

# PALOS

## CONTENTS

## Weekly Commentary

Issue No. 30 | JULY 13, 2020

Looking Over the Valley	1
Bloomberg's Opinion on the Recovery Shape	2
July Survey Conducted by Jeffries	3
The Market Is Not Pricing a V-Shaped Economic Recovery	4
Disclaimer & Contacts	5

## Macro View

By *Hubert Marleau*

### Looking Over the Valley

Submitted July 11, 2020

#### What Happened In the Market Last Week Ending July 10:

In the week ended July 10, the S&P 500 increased 1.8% to close at 3186. It wouldn't have done so well if it had not been for the relentless rally in Chinese stocks and the announcements by Gilead Science that Remdesivir could lower the fatality rate of Covid-19 and by Pfizer which may soon have an effective vaccine.

However, the rise in equity prices did not prevent investors from manifesting worries that the speed of the recovery could be jeopardized by the record-setting new coronavirus cases. Numerous Wall Street heavyweights are offering opinions that the stock market is unhinged from reality. One commentator said that he largely missed the tech-stock rally and has been buying gold and bitcoin. Take note that the latter have no P/E to stand on and most gold stocks have P/E ratios that are higher than those of tech stocks. Nevertheless, I have an exposure to gold stocks not at the expense of equities but more as an insurance policy. Currently, volatility is jittery, market depth is shallow and short positions are still sizable. Interestingly, many investors have hoarded cash or are building buffers. The atmosphere of the market has drawn several investors into so-called buffer ETFs. They actually cushion holders from a certain percentage of losses in exchange for a cap on gains.

The Wall Street Journal surveyed 60 business economists from July 2-7. It found that over 90% agreed that the economic recovery depended on containing the virus. Meanwhile, the OECD reported that while the world's leading economies showed significant improvement in June, it suggested that the reading should be interpreted with care. There remains serious concerns that official lockdowns may be imposed or people will voluntarily decide to exercise restraint, reducing the possibility of a quick economic recovery. Federal Reserve officials voiced similar views.

## Macro View cont.

*By Hubert Marleau*

---

In the Sun Belt, the number of Americans dying from the virus has started to rise again. Actually, more than 800 people have died in each of the last 3 days and that is 56% more than the previous week. However, the spike is not yet a trend. The new death toll is way below the level experience last April (2300). I'm not ready to give up because a lot has changed in the last two months. Firstly, older folk are especially cautious which has led to a decline in the average age of new patients. Secondly, younger patients are much less likely to die. Thirdly, caretakers have become adept at diagnosing the virus and treating it effectively. That is not to say that the surge in new cases won't raise the death toll to intolerable levels. Typically, it takes 3 to 5 weeks for a patient to die after getting infected. Consequently, it's too soon to know for sure. Interestingly, deaths edged down on Friday.

While most conventional economic data prints of last week were outstanding and far better than consensus expectations, Bloomberg's weekly consumer and business sentiment indices turned a bit sour, taking notice of the new Covid-19 cases around the world (Japan, Australia, Mexico and the U.S.) In light of this change in confidence, albeit small, the majority of economists now believe that the pace of recovery could get clipped enough to resemble a "swoosh" shape rather than a V.

At this point, I'm not ready to concede that the recovery will be put on hold. We need more clarification on what the developments in the Sun Belt will bring and that is not a given. What is more important is what people will do with their savings that they have amassed in the past three months along with the upcoming fiscal income relief that has been promised by the Congress and the White House. There are 18.0 million unemployed souls in the U.S.. They will either be rehired or be out of a job. The outcome will determine how those massive savings will be deployed.

According to Visa, the pandemic has accelerated the use of debit and credit cards to pay for the boom in online shopping, causing a precipitous decline in cash usage. While this behavioral shift may be permanent, it should not be construed as a guarantee that consumers will be reluctant to part with their money. What households will decide to do with their personal disposable income is very difficult to know. In an economy that is operating under its potential capacity, changes in the personal saving rate can make the whole difference between a fast or slow recovery. The personal savings rate was about 25% in April—normally it's around 5%. Given that the cohort of lower income earners spend almost all that they make, the future performance of the economy will have a lot to do with the sentiment of middle income earners and the effect on wealth that risky assets have provided to high income executives. Admittedly, it's a complex unknown because the pandemic has thrown a curveball. In a July

## Macro View cont.

*By Hubert Marleau*

---

survey conducted by Jeffries, it showed that in the last three months, 25% of the income stimulus was saved, 25% was used to buy basics, 18% paid down debt and 30% went out of the window. It shows that almost 50% of the money was put aside as a safety net. The big question is whether all these new savings will turn into pent-up demand or lay dormant. Acknowledging that the bulk of the savings are in the hands of those who are not struggling financially, have learned how to handle online purchases and have found ways to replace the experiences of gyms, theaters, sporting events, concerts, and restaurants with other options, I have a couple of reasons why I think consumer spending will gradually rise back to the usual 70% of N-GDP over the next few quarters.

