## PREVIEWING THE GENERAL ELECTION AND BEYOND

In our opinion, the medical, economic, and market outcome of COVID-19 will be a significant factor in the 2020 election. Should economic and health conditions continue to deteriorate, we expect a rise in expectations that Joe Biden captures the White House and a rise in the probability of an all-Democratic government. While he would swing the agenda away from the current Trump agenda (which has been received positively by the market over the past four years), Biden is generally viewed as promoting policy goals from the political mainstream and could easily push more fiscal stimulus. This would be viewed as having a neutral to positive impact on the market compared to the prospect of a Sanders presidency (which weighed on markets earlier this year). Should COVID-19 avoid the worst-case scenarios and the economy/market have a significant recovery in the latter half of the year, the momentum is likely to swing back toward President Trump. The big question will continue to be the effect of the current uncertainty on suburban voters. Incumbents are traditionally viewed as the safer choice, but Biden's familiarity may upend this calculation as we expect a "return to normalcy" to be the primary message of the Biden general election campaign.

In terms of a second term for President Trump, the initial reaction would be that this is a positive for the market should we see post-COVID-19 recovery in the second half of this year. A wave of momentum could produce down-ballot impacts that bring back an all-Republican government. Sentiment would be boosted on the continuation of the Trump deregulatory agenda and stimulus via additional corporate/individual tax cuts. However, an open question would remain as to whether the lack of any additional electoral checks would produce an unbound and bombastic President Trump on policy issues. A mitigating factor for the market here would be that second-term presidents are motivated by their legacy, and, as Trump is especially cognizant of market/economic metrics, his policy objectives should continue to support a positive environment for macro fundamentals.

Biden's strength in the South will stir a debate about the potential down-ballot impact. The Senate seats in Alabama, North Carolina, South Carolina, and the two seats in Georgia all lean Republican or are likely Republican seats at this point. We would not be surprised if these elections become more competitive. They are still a reach for Democrats, but winning any one of these would materially increase the chance of a Democratic Senate majority after the 2020 election with significant consequences for the markets from a policy perspective. An economic downturn coupled with this scenario would steer the early policy direction of a Biden presidency. We would expect to see stimulus efforts to jump-start the economy, which could be a positive boost to infrastructure and unlocking consumer spending via debt relief (e.g., student loans, medical debt). In turn, this could benefit the housing market by increasing demand if debt relief measures spur a boom in housing demand by younger consumers who would otherwise have delayed a real estate purchase. Of course, this would be balanced by potential negatives, such as significant policy reforms targeting the Health Care, Financial, and Energy sectors. As we frequently say in Washington, developments are never as bad as you initially fear, or as good as you hope.

### KEY TAKEAWAYS:

- In our opinion, the medical, economic, and market outcome of COVID-19 will be a significant factor in the 2020 election. Should economic and health conditions continue to deteriorate, we expect a rise in expectations that Joe Biden captures the White House and a rise in the probability of an all-Democratic government.
- Biden is generally viewed as promoting policy goals from the political mainstream and could easily push more fiscal stimulus. This would be viewed as having a neutral to positive impact on the market compared to the prospect of a Sanders presidency (which weighed on markets earlier this year).
- Should COVID-19 avoid the worst-case scenarios and the economy/market have a significant recovery in the latter half of the year, the momentum is likely to swing back towards President Trump.

RAYMOND JAMES

ISSUE 21 | APRIL 2020

# INVESTMENT STRATEGY QUARTERLY



# Letter from the Chief Investment Officer
## A Journey through the Unknown

The COVID-19 outbreak has led to unprecedented volatility and tremendous declines in wealth, but we have faith that once the pandemic is defeated, the wild swings in the financial markets will abate and prosperity will return. But what cannot be so easily recovered is the loss of a job, the loss of a business, or, worst of all, the loss of a loved one. While it is our duty to provide timely market insights, please know that now, more than ever, the health and safety of you and your families is at the forefront of our minds.

The Hubble Space Telescope celebrates its 30th anniversary this month. As the first major optical telescope soaring through space, its vitality in astronomical discoveries earned it the nickname "window on the universe." Since its launch in 1990, its discoveries have redefined our knowledge of the universe – from its estimated age (~13.7 billion years old) to the two moons circling Pluto. Its ability to capture clear, concise photographs is due to its location beyond Earth's atmosphere, where it is unencumbered by clouds and turbulence. The traveling telescope is an excellent metaphor for our investment strategy journey, as we seek to provide clear, concise views in a world of incessant change and increasing complexities. Not getting fixated on the daily headlines and approaching investments with a long-term view in mind can help avoid panic driven portfolio decisions.

The emergence of the coronavirus as a global pandemic was a 'Black Swan' event outside anyone's scope. Its discovery clouded the near-term economic outlook and created unparalleled market turbulence. As this unprecedented event unfolds, it is our responsibility to bring uncertainties into focus and provide pragmatic, insightful views to assist you in navigating your portfolio during this historically challenging time.

When it comes to the economy – **Houston, we have a temporary problem**. The COVID-19 outbreak and its negative economic impact are difficult to discern given the inability to determine the number of people infected, the transmission rate, and the longevity of the spread. But one thing remains clear – consumer spending is collapsing at a record pace due to the necessity for social distancing – the avoidance of restaurants, cinemas, tourism and spectator events. Already, many thousands of retail stores have shut their doors, multiple sports have suspended their seasons, and over 515 million students have been impacted by school closings worldwide. With consumer spending, which represents up to 70% of a developed market economy, contracting rapidly and likely remaining constrained for the next few months, a temporary virus-induced recession seems unavoidable. With spending in an interim black hole, our Healthcare Policy Analyst, Chris Meekins, assigns a 54% and 80% probability to the US starting to "turn the corner," or realising the true scope of the health crisis and resuming our normal activities, by Memorial Day (25th May) and the Fourth of July, respectively. If this proves prescient, the US economy would likely experience a robust rebound during the second half of the year, especially if policymakers continue to exhibit a "by any means necessary" approach to defeat this virus.

Mitigating this downside risk to the economy is the **beaming up** of policymaker response. In the United States, the Federal Reserve (Fed) has been and will remain proactive. Even after implementing two inter-meeting interest rate cuts – action only taken **once in a blue moon** – to reduce interest rates to zero and once again employing massive trillion dollar facilities, the Fed is still exploring ways to make sure **the gravity of the situation** does not cause the lending markets to function inefficiently. But the Fed is not alone, evidenced by the **all hands on deck** effort by central banks around the world similarly easing in a synchronised fashion. Over the last six months, almost 80% of central banks have eased policy rates – the highest level since the Great Recession. In fact, the average policy rate amongst the four largest central banks (the Fed, the European Central Bank, the Bank of England, and the Bank of Japan) has fallen into negative territory and set a new historic low. While these measures cannot cure the health crisis, they should help boost confidence and support a rebound in growth over the medium to longer term.

And this has been supplemented by record-setting government stimulus packages that will put money into the hands of consumers, small businesses and distressed industries in hopes of easing the economic impact of the virus. If the economy continues to struggle, we do not rule out additional phases of fiscal stimulus.

