

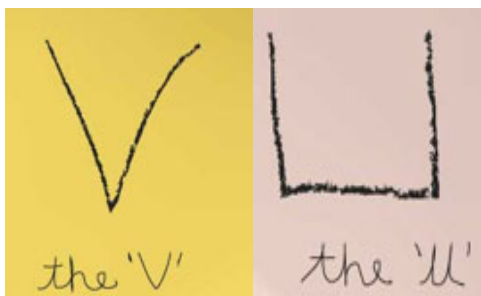
Is the “SWOOSH” the Answer?

Key Developments

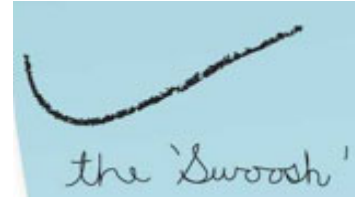
- The S&P 500 has gained 27% from the March 23 low—retracing 54% of the decline. After such a rally, some consolidation seems likely.
- The disconnect between rising stock prices and falling earnings is a sign that the market is pricing in an eventual recovery.
- The more likely recovery path for stocks now appears to be a "swoosh," i.e., a sharp contraction followed by a gradual recovery.

The Shape of Recovery

Let's start with the common shape tails everybody was talking about after the down-turn; V and U. The V scenario appears unattainable, not so much because near-term growth estimates are not bullish enough, but because the future earnings estimates for 2020 appear to be closer to getting corporations to break even and beyond that calling for growth. The U scenario appears out also as just discussed on slow future growth but also we already appear to be up from the U shaped bottom (which is detailed more below).



So where does that leave us for recovery shape? A swoosh; yes just like the beloved Nike logo. The Swoosh is some sort of in-between scenario that is more plausible outcome than the "V" and a "U" recoveries. The path of a Swoosh recovery is a sharp fall followed by a gradual but still aggressive recovery. What, Gradual aggressive? Yes, let's review the last six weeks and you will see the Swoosh potential appear.



Since walking back from the brink of financial collapse in late March, equities have rallied strongly in anticipation of a peaking of the COVID curve and a reopening of the economy.

The S&P 500 has gained 27% from the March 23 low and has retraced 54% of the decline. Believe it or not, the S&P 500 is back to its trend line from the 2009 low. It's an impressive feat, considering the economic devastation that the COVID crisis has unleashed.

In recent weeks the pace of the rally has slowed, and for the past 2 weeks the market has been trading water. Basically the market has entered a holding pattern in the middle of the range, while it waits for new data.

The recent gains have become more narrow and uneven, led by the same familiar secular growers as before. Analysts of the market typically want to see a broadening of gains to confirm that a new cyclical bull market is underway. Usually the stocks that go down the most (small caps, cyclicals) also recover the most. That is not happening, at least not yet. To the skeptics, this lack of participation is a sign that this is nothing more than a QE-induced bear market rally.

Market breadth (advancers minus decliners as a percentage of issues) has not been robust enough to confirm that we are out of the woods, but it hasn't been terrible either. The percentage of stocks above their 50-day moving average has improved from almost zero in March to +36% last Friday. That's below the +55% at the highs, but that is to be expected given that we have only climbed halfway back from the lows.

Likewise, the breadth oscillator (a measure of the momentum of breadth) has improved as well, although it has leveled off in recent days. In both cases, the market's

internals are tracking favorably compared to the 1987 and 2008 analogs.

Have markets priced in too much of a recovery?

Markets are always discounting the future, and after discounting a depression-scenario a month ago it now seems to be discounting a severe but short-lived recession followed by a recovery. But now the question is whether the markets have priced in too much of a recovery. Until the economy actually reopens we can't really know the answer. Hence the holding pattern. The market is waiting for new information.

Price leads earnings

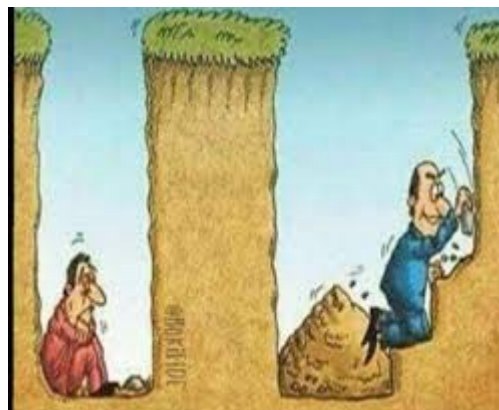
Because price leads earnings, the market picture has become confusing, to say the least. With price up 27% and earnings estimates falling rapidly (down 36% in Q2 and down 19% for 2020), by conventional valuation metrics the market is now more expensive than it was at the pre-COVID peak. The forward price-to-earnings (P/E) ratio (using expected earnings for the next 12 months) is now 19.2x vs. the February peak at 19.1x.



Don't fight the Fed

Especially when it is coming out with a Puncher's mentality and full Presidential and Congressional support to do anything and everything to support the economy. So if the traditional matrixes don't support what we are seeing then the only rational explanation of this is that investors are pricing in the economy getting restarted soon and with the monetary policies of the Fed. and the current administration's low tax and low regulation pressure on personal and corporate growth; that once

restarted the economy will be continuing the pre-COVID growth trend. But first it must finish filling in the hole and just how much energy and how many companies will be lost on the way up the grade to actual real growth is the real question.



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