Firstly, the risk that one will die from catching the Covid-19 is overblown. A NBER working paper shows that the risk of dying for people in their seventies who contract the virus is about 20 times that for infected people in their forties. The risk for people in their twenties or thirties is so low as to be hard to estimate and the same is true of children. Given that older people are not ignorant of the fact that they are mortal and do think about dying, they are, by and large, staying at home.

Although the Fed has publicly manifested reticent in controlling the yield curve (YCC), the bond market has more or less concluded that they will soon cave in. I've backed my position on this matter with the evidence that the level of economic activity is not where they want it. Inflation has been persistently below where they want it, but the rate of asset purchases is where they do want it. The 10-year nominal yield has remained stable for weeks while the US economic surprise index has recorded all-time highs week after week. If bond yields can't rise on strong data, it begs the question as to why. In my judgement, it means that the market is convinced that the Fed will ratchet up monetary accommodation one more time. The Fed might acquiesce to the bets of the bond players who are wishing for YCC. It has resulted in a significant lift in inflationary expectations---and that is definitely something that the Fed badly needs.

I've upwardly moved my trading range for the S&P 500 to 2900 to 3350, even though it seems rational from an economic point of view that the S&P 500 should trade narrowly around 3100 until we get clarity on the US death toll. The benchmark's 50-day moving average broke the 200-day line forming a so-called golden cross. According to Sundial Capital Research, it's a positive omen. It may not be flawless, but in the last 70 years golden crosses have accurately predicted the end of every major bear market. It looks as if the market is looking over the valley.

## Macro View cont.

*By Hubert Marleau*

---

Contrary to public consensus, the market is not pricing a V-shaped economic recovery. If one were to strip the ten biggest companies by market capitalization, valuation would not be as high as generally believed. The top ten represent about 30% of the S&P 500 with an average P/E of about 35 times. The other 490 S&P 500 companies are valued at a P/E of 17 times which is more in line with their historical averages. The biggest companies are MSFT, APPL, AMZN, GOOG, FB, JNJ, BRK, V, PG and UNH. If one were to replace JNJ, BRK, UNH and PG with NFLX, ADBE, NVDA, it would optimize the case.

Follow us on LinkedIn:



# Weekly Commentary

Issue No. 30 | JULY 13, 2020

## Disclaimer:

This publication is proprietary to Palos Management Inc. (along with its affiliate Palos Wealth Management Inc., "Palos"). This publication may be copied, downloaded, stored in a retrieval system, further transmitted, reproduced, disseminated, and/or transferred, in any form or by any means, but only as long as it is unaltered and attributed to Palos. This publication and its contents may not be sold or licensed without Palos' written permission. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made or implied regarding accuracy or completeness. The information provided does not constitute investment advice and it should not be relied upon on as such. If you have received this communication in error, please notify us immediately by electronic mail or telephone. This document may contain certain forward-looking statements that are not guarantees of future performance and future results could be materially different. Past performance is not a guarantee of future performance. "S&P" is a registered trademark of Standard and Poor's Financial Services LLC. "TSX" is a registered trademark of TSX Inc. The Bloomberg USD High Yield Corporate Bond Index is a rules-based, market value weighted index engineered to measure publicly issued noninvestment grade USD fixed rate, taxable, corporate bonds. To be included in the index a security must have a minimum par amount of 250MM.

# PALOS

1 Place Ville Marie, Suite 1670  
Montreal (QC) H3B 2B6, Canada

T. +1 (514) 397-0188  
F. +1 (514) 397-0199

1 St. Clair Avenue East Suite 504  
Toronto, Ontario M4T 2V7

T. +1 (647) 276-0110  
F. +1 (647) 343-7772

[www.palos.ca](http://www.palos.ca)