Executive Summary

BY: BRIAN BEAULIEU

Keep Calm and Carry On

OVERVIEW

"Keep Calm and Carry On," a pre-war slogan issued by the UK Ministry of Information in the summer of 1939, remains good advice when it comes to running businesses. US Fed Chairman Powell recently offered similar advice when he said, "I don't think anybody knows how long [the COVID-19 economic impact] will be. I do know the US economy is strong and we will get to the other side of this." He went on to say that the Fed Funds Rate cut wouldn't stop people from getting sick or fix disrupted supply chain issues. Clearly the action was meant to calm people's fears.

The COVID-19 black swan was followed by the Saudis' decision to significantly discount oil prices, disrupting the marketplace. The Saudis have provided the world with a second black swan. Perhaps we should have known they would do something radical (think back to 2015) once talks with the Russians broke down, but the magnitude of the move is off the charts. A tough situation for many was potentially made worse.

We are hosting a webinar – Probable Impact of COVID-19 on ITR Economics' Outlook – on March 13, 2020. ***We are amending that topic to include the probable economic fallout from the drop in oil prices.*** What follows is a preview of what we will present. Beyond what follows here, we will look at commodity prices, interest rates, and the consumer. The webinar will include a question and answer period.

A PERSPECTIVE PERTAINING TO COVID-19

ITR Economics has been providing analysis and forecasts for 72 years. Our current economic leadership has been doing this for 38 years. That history provides us with an institutional and personal perspective on events and their potential impact on the business cycle. The table below provides experiential context based on the last 38 years. The Stock Market Decline periods were picked on the basis of initial magnitude of decline matching market performance since February 14, 2020.

Stocks Decline (Year)	Trigger	S&P 500 % Change	S&P 500 Decline (in months)	Macroeconomic Impact (US Total Industrial Production)
1987*	Derivatives Trading	-30.2%	3	No effect; rise
1998*	Russian "Crisis"	-15.6%	5	Stalled rise 2 months
2000*†	Y2K	-46.3%	26	Recession began 2H00 unrelated to Y2K
2001	9/11 Terrorist Attack	-8.2%	1	Recession was already in progress
2011	Sovereign Debt "Crisis"	-17.0%	5	Stalled ascent for 9 months
2015	Oil Prices Plummeting	-8.9%	4	Recession started 9 months ***prior***
2018	Trade Concerns/Uncertainty	-14.0%	3	Down 3.8% over 8 months before recovery
* Market's largest one-day point decline (to date)				
† This was a forecasted recession. It is listed here because the Y2K concerns proved to be a false concern.				

Our takeaway from the above table is that serious, market-changing events occur and are not especially rare. Unfortunately, the current "crisis" is what we are considering a black swan event because the economics of the situation started from outside of the economic realm, and the impact/emotions have the potential to extend beyond modern precedent. Fear of COVID-19 spreading, perhaps misunderstandings about the numbers involved, and the general concern over supply chains, travel, and the financial markets have combined to make the current case perhaps more noteworthy than the above instances. However, having lived each of the above instances, we can assure you that "unprecedented," "black swan," "game-changing," and similar terms were applied to each of the above periods. The S&P 500 this time is reacting as it has before. What follows are some more specific observations:

1. The period of decline in the S&P 500 is short at 1–5 months, excluding the one instance where there was a legitimate recession (2000, which was forecasted by ITR)
2. The current S&P 500 decline is weeks old (not months), so more volatility and uncertainty could easily be ahead
3. As of 3:30 p.m. March 9, the S&P 500 was down 14.6% from the record high. Worse than the 2001 terrorist attack, the 2015 oil prices decline, and the 2018 drop related to trade concerns, but not as bad as the other occasions cited above
4. The overall economy is at times temporarily affected by the market's movement; other times it is not
5. The S&P 500 has lagged several actual recessions through highs and lows
6. The duration of weakness in US Total Industrial Production, when it has occurred, has been relatively brief at 1–9 months
7. The current decline in US Total Industrial Production is in its fifth month, and the index is down 3.1%

The increased downward pressure created by the Saudis' announcement will likely lead to larger negative numbers than we otherwise would have experienced. However, that doesn't necessarily translate to altering the implied timeline unless the drop in oil is truly going to tip the US into an actual recession. Our analysis over the next several days will focus on that potentiality. We will advise as soon as the analysis is complete.