With fear driving demand for bonds, yields moving higher will continue to exhibit a **failure to launch** scenario. Uncertainty surrounding the duration and magnitude of the virus fuelled a **flight to safety** mission that pushed the entire US Treasury yield curve below 1% for the first time ever. If volatility subsides and the economy not only stabilises but resumes its upward trajectory in the second half of the year, we'd expect the 10-year Treasury yield to remain around the 1.00% level come year end. Given the substantial energy sector and brick and mortar retailer exposure of high-yield bonds, we maintain our preference for investment-grade debt.

After the best year for equities since 2013, the 33% plus coronavirus-induced decline has brought investors **back down to earth** by ending prolonged depressed levels of volatility, heightened levels of complacency, and the second longest bull market in US history. However, once fears subside and the benefits of global monetary easing are felt, attractive valuations should entice investors back to the equity markets. Therefore, we remain long-term constructive on global equities and prefer cyclically-oriented sectors over defensives. The Information Technology sector should not be a **falling star**, as its secular growth story remains positive with the anticipated roll-out of 5(G) later this year.

Although a long-term positive for the global economy, oil prices have fallen to levels not seen since **many moons ago**. The emergence of the oil price war between Saudi Arabia and Russia, compounding the dramatic fall-off in global demand (estimated to be worse than the 2008 and 2009 declines combined) has resulted in prices at which the global oil industry cannot sustainably function. For this reason, the price war is bound to end soon. Further support for oil is embedded in our expectation that aggressive monetary policy and a burgeoning budget deficit (~$3 trillion) will cause the dollar to modestly weaken throughout the year. Oil will likely continue to test the $20/bbl level this quarter, while lock-downs and demand disruptions are the most severe, before rebounding towards $45/bbl by year-end.

**It doesn't take a rocket scientist** to know volatility will be present in both the near and intermediate term. Selectivity remains of the utmost importance and just as the **take-off** and **landing** of the rocket are the most critical steps of a flight mission, buying and selling decisions are critical to the success of a portfolio. Exercise patience rather than panic, and rely upon your financial advisor and asset allocation in order to achieve your long-term investment goals.

Please be safe and stay healthy!

**Lawrence V. Adam, III, CFA, CIMA®, CFP®**
*Chief Investment Officer,* Private Client Group

## Investment Strategy Committee Members

**Lawrence V. Adam, III, CFA, CIMA®, CFP® – Committee President,** Chief Investment Officer, Private Client Group

**Chris Bailey** European Strategist, Raymond James Investment Services Ltd.

**Scott J. Brown, PhD** Chief Economist, Raymond James

**James C. Camp, CFA** Managing Director, Strategic Income, Eagle Asset Management*

**Doug Drabik** Managing Director, Fixed Income Research

**J. Michael Gibbs** Managing Director, Equity Portfolio & Technical Strategy

**Kevin Giddis** Chief Fixed Income Strategist, Investment Strategy

**Nick Goetze** Managing Director, Fixed Income Solutions

**Nicholas Lacy, CFA** Chief Portfolio Strategist, Asset Management Services

**Joey Madere, CFA** Senior Portfolio Analyst, Equity Portfolio & Technical Strategy

**Ed Mills** Managing Director, Washington Policy Analyst, Equity Research

**Pavel Molchanov** Director, Energy Analyst, Equity Research

### Chief Investment Office

**Anne B. Platt, AWMA®, AIF®, RICP® – Committee Chair,** Vice President, Investment Strategy & Product Positioning, Investment Strategy

**Giampiero Fuentes** Investment Strategy Analyst, Investment Strategy

**Taylor Krystkowiak** Investment Strategy Analyst, Investment Strategy


**Chris Meekins,** Director, ***Health Care Policy Analyst,*** Equity Research

> Development of drugs to treat the disease and vaccines to prevent contraction of the disease has begun.

The outbreak of a novel coronavirus (COVID-19), initially in China and then around the world, creates concerns over its economic impact. According to the Centers for Disease Control (CDC), "Coronaviruses are common throughout the world. Seven different coronaviruses, that scientists know of, can infect people and make them sick. Some human coronaviruses were identified many years ago, and some have been identified recently. Human coronaviruses commonly cause mild to moderate illness in people worldwide." This newest coronavirus likely began near the city of Wuhan, China and then became widespread in an animal market in the city. The virus quickly reached epidemic levels and began to spread outside of the region. For the vast majority of patients, symptoms are mild or moderate and are similar to the common cold or influenza. For a smaller percentage, hospitalisation is required and, for about 1%, death occurs. Individuals with the worst symptoms tend to be older and have other contributing factors like smoking, asthma, diabetes, and similar respiratory issues. Though many scientific questions about the virus remain unanswered and some of the information may change, it appears the reproduction rate of the virus (when mitigation measures are not taken) is two to three, meaning each infected person infects another two to three people.

As cases spread around the globe, governments had to choose how to try to limit the spread. In the US, the government put in place travel restrictions from areas most impacted by the virus, quarantined individuals returning from other nations that may be infected, funded clinical trials of new therapeutics and vaccines, and took other steps that helped to initially limit the spread. The government did make one major mistake. The CDC initially sent out faulty diagnostic tests to state and local labs and took weeks to get functional tests out. In addition, the CDC limited which individuals could actually get tested. As a result, community transmission went unnoticed for weeks and the virus went unchecked. The government eventually got tests out to key leaders, but it was too late to prevent significant spread in the US.

Development of drugs to treat the disease and vaccines to prevent contraction of the disease has begun. Under ideal conditions, vaccines take around two years to be developed. For therapeutics, the hope is a drug that already exists can be re-purposed to treat this disease, which could be used in weeks. If an existing drug will not work, a new therapeutic will need to be developed, which likely could take two years.

The COVID-19 outbreak will likely impact the 2020 elections. At its core, the American public expects its president to be the "Protector in Chief." That usually focuses on national security (protection from war or terrorist attacks) and economic security (protection of jobs), but now it may include health security. Given the widespread outbreak, Americans who previously felt protected by the previous administration may now consider a different candidate.

## The UK Market and Economy

**Chris Bailey,** *European Strategist,* Raymond James Investment Services Ltd.

"All things that we ordained festival
Turn from their office to black funeral;
Our instruments to melancholy bells,
Our wedding cheer to a sad burial feast;
Our solemn hymns to sullen dirges change;
Our bridal flowers serve for a buried corse;
And all things change them to the contrary'
- William Shakespeare

The earliest documented transmission of COVID-19 within the U.K. may only have appeared on the 28th of February of this year, but by the first of April there were just shy of thirty thousand cases and very sadly over two thousand, three hundred people had died and the country had been on lock-down for over a week. Such is the rapid impact of a true exogenous shock such as a global pandemic on an open economy, which has a local equity index with a global earnings base.

Many of the events of the last four or five weeks feel highly unusual to classic British notions of freedom. However the solid institutional response within the U.K. has also been striking. Aside from the gargantuan efforts on the healthcare front line, economy-impacting actions including the Bank of England restarting quantitative easing and reducing interest rates to their lowest level for over 325 years, and a raft of cheap corporate lending and direct worker assistance initiatives announced by the government, have surprised many both in terms of their size and speed of announcement.

