a close, the broad-based S&P 500 Index turned positive for the year, while the tech-heavy NASDAQ is having an impressive year.

The Federal Reserve's massive response to the crisis, coupled with a strong response by the federal government, has also encouraged buying. In addition, investors may be looking beyond a dismal Q2, both in terms of GDP and profits, and attempting to price in more favorable conditions later in the year and into 2021.

Very Limited Visibility

I don't want to dismiss May and June's upturn in the economy. It has been encouraging to see economic activity bounce higher and millions return to work. Still, the outlook remains unusually uncertain.

As states around the country began to reopen, the number of Covid-19 cases has spiked, injecting a new round of uncertainty into the outlook. In order to contain the virus, some states have slowed reopenings and others have implemented new restrictions.

If we look at what is called "high-frequency data," economic progress slowed or stalled in July.

These metrics don't correlate perfectly with the economy or the larger S&P 500 firms, but they approximate what is happening in the broader economy.

Layoffs remain at historically high levels as measured by weekly jobless claims (Dept. of Labor). Yes, a record number of people are going back to work, but layoffs remain high.

The Prescription

The spread of Covid-19 is hampering the recovery and creating a new round of uncertainty. Might this be temporary? Might new cases begin to slow in August and September? Could we see a second wave in the fall and winter? There are no clear answers.

Today, the path of the economy is linked to the virus. There has been encouraging news regarding a vaccine. Goldman Sachs expects the FDA will approve at least one vaccine this year and large shares of the US and European populations will be vaccinated by the end of 2021Q2 & 2013Q3, respectively.

As Fed Chairman Jerome Powell said in in late July, "The path forward for the economy is extraordinarily uncertain and will depend in large part on our success in keeping the virus in check."

Social distancing, masks, and all CDC-recommended safety protocols are a step in the right direction.

The economy may not be the same when the pandemic is eventually in the rearview mirror, but we are a resilient people, we will persevere, and we will adapt. In the meantime, be prepared for a bumpy ride.

Helpful Tips

- ✓ Manage Horizons, allocating to both an income portfolio and a protective growth portfolio (where some volatility is acceptable).
- ✓ Investment Positioning: consider alternative investments, structured investments, or long term gov't bonds that provide actual (not perceived) diversification.
- ✓ Stamina matters: emotional discipline is *still* paramount.
- ✓ Cash Flow Centric: Make sure your plan is based in cash flow as opposed to being a "product centric" plan.