Yardeni Research

MORNING BRIEFING
March 18, 2020

Helicopter Money May Help To Unlock the Economic Lockdown

Check out the accompanying chart collection.

(1) Trump's pivot from relaxing to social distancing. (2) The invisible enemy is very contagious. (3) Flattening the infection curve. (4) False and true rumors. (5) Official and voluntary lockdowns. (6) Fiscal and monetary math: TARP2 + QE4 = helicopter money! (7) So is 2020 the same as 1987-88, 2008-09, or 2015-16? (8) Witch's brew: health, economic, and financial crisis. (9) Pandemic earnings and valuations.

Virology: Keep Your Distance. How bad is the COVID-19 pandemic? It's so bad that even President Donald Trump finally said so. As recently as Sunday, Trump was telling Americans to "relax," the pandemic would pass. On Monday, he pivoted from cheerleader-in-chief to commander-in-chief. In effect, he conceded that we are at war with the virus that causes the disease: "We have an invisible enemy." He acknowledged that the virus is extremely contagious, saying "This is a bad one. This is a very bad one." At a news conference on Monday, Trump released guidelines that called for people to avoid gathering in groups of more than 10 people; refrain from eating and drinking at bars, restaurants, and food courts; and work or attend school from home whenever possible.

Apparently, Dr Anthony Fauci, director of the National Institute of Allergy and Infectious Diseases, has finally managed to convince the President that his job is to do everything in his power to flatten the curve of infections, thus reducing the strain on the health care system and reducing the numbers of cases and deaths. Administration officials pointed to new predictive modeling showing a need for more aggressive and universal social distancing measures.

Consider the following related developments:

(1) *New York City infection rumor.* A March 16 Vox article titled "What are the rules of social distancing?" states that "[A]t least one study estimates that about 25 percent of transmissions of coronavirus may have occurred in pre-symptomatic stages—meaning it may be spread by people who don't yet know they have the virus."

Over the weekend, several UN diplomats said that New York City officials warned them that everyone in the city should assume they've been exposed to the novel coronavirus and that cases of infection are projected to proliferate until the fall. Monday's record drop in the stock market reportedly was triggered by Trump's acknowledgement in his press conference that day that the health crisis could last until July or August and even plunge the nation into a recession.

(2) *National lockdown rumor.* Sunday evening, a rumor that President Trump was going to announce a mandatory two-week quarantine for the whole country went viral, spreading primarily through text messages. "Please be advised. Within 48 to 72 hours the President will evoke what is called the Stafford Act," it read. "Stock up on whatever you guys need to make sure you have a two week supply of everything. Please forward to your network." The White House debunked the rumor in a tweet, saying "Text message rumors of a national #quarantine are FAKE. There is no national lockdown."

(3) *California's actual lockdowns.* Another viral message, which looked almost identical to the Stafford Act hoax, said just California is going to be quarantined. "State borders are closing because of the number of cases in CA," it read. "Businesses will close and we will only be able to move about for certain things not sure what."

Apparently, that wasn't a hoax after all. On Monday, San Francisco's mayor announced that the city will legally prohibit residents from leaving their homes except to meet basic needs—including visiting the doctor and buying groceries or medicine—until at least April 7. The dramatic restrictions, imposed under a city-issued public health order, also requires non-essential businesses like bars and gyms to close. But pharmacies, banks, and other businesses that perform an "essential" role for society will be allowed to remain open.

San Francisco joins six other Bay Area counties—Contra Costa, Marin, Alameda, Santa Clara, San Mateo, and Santa Cruz—in issuing shelter-in-place orders. City officials decided to take the drastic measure after closing public schools and prohibiting large gatherings last week. The number of confirmed cases of COVID-19 in San Francisco reached 40 on Monday morning, nearly two weeks after the city's first case was diagnosed on March 5. The hardest-hit county in the wider Bay Area is Santa Clara, with 114 confirmed cases at last count.