A big response was clearly necessary. The decision to effectively lock-down large swathes of an economy is a decision that should not be taken lightly, albeit influenced from learnings sourced from both Asia and Continental Europe, about seemingly the best way to minimise the medium and longer-term impacts of a pandemic. The shorter-term impact of effectively nationalising a material element of the national wage bill will show up in both the central bank and fiscal deficit balance sheets for years to come, but as a measure to maintain a degree of consumer and corporate structure is entirely justifiable.

The first objective has to be centred on virus control and the related subject of lock-down duration. Financial market volatility during the first quarter of the year has tentatively anticipated a recessionary lock-down in the western world (including the U.K.) that stretches deep into May. Drawing on the experiences of a number of countries in East Asia on virus suppression and control measures this should give the U.K. government time to tame the outbreak, albeit that closing this door will only mean opening the equally challenging objective of 'restarting the economy', a period of time which will require the slow but steady removal of government support mechanisms in order not to provide disincentives for private business to take risks (and hence create jobs and ultimately wealth).

One highly likely casualty of this crisis will be a speedy resolution of the required detailed Brexit trade discussions to finalise all day-to-day aspects of the U.K.'s exit from the European Union. Expect this to be postponed to 2021. Similarly many of the specific initiatives anticipated by regions geographically far removed from London will now only practically be considered in a backdrop where COVID-19 has ceased to be a significant national (and international) concern. The highly open nature of the U.K. economy and global earnings backdrop of the U.K. equity market, will mean that real advances in both the Pound and the stock market will only come with a period of resurgent international calmness about COVID-19 - and economic growth rates.

However, what is very clear already is that a number of domestic themes developed in recent weeks will be deeply influential throughout the early part of the 2020s within the U.K. economy. ▸▸


## Supply Chain Disruptions

Given the increasingly globalised nature of supply chains, viral pandemics like COVID-19 can have prolonged negative knock-on effects to the economy.


The U.K. will have to learn to become a little more self-sufficient as global supply chains and just-in-time techniques will pragmatically be slightly less relied upon. For a U.K. economy on the cusp of practically embracing a post-Brexit world, this ideally should set off a new epoch of national entrepreneurship and general initiative, backed by sufficient government spending to fund an active pro-regions policy.

Flexibility and pragmatism are going to be central for any country trying to bounce back from the extreme challenges of the COVID-19 period. These traits should play to traditional British strengths but will require careful management by both the government and the Bank of England. However, given the sharp increase in national indebtedness that the crisis has manifested, unless we want to spend later years in the 2020s talking about inflation or sovereign rating agency cuts, it is essential they are successfully implemented. As with any period of huge challenge, ultimately emerging victorious matters little if you cannot offer up a suitably attractive peacetime.

**KEY TAKEAWAYS:**

- Actions by the U.K. government and the Bank of England have surprised many both in terms of their size and speed of announcement;
- Immediate objectives have to be centred on virus control and the related subject of lockdown duration;
- Brexit and regional policy initiatives are highly likely to be postponed to 2021 at the earliest;
- The U.K. will have to learn to become a little more self-sufficient as global supply chains and just-in-time techniques will pragmatically be slightly less relied upon.

## Continental Europe

**Chris Bailey,** ***European Strategist,*** Raymond James Investment Services Ltd.

'There are decades where nothing happens; and there are weeks where decades happen'

— *Vladimir Ilyich Lenin*

Very sadly, official national government statistics show that - at the time of writing - three out of the five countries suffering the most COVID-19 related deaths are from the eurozone. The reason that Italy, Spain and France have been so impacted partially reflects the open nature of the pan-European economy with material tourism, travel and trade links, partially an ageing population and partially relatively large centres of population. What cannot be criticised is the application and rigour of key healthcare workers and national governments. The latter has seen multiple new fiscal expenditure and support plans, including the overt ending of the German balanced budget rule. Sadly this latter event - which many eurozone watchers had been requesting for a considerable period of time - needed the impetus of a truly international crisis (and the high likelihood of a sharp economic contraction) to occur.

From a broader European Union perspective however, policy cohesion cracks have been exhibited. Whilst the European Central Bank under Christine Lagarde was quick to offer unlimited support in both words and actions, an institution already with its key monetary policy instrument set at a negative interest rate level can only offer so much new support. Meanwhile, the continued debate - as opposed to action - over the potential use of truly pan-European level instruments including 'coronabonds' issued by the European Stability Mechanism (a European Union agency that provides financial assistance, in the form of loans, to eurozone countries or as new capital to banks in difficulty), has shown the difficulty in coordinating a series of national governments. This is especially true when agreeing to the use of such instruments is highly likely to mean an effective transfer from the more fiscally prudent northern European states led by Germany, to typically less fiscally prudent southern European nations.

We have been here before with the European Union, most pertinently with the Greek debt crisis but also in the recent Brexit discussions. In both events, last minute deals were struck when none appeared likely. Equivalently at the time of writing, current rumours surrounding the rolling out during the second quarter of 2020 of a de-tuned ESM loan initiative accompanied by an EU-wide unemployment scheme persist. Expect an announcement during upcoming weeks.

The next few weeks will also be highly influential in the COVID-19 battle. Despite the distressing images and flow of statistics, tentatively the most impacted eurozone countries are bringing new cases, hospitalisations and (with a lag) death rates under control as lockdown periods extend closer to the duration of a few weeks. As with other western countries, the challenges of restarting economies coherently and in a sustainable manner await beyond the overt virus suppression periods.

What also awaits is a deeper discussion about the cohesion of the European Union. Whilst pan-European institutions and structures - such as the euro - remain broadly popular, the COVID-19 crisis has highlighted again that pan-European policymakers are relatively slow moving compared to single country national equivalents, albeit that when finally roused into action, they can be surprisingly material in the extent of their policy prescriptions. Much of these discussions can wait for later in the decade. After all, with the retirement from front line politics of the current German Chancellor Angela Merkel still set for next year, much is naturally going to change within the pan-European political scene.

**KEY TAKEAWAYS:**

- Three out of the five countries suffering the most COVID-19 related deaths are from the eurozone;
- Multiple new fiscal expenditure and support plans, including the overt ending of the German balanced budget rule have been announced in recent weeks;
- Expect an announcement during upcoming weeks of new eurozone level initiatives.

COVID-19 360°

"These [stimulus] efforts won't prevent the economy from weakening, but should limit the damage and help in the eventual recovery."

## US Economic Impact

**Scott J. Brown, PhD,** *Chief Economist,*
Raymond James

COVID-19 is having a major impact on the US economy. Economists have had to lower their outlook for growth almost on a day-to-day basis. In his telephone conference call following the Federal Reserve's (Fed) second emergency rate cut, Chair Jerome Powell said that the Fed's economic forecasts "depend heavily on the spread of the virus, the measures taken to affect it, and how long that goes on, and that's just not something that is knowable."

