Update on the economy and the financial markets

Perspectives from Tony Malloy, Executive Vice President and Chief Investment Officer

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- *"May you live in interesting times"* is an ancient proverb that will be familiar to many. While seemingly a blessing, the expression is normally used ironically: Life is better in "uninteresting times" of peace and tranquility than in "interesting" ones, which are usually times of trouble.

- At the risk of stating the obvious, we are clearly living through interesting times. But as our head of corporate bond trading, Ralph Marinaccio reminds me, this is often the case, as it seems that every ten years or so, some big economic or market event happens, seemingly out of nowhere.

- I've observed several major economic crises over the course of my nearly 40-year career. In 1981, then Fed Chair Paul Volcker broke the back of inflation, resulting in a significant recession. Black Monday arrived in October 1987, the biggest one-day percentage drop in stock market history. Who can forget the dot-com crash in 2001 or the Great Recession in 2009?

- History teaches us that these "interesting" times happen a lot more regularly than we choose to remember. After living through an "uninteresting" decade that included the longest economic expansion in U.S. history, we find ourselves shocked by the sudden and swift reversal of economic and market fortunes.

- While economic and market shocks are not unusual, there are aspects of this crisis that are truly unprecedented. The International Monetary Fund recently labeled the current crisis the Great Lockdown.

- At least one-quarter of the U.S. economy has suddenly gone idle amid the COVID-19 pandemic. This is an unprecedented shutdown of commerce that economists say has never occurred on such a wide scale.

- Forty-one states have ordered at least some businesses to close to reduce the spread of the coronavirus. Restaurants, universities, gyms, movie theaters and public parks have closed

- The business closures will ultimately hurt the demand side of the economy, which in turn will further dent output. The most significant evidence of that, thus far, is layoffs. Roughly 17 million people, or 1 in 10

- workers, applied for first-time unemployment benefits in the past three weeks, shattering previous records.

- Most of those jobs were in restaurants and bars, though employment fell broadly, including in hotels, construction, state government, health care and retail. Those workers could ultimately pull back on spending, in turn hurting other businesses that remain open.

- Indeed, retail sales declined 8.7% in March, the biggest monthly decline ever, as people stopped buying vehicles, clothing, furniture and dining out. The fall-off signals the severity of the pandemic's effect on consumers, who drive 70% of the economy but have been forced to stay home.

- Industrial production declined 5.4% in March, the sharpest fall in 75 years. While the coronavirus containment measures are primarily slamming the brakes on services sector activity, the manufacturing sector is also set for a significant downturn.

- The International Monetary Fund ("IMF") expects the global economy to contract by 3% in 2020, the worst recession since the Great Depression, surpassing that seen during the Great Recession a decade ago. Importantly, the IMF projects the global economy is likely to rebound in 2021 by 5.8%, due to the unpresented amount of monetary and fiscal stimulus.

Fiscal Policy

- The unprecedented government-mandated shutdown of the economy has been met with equally unprecedented fiscal and monetary policy responses.

- The $2.2-trillion CARES Act should not be thought of as fiscal stimulus but as an economic stabilization package. The collapse in economic activity in March 2020 is the result of a mandated "time out" of individuals and businesses by government, not a normal cyclical recession. Many of the provisions of the Act are designed to prevent the private sector from unraveling, so that when the containment of the virus permits shutdowns to be lifted, activity can bounce back.

- The CARES Act is off to a slow start – not surprising as the number of applicants for either unemployment or small business loans is overwhelming the system. Government agencies and the Small Business Administration suffer from antiquated technology and insufficient manpower to handle all these requests. To be fair, 17 million people have filed for unemployment in three weeks. That has never happened before.

- President Trump has said the small-business lending program has had a "few glitches," but banks and business owners around the country report mass confusion and delays in accessing the funding. The initial program was supposed to do $350 billion in loans. Trump is asking Congress for an additional $250 million.

- The President and House Speaker Pelosi are also discussing additional measures that the government might take, including a $2-trillion infrastructure bill. This is an indication of both how severe the contraction might be in the second quarter but also of how the government seems prepared and willing to do whatever it takes to bridge the gap.