(4) *TARP2.* Treasury Secretary Steven Mnuchin met with Senate Republicans yesterday to discuss a third coronavirus response package. The Trump administration wants a $1 trillion

economic stimulus plan, including about $50 billion in aid to the airline industry, battered by the global pandemic. Congress already passed $8.3 billion in emergency funding to help stop the coronavirus disease's spread. A separate plan to expand paid-leave benefits, boost unemployment insurance, and make testing more affordable is working its way through Congress this week.

What I call "TARP2" (after the federal government's 2008 Troubled Asset Relief Program) is, in effect, "helicopter money." Fiscal policy will provide individual taxpayers with either a check or a cut in their payroll taxes, while the Fed will purchase up to $500 billion dollars in US Treasuries.

(5) *Bottom line.* So Melissa and I have a simple message: "Please panic." As we observed on Monday, the best and fastest cure for a global virus pandemic is a global viral panic. If we panic by staying home and keeping our social distance, we might actually succeed in flattening the curve. During World War II, the British government printed posters stating: "Keep calm and carry on." Today, the posters should read: "Panic and stay at home."

Or more simply, as Trump tweeted on March 14: "SOCIAL DISTANCING." If he finally gets it, there is a good chance that all of us finally get it!

Strategy I: Bear Markets Now & Then. Is this 1987-88, 2007-09, or 2015-16 all over again? It's 2020: all of them together combined with a 2020 viral pandemic. Consider the following:

(1) *Hoping it is just 1987-88 all over again.* On Monday, the S&P 500 dropped to 2386.13, down 29.5% since the record high on February 19 (*Fig. 1* and *Fig. 2*). If that was the bear-market low (which Joe and I hope it might have been), then the rout would be comparable to the 33.5% drop in the index during the bear market of late 1987 (*Fig. 3*). The first has lasted 26 days so far (through Monday's close), while the latter lasted 101 days (*Fig. 4*).

The big difference between now and then is that there was no recession in 1987 or 1988. So the 1987 bear market was very unusual, because bear markets usually have been associated with recessions. S&P 500 forward earnings rose during both 1987 and 1988 (*Fig. 5*). We won't be so lucky this time given that forward earnings have flattened out (albeit at record highs) in recent months, and a severe (though probably short) recession is likely during Q2 and Q3 of this year (*Fig. 6*).

(2) *Similarities with 2007-09.* The bear market of 2007-09 lasted 517 days, pushing the S&P 500 down 56.8% (*Fig. 7*). Real GDP dropped 4.2% from December 2007 through June 2009. The Great Recession was caused by the Great Financial Crisis (GFC).

Both monetary and fiscal monetary policymakers are responding to the GVC (Great Virus Crisis) with similar programs as the ones that were implemented during the GFC. On Sunday, the Fed cut the federal funds rate to zero and implemented QE4, committing to purchase $700 billion in Treasury and mortgage-backed securities. Yesterday, the Fed reopened its commercial paper funding facility, which will establish a special purpose vehicle that will purchase unsecured and asset-backed commercial paper from eligible companies, as long as the paper is rated A1/P1 as of March 17. The facility would be available to companies of various industries, not just banks.

TARP2, discussed above, is reminiscent of TARP1, which in 2008 injected capital into the banking system. The latest version is aimed at injecting money into the bank accounts of individuals and small businesses that are financially most at risk from the GVC.

(3) *Similarities with 2015-16.* The price of a barrel of Brent crude oil crashed 76% from $115.06 on June 19, 2014 to $27.88 on January 20, 2016 (*Fig. 8*). The price plunged 34% from Friday, March 6 through Monday, March 16 to $30.05, nearly back to the 2016 low. The yield in the high-yield corporate bond market soared to peak at 10.07% on February 11, 2016, led by yields on junk bonds issued by energy companies (*Fig. 9*). This time, that yield jumped from a recent low of 5.01% on February 19 to 8.96% on Monday, March 16, also led by yields on energy junk bonds.

Unlike in 2015, the recent big drop in the price of oil, which started last Monday, March 9, triggered a mad dash for cash in all the capital markets. For example, the spread between the AAA municipal bond yield and the 10-Year US Treasury yield widened from 21 basis points on Friday, March 6 to 101 basis points on Monday of this week (*Fig. 10*).