Testing for the virus has been woefully inadequate. That makes it impossible to accurately gauge how far the virus has spread and whether mitigation efforts are working. In turn, the failure to test adds considerable uncertainty to the economic outlook. While a number of states have been under lockdown, social distancing has been more sporadic in many places (for example, spring break in Florida).

Initially, the virus appeared likely to have a sharp but brief impact on China's economy. US firms would experience supply chain disruptions and a temporary loss of sales into China. As it spread to other countries, supply chain disruptions would become more significant and the outlook for global growth would be diminished. However, the spread in the US and the efforts taken against it have had a sharp, negative impact on the outlook for domestic growth and jobs.

Social distancing is the main tool to limit the spread of COVID-19 with the goal of flattening the curve, providing more time to develop treatments and a possible vaccine. Sharp declines in activity have occurred in a number of industries, including restaurants, airlines, hotels, cruise lines, sporting and spectator events, and retail. Layoffs and the loss of income will have second-round effects on consumer spending. A weaker global economy will hurt US exporters. Increased uncertainty will reduce business fixed investment. Real Gross Domestic Product could fall 5%, 10%, or more for the year as a whole (4Q20/4Q19).

The unemployment rate, 3.5% in February, could rise to 10%, 15%, or 20%.

Credit problems have shown up shockingly early, threatening to amplify the economic downturn. The US Treasury market, the most liquid in the world, experienced trouble in the second week of March. The Fed has responded with two emergency rate cuts, leaving the target range for the federal funds rate at 0-0.25%. The Fed restarted large-scale asset purchases (quantitative easing) and then made that unlimited. It has encouraged banks to lend out of their capital and liquidity buffers. Day by day, the Fed has introduced an alphabet soup of credit, liquidity, and funding facilities – and will likely do more to prevent a broad collapse in credit. At no risk to US taxpayers, the Fed expanded swap lines to other central banks to relieve global strains.

Lawmakers in Washington have responded with a $2 trillion fiscal stimulus package, including increased health care spending, increased unemployment benefits, aid to damaged industries, cash and credit for small businesses, and "recovery rebate" checks for individuals. These efforts won't prevent the economy from weakening, but should limit the damage and help in the eventual recovery.

The federal budget deficit, already at $1 trillion with the economy at full employment, will rise sharply, but that is not a concern. State and local governments have balanced budget requirements. Revenue declines were a significant issue in the 2008-09 financial crisis and its recovery. The stimulus package has some relief for the states, but not nearly enough. That will have to be addressed later on.

Americans want the economy to get back to normal, but ending social distancing too soon could make things worse. Moreover, there are likely to be longer-lasting changes in consumer behaviour and global trade once the virus passes.

## US Equities

**J. Michael Gibbs,** *Managing Director,* Equity Portfolio & Technical Strategy

**Joey Madere, CFA,** *Senior Portfolio Analyst,* Equity Portfolio & Technical Strategy

### 2020 Price Target

| S&P 500 | EPS ESTIMATE | P/E | PRICE |
|---|---|---|---|
| Bull Case | $167 | 21x | 3,507 |
| Base Case | $155 | 19.5x | 3,023 |
| Bear Case | $130 | 16x | 2,080 |

Source: Raymond James Equity Portfolio & Technical Strategy

The market's selloff since the peak on 19 February has been historic to say the least, reaching -34% at the lows on 23 March. With the global economy screeching to a halt, and the number of new COVID-19 cases increasing every day, global equities are understandably on the defensive. Admittedly, it is nearly impossible to have a great deal of confidence in economic and fundamental assumptions with the duration of the COVID-19 pandemic so uncertain and fluid at the moment. However, the economic outlook has worsened dramatically in recent weeks. The key is the spread of the virus. In our base case assumption, we look for the number of new COVID-19 cases to plateau around Memorial Day. In this scenario, we anticipate a pronounced economic slowdown at the end of Q1, throughout Q2, and lingering into Q3. This most likely results in a very sharp, but short recession, allowing time for the economy to start showing signs of a recovery in the fall and latter half of the year.

This base case scenario brings our S&P 500 earnings estimate for 2020 down to $155, reflecting a -4% earnings contraction for the full year. From a valuation standpoint, the S&P 500 now trades at a ~15x price-to-earnings multiple (P/E), below the long-term average of 16.5x and 28% lower than the peak 20.7x P/E seen on

**Full-year 2020** earnings estimate 〉 **$155** from **$167**

19 February . On average, bear markets historically have seen P/E multiples contract by 28%. Looking forward, it is important to remember that the stock market is a forward-looking mechanism, meaning valuation multiples will start to rise long before

**P/E FORWARD MULTIPLE**
**19.5x**

**2020 PRICE TARGET**
**3,023**

economic data and corporate profits find a trough. Stocks have historically bottomed four months prior to recession end and four to six months before earnings trough. For example, the credit crisis P/E bottomed at 10x, and expanded to 17x by the time earnings troughed. For this reason, we maintain a 19.5x P/E year-end base case forecast as the market tends to discount the eventual recovery ahead of time. This results in a base case S&P 500 target of 3,023 for 2020 reduced from 3,400.[1]

Our bear case assumes a deeper recession that lingers, resulting in a 3% GDP contraction this year and $130 in S&P 500 earnings (-20% y/y earnings decline). Using a 16x P/E multiple, the result is a bear case S&P 500 target of 2,080. At this point, uncertainty regarding the ultimate economic impact and, more importantly, the magnitude of recovery by year end, leaves us with guarded confidence in our forecasts. In the coming weeks, additional information regarding the virus spread and need to keep businesses locked down should improve forecasting ability. ▶▶

[1] The January 2020 ISQ outlook showed an S&P 500 price target of 3,400 for 2020.

COVID-19 360°

“We believe the current volatility presents a tremendous opportunity for long-term investors.”

We believe the current volatility presents a tremendous opportunity for long term investors. The market will react to the spread of the virus in the coming days and weeks, and for this reason we remain guarded in the short term with the number of new cases still accelerating in the US. Determining when and at what price level stocks will bottom is guesswork at this point. Instead of focusing on 'picking a bottom,' developing a strategy to execute on the inevitable recovery is a better choice. With stocks down sharply, those with diversified portfolios and a long-term outlook can buy partial positions with some available capital now.

We suggest reserving some buying power. Even if the news is challenging and equities experience additional weakness, stocks will eventually find a bottom. As the market shifts from decline to advance, allocate additional capital. As previous bull market recoveries reveal, buying at the absolute bottom is not necessary to generate sizeable returns. Bear market declines are often rapid, whereas bull markets typically last for much longer periods of time. Since 1958, the average bull market lasted approximately 41 months and advanced by 155%, whereas the average bear market retreated 33% over a mere 12 months during that same period.

