The Virus Rebound

By Peter Scholtz
June 2020

The last three months have witnessed one of the most dramatic stock market moves ever, straight down and then straight up. I have never seen an event like this in my 46-year career. I guess these dramatic moves shouldn't be that surprising as this is what happens when you shut down the economy so completely and so quickly. Now that the stock market has recovered sharply, where do we go from here? As the economy reopens and employment recovers, the Fed remains very supportive of capital markets – likely beyond what is needed. Professionals are under-exposed to stocks, waiting for a pullback. Politics and China are concerns, but they are overshadowed by the return of business domestically. The reopen should give us an initial pop in the economy, with the rest slowly recovering over a two year period. It will take time for main street. There is one variable that is critical to the path of the economy and therefore, the stock market. It is the Coronavirus.

I recently watched a Hedgeye call with Michael Taylor, a successful hedge fund manager who spent the first part of his career studying viruses and developing vaccines. He claims there are maybe 25 people in the world that understand this area really well. He is confident, and his insights led him to realize the magnitude of the problem in late January, when China first started shutting down. Michael claims that the odds of a virus rebound after we reopen the economy, is a virtual certainty. Even if you think the true infected number of persons is 20 times the reported million plus cases, you still would have around ten percent of the U.S. population with antibodies. Michael claims that when we reopen there will be approximately 50,000 people who are asymptomatic, but contagious. This will lead to infection rates climbing again by the end of July. These mildly infected people don't get tested or treated. They are simply carriers. As we move into the fall, the numbers will climb right when the weather is turning more conducive to flu-like diseases. We may need another shutdown – although Trump has said it won't happen. Small businesses might not make it through another storm like this spring. It could be very bad for the economy.

Marko Kolanovic, PhD, is a quantitative analyst for J.P. Morgan bank. He is heavy into statistical studies and has been tracking the virus and its path the entire time. He claims his team has accurately predicted the scale and path since early on. He has studied each state as well as each country around the globe and has a striking conclusion. He writes, "while we often hear that lockdowns are driven by scientific models, and that there is an exact relationship between the level of economic activity and spread of virus - this is not supported by the data…..In particular, regression shows that infection rates declined, not increased, after lockdowns ended." There is a decrease in infection rates after countries eased national lockdowns with greater than 99% statistical significance. "These virus dynamics are perhaps driven by the elimination of the most effective spreaders, impact on the most vulnerable populations such as nursing homes, common sense measures unrelated to full lockdowns (such as washing hands, avoiding groups, social distancing, etc.) and weather patterns in the northern hemisphere." The implication is that a slow reopening of the economy will not arrest the decline in new daily cases. The virus may just fade away.

107 ELM STREET • FOUR STAMFORD PLAZA, 5TH FLOOR • STAMFORD, CT 06902
TEL: (203) 714-9900 • FAX: (203) 588-9032

Both of these men are smart, responsible and logical. The difference between the virus strongly re-emerging and completely fading out this summer is night and day to the nation and the stock market. I have pondered this question for weeks.

On March 15th, I wrote that the virus will run its course in a few months and by June we will see:

1. Accommodative Fed
2. Potential Fiscal Stimulus
3. A centrist political outlook
4. Financial stress is eased
5. A snapback in the economy led by the consumer

The accommodative Fed has been in conjunction with an unprecedented Fiscal Stimulus. Financial stress continues to ease. Since Biden has become the Democratic nominee, extreme legislation like Medicare For All is now off the table, although there could be a left-leaning policy push. The economy is experiencing a snapback, which appears to be V-shape in nature. The key word here is “appears” as the easy increases in activity are done, the rest of the economy will take time to recover. Large gathering venues will take a year or longer. My favorite alphabet letter to describe the recovery is the reverse square root, maybe a little steeper on the onset, and then slowing rising in the more economically sensitive areas.

My March 15th comment on the virus running it course in a few months is valid, but not applicable here. After we locked down in late March, we have seen a “rolling” wave going through the country. Early breakout areas like New York City and Connecticut are greatly improved, but we have other areas, like the rural Midwest, that are just ramping up. It’s a rolling couple of months for each geography. I still believe the medical response will be great, but not soon enough, in terms of a vaccine. We need another six months or more for that. The recent lockdown may decrease daily cases so low that they will be only slowly ramping back up in the fall, until a vaccine can finally arrest it. This is the best case. The worst case is that it comes back strong in the late summer. At least we will be better prepared and like Kolanovic stated, smart behavior and sensitivity to high risk people will greatly mitigate the death rate from what we have seen so far. Hospitals are prepared and no longer overwhelmed.

The Fed accommodation has generated a market recovery exceeding anything I have ever seen. Any hint that the virus has truly been subdued will lead to a strong economic recovery and further stock market gains. Investors have slowly eased back into the market, although there is plenty of cash and healthy skepticism remaining.

We remain heavily weighted in the “stay-at-home” stocks, which should do well under all circumstances. We also have slowly nibbled on the “re-open” stocks as they clearly (being near the brink) have strong potential. The virus should be completely subdued by late 2021, and therefore the bears have a time limit. We should see minor setbacks, but the lows have been made, barring a massive virus rebound, and by late 2021 the economy should be in full recovery mode. One should remain constructive on the markets and look to buy any likely setbacks.