WHAT IT MEANS FOR US IN 2020

It comes down to demand and supply. Businesses must be ready with the *supply* because the *demand* will be there. It is only a matter of when the demand is there, not if. We have stated numerous times in the ITR Trends Report™ and other communications that the demand is going to manifest in the second half of 2020. That the second black swan compounded the first requires that we reevaluate the timeline. The shift to business cycle rise could be delayed until late in 2020 or perhaps even 2021.

Our position is that it pays to play the long game. The business cycle will dominate as the underlying economic trends that we all utilize to run our businesses and care for our families overwhelm short-term distortions. We will touch upon some additional "long game" aspects during the webinar. For now, we will focus on trying to answer this question: "When we can expect the real economic trends to return to dominance?"

We opted to take a numbers-driven, non-emotional approach to the first black swan, COVID-19. This is different than what you may be absorbing from other sources. The news cycle suggests that fear has yet to run its course. Fear means questionable and costly decisions will tend to occur. Fear drains efficacy out of the economy and inhibits growth. However, fear also provides opportunities for those that Keep Calm and Carry On. We hope to help you avoid unprofitable decisions that are predicated on temporary distortions. We are not going to go into the science of COVID-19. You know as well as we do that a treatment for the illness is in clinical trials already, and that, if successful, the treatment is likely to hit the market before a vaccine is available. A vaccine is estimated to be 12–18 months away. You have seen the fatality tables that make it clear that age is a factor, as is comorbidity. Like us, you are likely grateful that children have been by and large absent from the critical cases associated with COVID-19.

We analyzed the current situation using several different analytical approaches. The perspective table provided above is one of them. We also ran modeling on the economic impact of the virus based on the trends to date. Additionally, we looked at confluent economic factors such as commodity price trends. And, like you, we are scanning the news for the latest economic stirrings in China, what factors contributed to the magnitude of the decline in the S&P 500 (programmed derivatives trading seems to have played a role), and fatality rates (especially as they relate to comorbidity and age). We are having conversations with our clients.

If not for the oil market, it certainly looked to us that the US economy would be in a discernable recovery trend in the second half of 2020. The magnitude of COVID-19 fears and resulting fear-induced decisions have the potential to delay the recovery from the beginning of the second half to later in the second half, but we still see the recovery occurring. As stated above, events in the oil market could delay the onset of recovery further.

WHAT TO WATCH

Making decisions based on the future typically comes down to having confidence in the vision. With that in mind, here are some data points that should add confidence in the coming months. We will cover more at the March 13 webinar. The single best thing you can do is watch the leading indicators with us between now and July.

Several of the leading indicators that comprise our leading indicator system demonstrated weakness following the outbreak of the virus. One such indicator is the JP Morgan Global PMI (Purchasing Managers Index). The JPM Global PMI "lost" the 1/12 low of January 2019 because the February 2020 data point showed pronounced weakness. Examining the details revealed that the abnormal 6.3% month-to-month decline in the index stems primarily from China and other COVID-19 infected areas (the Czech Republic was also a large contributor). There were 16 countries posting weakness and 15 posting positive numbers (notably including the US, Canada, India, and Brazil).

What to watch for:

- We expect that the 1/12 will reinitiate a rising trend sometime between the March–July data. The index would have to decline below 46.0 for this not to happen.

It is significant that another indicator, the S&P 500, is maintaining its December 2018 1/12 rate-of-change low despite the March 9 selloff. Even at the lowest point the S&P 500 experienced since the virus outbreak began, the December 2018 1/12 low still holds. There are two trip wires we established for the S&P 500. However, the S&P 500 is getting perilously close to the trip wire identified below. As of mid-afternoon on March 9, the S&P 500 stands at 2762.5.

What to watch for:

- Decline below 2,633.7 would be a signal that the recovery may be delayed beyond 2H20

We suggest that our consulting clients and subscribers examine their own specific performance in 2015–2016 and ask themselves if anything has changed since that would make their 2020 performance better or worse. We are not saying that 2020 is a simple repeat of 2016; however, 2016 is a useful, recent paradigm to examine.

We are going to go through our EVP-program consulting clients to identify those companies that show the greatest sensitivity to oil prices, the stock market, and health related issues (tourism, transportation, large events, etc.). Our team will be reaching out to our EVP clients based on sensitivity to those variables to coordinate efforts and determine if a revised forecast is warranted.

We will simultaneously be doing the same for the series used in the ITR Trends Report. Those series will be revised, and the new pages made available, as required. The OnDemand™ platform will enable us to share results with you without your having to wait for the April issue of the Trends Report.

ITR Economics will provide additional updates to you directly as well as through social media.