## Recessionary Bear Markets

| MARKET TOP | MARKET BOTTOM | TOTAL MONTHS | BEAR MARKET DECLINE | MONTHS TO RETURN TO HIGH FROM BOTTOM |
|---|---|---|---|---|
| **Jul-57** | Oct-57 | 3 | -20% | 12 |
| **Jan-60** | Oct-60 | 10 | -18% | 6 |
| **Dec-68** | May-70 | 17 | -36% | 31 |
| **Jan-73** | Oct-74 | 22 | -48% | 75 |
| **Feb-80** | Apr-80 | 2 | -21% | 4 |
| **Feb-81** | Aug-82 | 6 | -24% | 3 |
| **Jul-90** | Oct-90 | 3 | -21% | 4 |
| **Mar-00** | Oct-02 | 27 | -49% | 60 |
| **Oct-07** | Mar-09 | 17 | -59% | 50 |
| **Average** | | **11.9** | **-33%** | **27** |
| **Median** | | **10.0** | **-24%** | **12** |

Source: Raymond James Equity Portfolio & Technical Strategy

# The East Asian Response

**Chris Bailey,** *European Strategist,* Raymond James Investment Services Ltd.

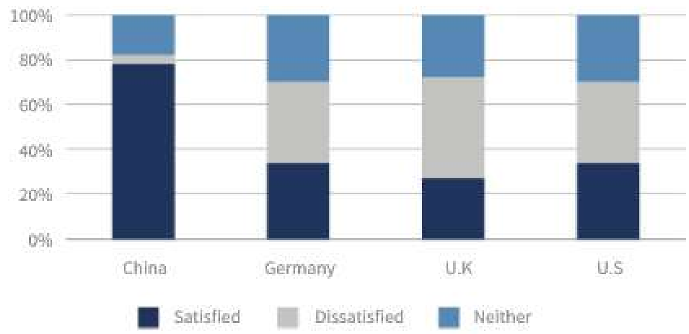
'To know what you know and what you do not know, that is true knowledge'
- Confucius

The history books will be the ultimate arbiters on China's response and data disclosures around the COVID-19 virus. The magnitude - in true reality - of Chinese total cases and deaths may never be sufficiently fully disclosed to satisfy some observers. However, what is more tangible is the aggressive and ultimately successful response over recent months of the Chinese authorities to a virus which threatened the stability of the world's largest emerging market. China's economy will struggle to produce a growth rate even close to that anticipated by central planners at the turn of the year, but the response playbook developed within its borders as well as elsewhere in East Asia has already been deeply influential around the world.

By the end of March - scarcely two months after the Lunar New Year period that occurred under progressively tighter and tighter lockdown conditions - economic life in cities across China (including amazingly the epicentre of the COVID-19 outbreak, Wuhan in Hubei province) is progressively returning to normal. Once again, the Shanghai subway system is busy, traffic jams are occurring in Beijing and across the country people can now sit together in their favourite coffee or tea shop. Scrape below the surface, however, and it becomes obvious that lockdown alone is not the reason for the ability of China, South Korea, Taiwan and Hong Kong to have great success in trying to move on from COVID-19 fears directly dominating economic and social life.

Face mask culture in East Asia (in prior years mainly to guard against colds or pollution) may have been helpful at-the-margin, along with a wide range of temperature monitoring devices at airports and retail destinations, but big data is at the heart of the region's seemingly successful pushing back against the virus threat. With an unseen enemy such as COVID-19, any ability to identify and monitor the infected can be hugely helpful given its likely material impact on the reproduction rate (i.e. how many uninfected people an infected person will infect). If you can push this to less than one and keep it there, even the most persistent of viruses will naturally fade away.

**Percentage of citizens who are satisfied/dissatisfied with the response of their fellow citizens to COVID-19**




Source: Statista Survey (undertaken 23 - 30 March)

Authorities in China – and some other countries in the region – used national identity cards, app and GPS monitoring data not only to observe if lockdown restrictions were being adhered to, but also to help agents trace the potentially infected. Put all of this together and the invisible enemy becomes a little more visible.

To western sensibilities who have grown up on notions of liberty, equality and fraternity, this approach may appear a little bit too 'Big Brother' for their liking. Certainly such data applications raise a myriad of privacy concerns but in the narrow - but sadly hugely recently impacting - world of pandemic virus control, it has proved immensely helpful.

Naturally the COVID-19 pandemic continues to impact the economies of East Asia, especially in the form of 'imported' cases, often from citizens returning from work or study in western countries. Consumers are still struggling to fully return to their pre-crisis habits, and business owners remain mindful of both local disruption and international lockdowns, but the broad tone is far closer to the historic norm than anywhere else in the world. Expect therefore western governments to copy other elements of the East Asian playbook to aid their battle against COVID-19. However, such a partial adoption probably also means one other harsh reality: the speed of East Asia's return to normality should probably not be naively applied to the western world too.

**KEY TAKEAWAYS:**

- China (and some other countries in East Asia) are emerging from the COVID-19 crisis;
- Big data is at the heart of the region's seemingly successful pushing back against the virus threat;
- Such data applications raise a myriad of privacy concerns but in the narrow world of pandemic virus control, it has proved immensely helpful;
- The speed of East Asia's return to normality should probably not be naively applied to the western world.

## Fixed Income

**Doug Drabik,** *Managing Director,*
Fixed Income Research

**Kevin Giddis,** *Chief Fixed Income Strategist,*
Investment Strategy

**Nick Goetze,** *Managing Director,*
Fixed Income Solutions

While it appears that the effect of COVID-19 on the fixed income market is changing almost every day as new cases are discovered and the course of the pandemic remains uncertain, the consistency of the bond market's response is worth noting. Each day that the virus remains uncontained, the greater the chance that the global economy will be affected to a greater degree. Early on, this was considered a regional outbreak, mostly affecting Asia and surrounding countries.

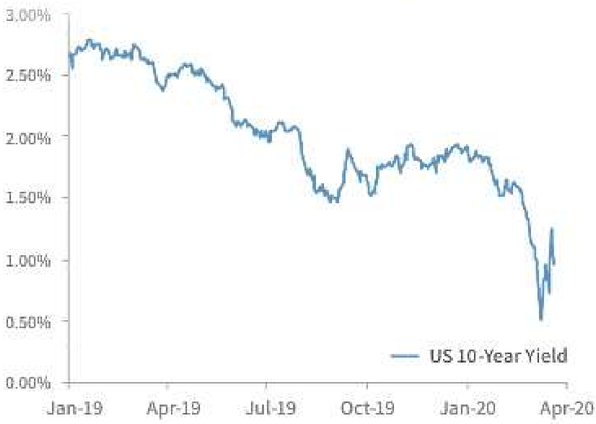
The outbreak of COVID-19 began impacting the bond market in early January, when the yield on the 10-year Treasury was approximately 2%. The general feeling was that the virus would remain an epidemic (as opposed to a pandemic) and not spread to the rest of the globe. All of that changed on Monday, 24 February when cases of the virus turned up in Italy. The theory of this being a short-term event was immediately dispelled, and the reality of a growing global outbreak spurred a rally in the US Treasury market, which has now reached near-record heights.

A wider-ranging question remains: what is the long-term impact of COVID-19? The shutdown of businesses and isolation measures have turned a medical crisis into a financial one as well.

