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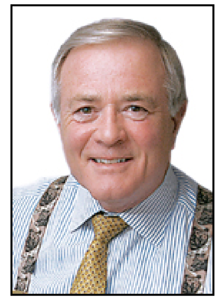

William Rutherford

OP-ED: Stock market bounces back; economy still fragile

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Financial results for the first quarter of 2020 have been reported by most members of the S&P 500, showing corporate earnings down 11.2 percent year on year, even though revenues were up 1.9 percent. Due to the COVID-19 virus, S&P earnings for the full year 2020 are expected to be down 23 percent or more. Growth is expected to resume next year, largely because of the easy comparisons with this year.

In the meantime, unemployment remains very high and rising. The Labor Department's monthly employment report for April shows the jobless rate soared to 14.7 percent – the highest level since the Great Depression. The U.S. has lost 20.5 million jobs amid the coronavirus pandemic. Almost all the job growth achieved during the 11-year recovery from the Great Recession has now been lost in one month.

On June 5 (after this column was written), the Labor Department was to have released May's employment report, and expectations were for 9 million additional people to have lost their jobs. This would increase the unemployment rate to slightly more than 20 percent. The Labor Department says the real unemployment rate is likely higher, because about 7.5 million workers should have been classified as "unemployed on temporary layoff," instead of employed but not at work.

The stock market has gone up even as the economy has weakened and riots in many cities have destroyed businesses already teetering from the impacts of virus-related shutdowns. The market seems to have disconnected from the economy and the social unrest, largely because the White House and Federal Reserve continue to provide monetary stimulation.

European economies burdened with troubled industries, like car manufacturing, energy and finance, have lagged this year. There is even renewed anxiety over the survival of the Euro currency, but Germany's central bank appears to be stepping up to backstop and prevent this.

Technology has generally taken the market lead, with a small group of tech darlings – primarily Alphabet (Google), Amazon, Apple, Facebook and Microsoft – now comprising a fifth of the S&P index. With interest rates extremely low, cash and fixed income do not seem attractive. Throw in the specter of inflation, resulting from the Fed "printing money," and a weaker dollar, and investors will flock to equities.

There is the risk of surprises. Warren Buffett has famously said, "You don't know who is swimming naked until the tide goes out." Companies like Enron and Lehman Brothers came to disastrous ends in times of financial stress. The one-month bear market may be just the first indicator of a similar shakeout. Recent bankruptcy filings for well-known companies without sufficient balance sheet strength to withstand the virus shutdown include J.C. Penney, Neiman Marcus, J. Crew, Hertz and Gold's Gym. Many other companies have recently announced cuts to dividends in order to conserve cash.

The course of the virus is still uncertain, so there is plenty to worry about.

On the other hand, the current White House occupants are determined to get reelected and have directed the infusion by Congress of trillions of dollars into the economy in order to accomplish this. The Federal Reserve has also supported the economy with vigor. There is almost no end to what these giant monetary forces can do for the economy (and the stock market).

And yet the White House also seems determined to revive its trade war with China, adding retribution for the virus to the mix. Not only does the president refer to the coronavirus as the Chinese Virus, he threatens to not redeem $1.2 trillion in Treasury bonds that the Chinese own. Even the threat of such an action could destabilize the world financial system, which is built on trust in the orderly functioning of debt, equity and currency markets.

There are plenty of risks, and there will be a huge bill to pay. Each asset class has its own set of risks. Equities seem to remain the best place to hide out.

Queen Elizabeth's remarks in her recent VE Day speech about the war in Europe seem applicable to our current war against COVID-19 and social unrest. "At the start, the outlook seemed bleak, the end distant, the outcome uncertain," she said. "But we kept faith."

This drama has more acts.

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