(4) *This too shall pass, but when?* The big difference between now and then is the virus pandemic. If it passes in a few months, as we expect, then the bear market should be over soon. If it gets much worse and lasts past the summer, the bear market would be more like that of 2007-09.

Strategy II: Pandemic Earnings. S&P 500/400/600 earnings estimates are starting to get infected by the virus. Consider the following:

(1) *S&P 500/400/600 forward revenues and earnings.* The forward revenues of the S&P 500/400/600 have remained surprisingly resilient through the March 5 week, but they are starting to look toppy and are likely to fall in coming weeks (*Fig. 11*). During the latest week ending March 12, forward earnings for the S&P 500/400/600 fell simultaneously for all three indexes for the first time since mid-November (*Fig. 12*). All three are looking toppy too.

(2) *S&P 500/400/600 earnings estimates for 2020.* The forward earnings measure is a time-weighted average of the 2020 and 2021 estimates. To assess the immediate impact of COVID-19 on earnings, it makes more sense to look at the quarterly earnings estimates for 2020. Since COVID-19 hit the news on January 23, the consensus annual 2020 estimates for the 500/400/600 are down 2.3%, 2.4%, and 5.0%. However, analysts still estimate year-over-year annual earnings growth for 2020 will be positive at 6.1%, 7.9%, and 5.6%. We think growth will be less than zero this year. We are just not sure how far below zero the rates will be.

Analysts' Q1 earnings-per-share forecasts are down 4.1%, 6.5%, and 14.2% since the COVID-19 news (*Fig. 13*). The year-over-year declines for Q1 are currently -1.3%, -2.2%, and -4.8% (*Fig. 14*). However, the analysts' Q2 year-over-year comparisons still show positive growth of 2.7%, 2.8%, and 4.9%. As the estimate cuts continue to ramp up in the coming weeks, those growth forecasts will turn negative too. The question is whether the same can be said for Q3 and Q4. We are working on the answer.

Strategy III: Pandemic Valuations. Stock prices have been extremely volatile since the S&P 500 entered a bear market last Thursday. The extreme daily price swings from Thursday to Monday have caused the S&P 500 forward P/E ratio to whipsaw up to two points each day. Consider the following:

(1) *S&P 500/400/600 forward P/Es.* The S&P 500's forward P/E fell from 15.3 on Friday to 13.5 on Monday, the lowest readings since June 24, 2013 (*Fig. 15*). The S&P 400's forward P/E fell from 12.9 on Friday to 11.1, the lowest reading since March 11, 2009. The S&P 600 forward P/E fell from 12.7 on Friday to 11.0 on Friday to its lowest level since March 9, 2009.

(2) *S&P 500/400/600 sectors with single-digit forward P/Es.* Looking at sector valuations within the indexes, Monday saw forward P/Es drop into the single digits for seven of the 33 sectors in

the S&P 1500. (See our *S&P 500/400/600 Sectors Daily Valuations*.) Within the LargeCap index, members of the single-digit P/E club include Energy (9.0) and Financials (8.4). Three MidCap sectors were in the single digits: Consumer Discretionary (9.5), Energy (9.0), and Financials (7.8). For the SmallCap index, they include Consumer Discretionary (7.5) and Financials (7.8).

(3) *Growth vs Value forward P/Es.* Valuation for the Value indexes fell to multi-year or record lows on Monday. LargeCap Growth's forward P/E of 17.2 was its lowest since December 26, 2018, while Value's 10.6 was the lowest since June 5, 2012. The corresponding Growth and Value forward P/Es for the MidCap index were 15.1 and 9.2 on Monday. Those were the lowest levels since December 24, 2018 and November 20, 2008. For the SmallCap index, the Growth and Value forward P/Es were down to 12.9 and 10.4 on Monday. That was a record low for Value and Growth's lowest level since March 16, 2009.