To date, the impact has been forceful and abrupt on bonds. However, other geopolitical news has influenced market direction only to fade in time as the psychological affect ultimately proved greater than the fundamental affect.

Although these geopolitical events have influenced bonds, a consistent force in the market since the financial crisis of 2009 has been easy monetary policy around the world, which has pushed both stock and bond markets up (down in yield). Are the markets more prone to unexpected world events such as COVID-19? Or has the bond market been animated primarily by the policies of central banks? By the end of 2019, the market had all but forgotten Brexit and the phase one trade deal with China. Bonds were poised for lower prices/higher yields. The advent of COVID-19 completely derailed this trajectory. The uncertainty and fear surrounding the outbreak has driven panicked moves, triggering model-driven actions and creating a liquidity issue, which has since driven a significant gap in credit spreads. However, this is likely to normalise as fear subsides.

### US 10-Year Treasury Yield




Source: FactSet as of 3/20/2020

> The COVID-19 outbreak has pushed yields on the 10-year Treasury note to all-time lows.

While it is very hard to make investment choices when this is happening, here are a few things for investors to keep in mind: 1) Historically these outbreaks do have a timeline. 2) The high-quality fixed income allocation needs to be maintained for liquidity and to preserve capital. 3) New fixed income allocations and/or cash flows should be filtered into lower durations. 4) Do not try to pick the bottom. Rather, position your portfolio to take advantage of when the economic cycle turns back upward.

Central banks stand by to provide the proper monetary stimulus. They have already announced the implementation of a number of 2008-era programs, which are designed to increase liquidity and restore functionality to the markets. Look for the fiscal stimulus package to follow suit. Again, preserve capital, but remain cautious using fixed income for needs beyond that. When this virus is contained (which is anyone's guess) we expect the bond market to snap back, pushing yields higher in the process (but likely well below where we were at the beginning of 2020). Having said that, each day is a challenge to the return of normal market activity.


"We forecast global demand down 1.5 million bpd for 2020, steeper than the declines from 2008 and 2009 (the two financial crisis years) combined."

## Oil Markets

**Pavel Molchanov,** *Director, Energy Analyst,*
Equity Research

The oil market is facing an unprecedented one-two punch, but we envision recovery by 2021.

Oil's bear market dates back to February, with the clear culprit being the impact on global oil demand arising from the transportation and economic disruptions due to COVID-19. During January and February, COVID-19 had been seen as a problem largely contained within China. Throughout March, however, it became clear that the impact would be truly global in scope. As the public health situation in China shows encouraging signs of stabilisation, the opposite is true practically everywhere else. As governments impose flight restrictions and other travel bans, enforce lockdowns, and require non-essential businesses to close doors, the impact on oil consumption is unlike anything in modern history. Numerous airlines are reporting over 50% flight cancellations. With 800+ million students affected by school and university closures, that means many fewer buses and cars on the roads. Countless millions of people are working from home, due to government directives or company instructions. In the second quarter of 2020, the impact of all these disruptions is likely to exceed 5 million barrels per day (bpd), or 5% of global demand. Needless to say, the timing of improvement in demand, enabled by the easing of the various restrictions, will largely be a function of medical and public health developments vis-a-vis the virus. Assuming that this second quarter figure marks the peak of impact, we forecast global demand down 1.5 million bpd for 2020, steeper than the declines from 2008 and 2009 (the two financial crisis years) combined.

Sometimes, when it rains, it pours. Such is the case with the oil price war between Saudi Arabia and Russia, which emerged suddenly and dramatically on 7 March, compounding the already ultra-bearish demand backdrop. These two countries had collaborated as part of the OPEC+ coalition over the previous three years, but no longer. Saudi Arabia is vowing to increase oil production to record levels in response to Russia's refusal to cooperate with new production guidelines. This price war, to be clear, is not against US shale; this is a key contrast to the 2014-2016 price war. Saudi Arabia can see perfectly well what has been happening in the US oil industry: depressed rig counts and sharply slowing production growth, even before the dramatic events of recent weeks. The Saudi vs. Russia fight is partly economic, and it is also political. Russia will have a major constitutional referendum on 22 April, arguably the most sensitive moment in domestic politics during Vladimir Putin's 20 years in power. In the run-up to the referendum, the Kremlin is stirring up nationalist fervour at home, and that translates into more intransigence than usual in foreign policy. Moreover, the Saudis and Russia have never stopped being at loggerheads over Iran and Syria. Here is the good news: assuming that Putin wins the referendum, we anticipate that Russia will become more receptive to international deal-making, opening the door to an agreement with Saudi Arabia in May/June, followed by normalisation of Saudi oil production. It bears mentioning that the Saudi economy needs $70/Bbl Brent crude to balance its all-in fiscal requirements. Moreover – and this is another big distinction versus 2014-2016 – Saudi Aramco (its state-owned oil company) is now publicly traded. Does the Saudi crown prince want to deal with angry domestic investors who are seeing losses from the IPO price? Again, this factor, a key test of the royal family's credibility, did not exist four or five years ago. Russia's economy is less oil-sensitive, but it would also begin to feel real pain within months. Thus, we look at this Saudi-Russia breakup as a transitory issue. ▸▸

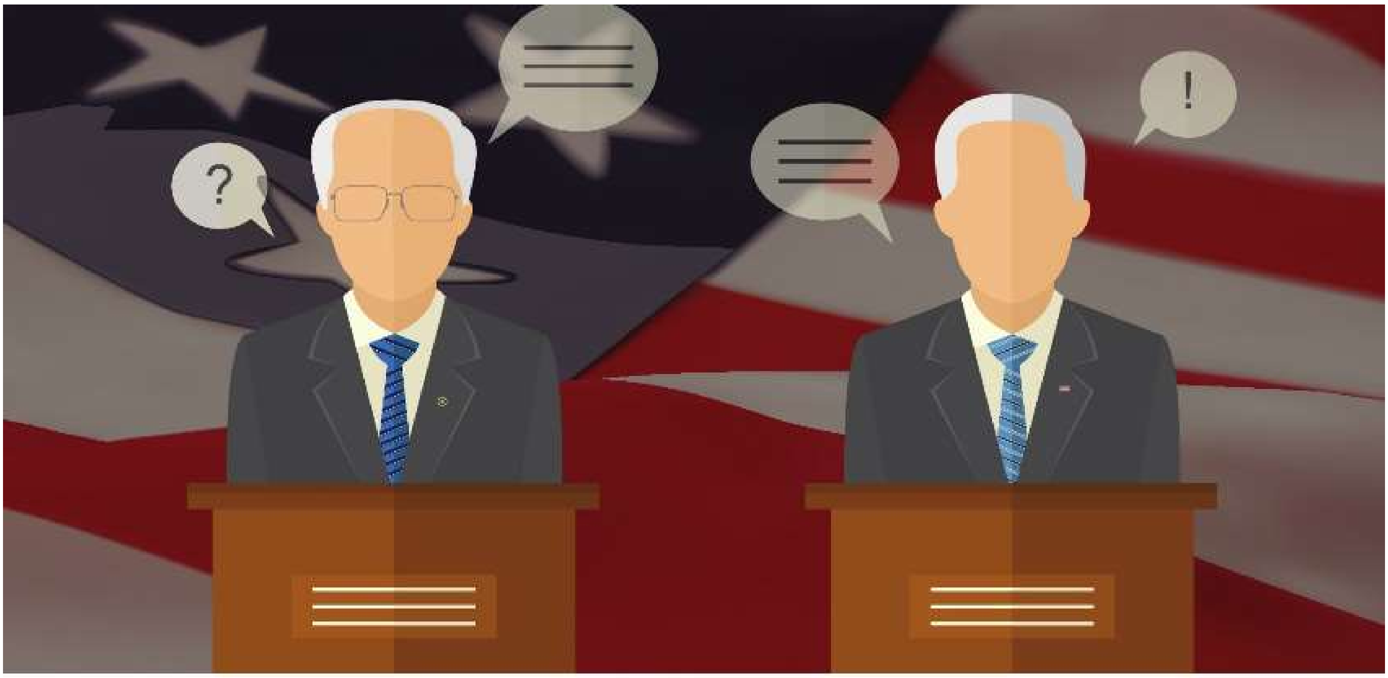
## Drop in Oil Demand


Source: Raymond James Equity Research as of 20/03/2020

> "An oil price war between Saudi Arabia and Russia emerged suddenly and dramatically on 7 March, compounding the already ultra-bearish demand backdrop."

In the short run, oil market conditions will surely be volatile. The floor during the 2014-2016 oil down cycle had been set when numerous data points began to emerge about higher-cost/lower-margin oil producers physically shutting down wells. Plenty of the world's oil trades at hefty discounts relative to the light sweet benchmarks, so the point at which marginal cost begins to exceed marginal revenue at certain oilfields is closer than it might seem at first glance. West Texas Intermediate (WTI) crude stayed under $40/Bbl for approximately 100 days (from December 2015 through March 2016). Its absolute bottom was $26/Bbl in February 2016. This time, the degree of oversupply is much worse, so it stands to reason that the trough will also be lower. We think that WTI will test the $20/Bbl level in the second quarter of 2020 – the lowest since 1999 – averaging $25/Bbl for the quarter. After that, we forecast a V-shaped bounce to $45/Bbl in the fourth quarter and then a slower recovery to an average of $55/Bbl in 2021.

So, how is the oil industry handling this exceptionally difficult period? What practically every oil producer is currently focused on, as the first line of defence, is cutting capital spending. In many cases, they are cutting quite sharply, by 30% or even more, as compared to the initial budgets from January/February. Some reductions in corporate costs are also inevitable, and a limited number of companies will cut or suspend dividends. The main driver will be to slow drilling activity and postpone projects. By responding rapidly in this way, the large, investment-grade companies will be able to steer themselves through this period. In fact, they may even benefit - over a long-term timeframe - by taking advantage of this crisis as an opportunity to pick up cheap, distressed assets when some of the smaller players with excessive leverage end up going through bankruptcy.




# On the Ropes to Presumptive Nominee: Biden's Historic Resurgence

**Ed Mills,** *Managing Director, Washington Policy Analyst,* Equity Research

A whirlwind Democratic primary appears to be nearing its conclusion with Vice President Biden emerging as the presumptive nominee (in our view) following a come-from-behind victory in South Carolina and a near-sweep in state victories through March. Biden currently leads Sanders with 1,215 delegates to Sanders' 909, a sizeable lead (1,991 delegates are needed to clinch the nomination on the first ballot).

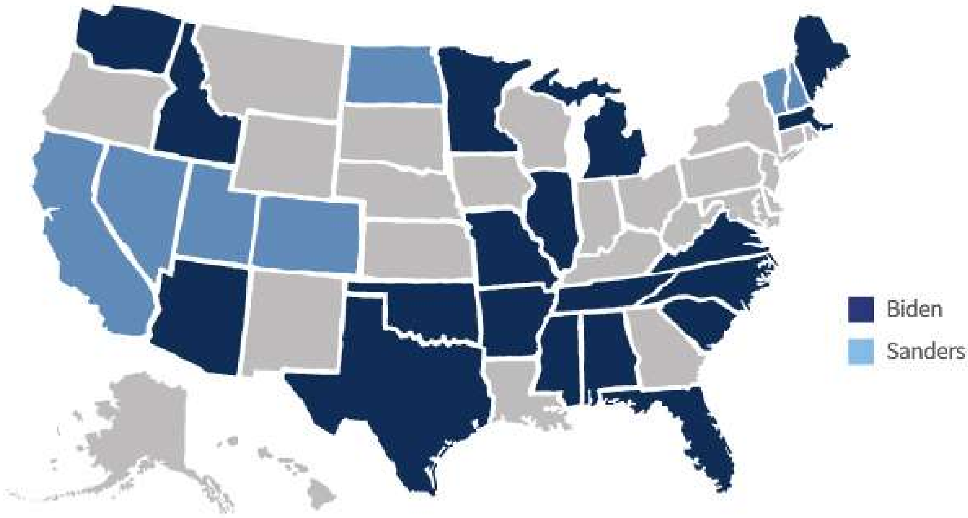
> A female vice-presidential candidate will be on any Biden-led ticket, according to a pledge made by Biden at the last debate.


**1,991 delegates are required to obtain the nomination.**

The winner of either the Iowa, New Hampshire, or South Carolina primary has gone on to become the Democratic nominee since 1952. As such, there is no recent historical comparison to Biden's resurgence to the top of the pack after finishing a distant fourth or fifth place in Iowa and New Hampshire. The last Democratic candidate to emerge as the nominee without having won Iowa or New Hampshire was Bill Clinton in 1992, but Clinton technically tied New Hampshire's popular vote winner (Tsongas) in the delegate count. It would be easy to say that Biden was expected to win the South Carolina primary, so the results were somewhat in line with expectations. However, his margin of victory (especially following distant finishes in the early states) is extremely noteworthy. In the lead up to South Carolina, there were a series of polls that showed Senator Sanders right on Biden's heels. Unfortunately for Sanders, he emerged from South Carolina not much better than his 2016 result, which is ultimately where his momentum stalled out again in the 2020 race.

The coalescence behind Joe Biden as the clear alternative to Senator Bernie Sanders produced a much better than expected Super Tuesday result for the former Vice President. Former New York City Mayor Bloomberg picked up delegates, but massively underperformed expectations given he spent half a billion dollars

## Democratic Primary Battleground




on his campaign. Senator Elizabeth Warren came up short, including a loss in her home state of Massachusetts. However, she may have been an unsung hero for the Biden campaign given that she used the last two debates to halt the rise of Bloomberg and that she likely pulled liberal voters from Sanders. From there, Democratic voters overwhelmingly pivoted toward Biden as he stacked up a series of impressive wins and expanded his delegate lead over Senator Sanders. Biden also quickly racked up endorsements from his rivals, and his coalition is now being compared to that of President Obama's in 2008. Biden's victory in Michigan was of particular note, given that it was previously won by Sanders in 2016 and ultimately helped to reinvigorate/prolong Sanders' challenge to Secretary Clinton.