CALENDARS

US: Wed: Housing Starts & Building Permits 1.500mu/1.500mu, MBA Mortgage Applications, DOE Crude Oil Inventories. **Thurs:** Leading Indicators 0.1%, Jobless Claims 219k, Philadelphia Fed Manufacturing Index 10.0, EIA Natural Gas Storage. (DailyFX estimates)

Global: Wed: European Car Sales, Eurozone Headline & Core CPI 1.2%/1.2% y/y, Eurozone Trade Balance €19.2b, Japan CPI Headline, Core, and Core-Core 0.5%/0.6%/0.7% y/y, Australia Employment Change & Unemployment Rate 8.5k/5.3%. **Thurs:** China 1-Year & 5-Year Loan Prime Rates 3.95%/4.70%. (DailyFX estimates)

US ECONOMIC INDICATORS

Regional M-PMI (*link*): The New York Fed—the first district to report on manufacturing activity for March—showed a sharp contraction in activity. March's composite index is one of the first readings of the coronavirus outbreak's impact on the economy. It shows the composite index (to -21.5 from 12.9) plummeted a record 34.4 points, dropping to its lowest reading since the financial crisis in 2009. Firms no longer expect general business conditions to be better over the next six months, with this outlook measure plunging 21.7 points to 1.2—also the lowest since 2009. The composite index's new orders (to -9.3 from 22.1) gauge plummeted 31.4 points—its biggest drop since November 2010—though March's level was just above last June's -9.7. Shipments (-1.7 from 18.9) declined slightly after February's sharp acceleration. Employment (-1.5 from 6.6) was little changed over the month, while the average workweek (-

10.6 from -1.0) was the shortest since the end of 2015. As for the forward-looking indicators, both future new orders (to 17.6 from 27.5) and future shipments (20.5 from 26.5) declined but remained firmly in positive territory, suggesting that firms expect orders and shipments to be higher in six months than this month's levels.

Retail Sales (*link*): Consumer spending was slowing before the coronavirus struck with force. Nominal retail sales dipped in February after climbing to a new record high in January, while core retail sales—which excludes autos, gasoline, building materials, and food services—continued its recent flat trend. (BEA uses the core retail sales measure to estimate personal consumption expenditures each month.) Core sales, adjusted for inflation, was down 0.4% (saar) during the three months through February, based on the three-month average, after peaking at 7.1% last August; the gain in real headline sales slowed to 0.5% over the comparable period from 5.7% in August. In February, nine of the 13 sales categories decreased while three increased; sales at food & beverage stores were flat. The biggest declines were recorded by gasoline (-2.8%), electronic & appliance (-1.4), building materials (-1.3), and clothing (-1.2) retailers. Gains were recorded by miscellaneous (1.4), nonstore (0.7), and sporting goods retailers.

Industrial Production (*link*): Industrial output in February posted its first increase since November, remaining in a flat trend just below December 2018's record high. (The economic impact of the coronavirus outbreak is not yet visible in the numbers.) Production jumped 0.6% last month as cold weather boosted utilities output 7.1%, while an increase in auto production led to a 0.1% increase in manufacturing output. Both headline (0.0% y/y) and manufacturing (-0.4%) production were flat with a year ago. By market group, business equipment production contracted 3.7% y/y, while consumer goods output was flat. A 19.8% y/y plunge in transit equipment output (impacted by the halt in Boeing's 737 Max production) accounted for the decline in business equipment production. Production of information processing equipment expanded 6.7% y/y, while output of industrial equipment was on par with a year ago. As for consumer goods production, a 1.9% y/y gain in durable goods output helped offset a slight decline in nondurable goods production.

Capacity Utilization (*link*): The headline capacity utilization rate in February climbed to 77.0% after sinking to a 28-month low of 76.6% in January; it was at a cyclical high of 79.6% during November 2018. February's rate was 2.8ppts below its long-run (1972-2019) average. Manufacturing's capacity utilization rate was unchanged at 75.0%—3.2ppts below its long-run average; the rate peaked at 77.3% at the end of 2018. The utilization rate for mining fell to

88.4%, but it was 1.2ppts above its long-run average., while colder weather boosted the operating rate for utilities to 75.8% (from 71.0%), 9.4ppts below its long-run average.

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