The overall vote totals to date have supported the narrative that Senator Sanders is a high floor, but low ceiling candidate. Sanders won the delegate-rich state of California, his home state of Vermont, as well as Utah and Colorado. However, he fell short of the earlier delegate projections where he easily could have built an all but insurmountable lead in the delegate count. Senator Sanders consistently underperformed his 2016 vote totals, especially in Missouri and Michigan.

### THE IMPACT OF COVID-19 – FLOCK TO THE FAMILIAR?

The spread of COVID-19 has upended the race in an unprecedented and uncertain way, which may still have ramifications on the Democratic convention depending on the trajectory of the outbreak. This uncertainty may have contributed to Biden's late-stage resurgence as voters may have been swayed more toward the safe and familiar choice during uncertain times. To date, nine states and Puerto Rico have postponed their primaries which leaves the race in a state of limbo, and we expect the list to grow (New York's primary is still scheduled for the end of April, potentially around the peak of the state's outbreak, per current projections).

As these primary reschedules ramp up, the Sanders campaign and Democrats could be faced with challenging logistics on how to finalise the process of selecting their nominee. The clearest path forward would be for Sanders to drop out of the race, making Biden the presumptive nominee. Alternatively, the Sanders campaign could hold out hope that the political winds change when voting resumes. We view this as unlikely, as Sanders would have to win the remaining contests by a margin of about 25 points, per election forecasters.

### EARLY VEEPSTAKES

A female vice-presidential candidate will be on any Biden-led ticket, according to a pledge made by Biden at the last debate. The final selection likely hinges on the political environment that emerges in the coming months related to COVID-19. Senator Amy Klobuchar (D-MN) is seen as a 'safer, more moderate' pick. Senator Kamala Harris (D-CA) will be in the mix, but her personal attacks against Biden during the debates and the lacklustre performance of her campaign are viewed as knocks against her. Stacey Abrams of Georgia could be a pick that excites younger and African American voters. Senator Elizabeth Warren (D-MA) is also reported to be in the mix, if there is a need to have a bridge to the liberal wing of the party. Given that Biden would be the oldest elected president on inauguration day, his pick takes on additional importance which could swing the odds toward a safer pick.

## PREVIEWING THE GENERAL ELECTION AND BEYOND

In our opinion, the medical, economic, and market outcome of COVID-19 will be a significant factor in the 2020 election. Should economic and health conditions continue to deteriorate, we expect a rise in expectations that Joe Biden captures the White House and a rise in the probability of an all-Democratic government. While he would swing the agenda away from the current Trump agenda (which has been received positively by the market over the past four years), Biden is generally viewed as promoting policy goals from the political mainstream and could easily push more fiscal stimulus. This would be viewed as having a neutral to positive impact on the market compared to the prospect of a Sanders presidency (which weighed on markets earlier this year). Should COVID-19 avoid the worst-case scenarios and the economy/market have a significant recovery in the latter half of the year, the momentum is likely to swing back toward President Trump. The big question will continue to be the effect of the current uncertainty on suburban voters. Incumbents are traditionally viewed as the safer choice, but Biden's familiarity may upend this calculation as we expect a "return to normalcy" to be the primary message of the Biden general election campaign.

In terms of a second term for President Trump, the initial reaction would be that this is a positive for the market should we see post-COVID-19 recovery in the second half of this year. A wave of momentum could produce down-ballot impacts that bring back an all-Republican government. Sentiment would be boosted on the continuation of the Trump deregulatory agenda and stimulus via additional corporate/individual tax cuts. However, an open question would remain as to whether the lack of any additional electoral checks would produce an unbound and bombastic President Trump on policy issues. A mitigating factor for the market here would be that second-term presidents are motivated by their legacy, and, as Trump is especially cognizant of market/economic metrics, his policy objectives should continue to support a positive environment for macro fundamentals.

Biden's strength in the South will stir a debate about the potential down-ballot impact. The Senate seats in Alabama, North Carolina, South Carolina, and the two seats in Georgia all lean Republican or are likely Republican seats at this point. We would not be surprised if these elections become more competitive. They are still a reach for Democrats, but winning any one of these would materially increase the chance of a Democratic Senate majority after the 2020 election with significant consequences for the markets from a policy perspective. An economic downturn coupled with this scenario would steer the early policy direction of a Biden presidency. We would expect to see stimulus efforts to jump-start the economy, which could be a positive boost to infrastructure and unlocking consumer spending via debt relief (e.g., student loans, medical debt). In turn, this could benefit the housing market by increasing demand if debt relief measures spur a boom in housing demand by younger consumers who would otherwise have delayed a real estate purchase. Of course, this would be balanced by potential negatives, such as significant policy reforms targeting the Health Care, Financial, and Energy sectors. As we frequently say in Washington, developments are never as bad as you initially fear, or as good as you hope.

### KEY TAKEAWAYS:

- In our opinion, the medical, economic, and market outcome of COVID-19 will be a significant factor in the 2020 election. Should economic and health conditions continue to deteriorate, we expect a rise in expectations that Joe Biden captures the White House and a rise in the probability of an all-Democratic government.
- Biden is generally viewed as promoting policy goals from the political mainstream and could easily push more fiscal stimulus. This would be viewed as having a neutral to positive impact on the market compared to the prospect of a Sanders presidency (which weighed on markets earlier this year).
- Should COVID-19 avoid the worst-case scenarios and the economy/market have a significant recovery in the latter half of the year, the momentum is likely to swing back towards President Trump.

## DISCLOSURE

Issued by Raymond James Investment Services Limited (Raymond James). The value of investments, and the income from them, can go down as well as up, and you may not recover the amount of your original investment. Past performance is not a reliable indicator of future results. Where an investment involves exposure to a foreign currency, changes in rates of exchange may cause the value of the investment, and the income from it, to go up or down. The taxation associated with a security depends on the individual's personal circumstances and may be subject to change.

The information contained in this document is for general consideration only and any opinion or forecast reflects the judgment of the Research Department of Raymond James & Associates, Inc. as at the date of issue and is subject to change without notice. You should not take, or refrain from taking, action based on its content and no part of this document should be relied upon or construed as any form of advice or personal recommendation. The research and analysis in this document have been procured, and may have been acted upon, by Raymond James and connected companies for their own purposes, and the results are being made available to you on this understanding. Neither Raymond James nor any connected company accepts responsibility for any direct or indirect or consequential loss suffered by you or any other person as a result of your acting, or deciding not to act, in reliance upon such research and analysis.

If you are unsure or need clarity upon any of the information covered in this document please contact your wealth manager.

APPROVED FOR CLIENT USE

RAYMOND JAMES

Head Office Ropemaker Place 25 Ropemaker Street London EC2Y 9LY

www.RaymondJames.uk.com

Raymond James Investment Services Limited is a member of the London Stock Exchange and is authorised and regulated by the Financial Conduct Authority Registered in England and Wales number 3779657 Registered Office Ropemaker Place 25 Ropemaker Street London EC2Y 9LY