- The new federal programs should support many businesses, so that when the virus permits the resumption of activity, we can see a sharp rebound in the economy.

Monetary Policy

- The Federal Reserve has clearly signaled it is ready to do everything in its power to mitigate the economic fallout and is resorting to measures never taken before by the U.S. central bank, as it takes steps to directly intervene in credit markets.

- Last week, the Fed announced an expansion of its stimulus package to provide $2 trillion in additional aid to small, medium and large companies, as well as cash-strapped states and cities. The latest actions are in addition to the central bank's slashing interest rates to zero in March and buying numerous government bonds to keep borrowing as cheap as possible for American families and businesses.

- The Fed committed to provide another $850 billion in purchases of corporate bonds and asset-backed securities (ABSs), an additional $500 billion in muni bond purchases, and a new Main Street Lending Program that will fund up to $600 billion in small-business loans. The Fed released further guidance on its corporate and ABS programs to clarify that "fallen angels" (investment-grade bonds recently downgraded to high yield) will now be deemed eligible for the Fed's purchase program, as will some additional pockets of the ABS market.

- The Fed's latest actions go even further than what the central bank did during the Great Recession. The Fed is directly buying debt from large corporations and states, a level of support it hasn't tried before. There's widespread worry that some companies and households will go bankrupt during the pandemic, because they will not be able to borrow money in time, but the Fed has taken large and unprecedented steps to keep as much credit flowing as possible.

- Congress and the Treasury have made possible a new generation of loan programs by extending nearly $450 billion to cover losses the Fed might sustain in its lending programs. The Fed relied on $185 billion in additional support from the Treasury in launching the programs announced Thursday.

- That leaves the Fed with a significant amount of resources available still to expand these programs or introduce new ones should they be needed. Fed Chair Powell signaled that the central bank was in no hurry to withdraw its crisis support and deflected worries that the expansion of credit by the Fed would lead to inflation.

- "I worry that, in hindsight, you will see that we could have done things differently. But one thing I don't worry about is inflation right now," he said.

- "The Fed is at war against the virus, and this is a wartime degree of commitment to credit policy," said Krishna Guha, vice chairman of Evercore ISI.

Markets

- Financial markets have rallied in response to the Fed's actions, the CARES Act and a sense that policymakers will do whatever it takes to stabilize the economy until it can be restarted. Markets have also rallied based on signs that infection rates and deaths are peaking in New York City and the Center for Disease Control's lowering of its projections for total deaths in the U.S. to 60,000 from 240,000 two weeks ago.

- Equity markets had their best week of the year last week. The S&P 500 Index finished up 12%. Incredibly, after the recent rally and all that has transpired, it is down only 12% this year.

- The equity market is a mystery to me. It seems to be looking past JP Morgan's forecast for a 40% contraction in 2Q GDP and 20% unemployment – levels not seen since the Great Depression.

- The markets seem to be expressing confidence that the Fed's action and the CARES Act (likely followed by even more fiscal stimulus) will be enough to stabilize and then restart the economy once the stay-at-home orders are lifted.

- The markets seem to be ignoring the risks of the pandemic staying with us longer (or coming back in waves) and overlooking the lack of testing, tracing and treatment required to give people confidence to return to their normal lives.

- The markets also seem to be ignoring other risks, including whether the Euro zone can hold together. (It doesn't help when Germany won't support Italy at a time like this.)

- The late Marty Zweig is credited with the saying "Don't fight the Fed." In his book, *Winning on Wall Street*, he wrote, "Indeed, the monetary climate – particularly the trend in interest rates and Federal Reserve policy – is the dominant factor in determining the stock market's major direction."

- As my colleague Phil Rio noted, it's fair to say that the Fed Put is in full effect.

New York Life

- Happy birthday! New York Life turned 175 years old this week!

- As mentioned previously, New York Life was built for times like these.

- Last week, New York Life issued a surplus note to help fund our purchase of Cigna's group Cigna's group life and disability insurance businesses later this year and further strengthen our already enviable liquidity and capital profile.

- It is worth noting that this is our largest ever surplus note issuance ($1.25 billion) and our lowest ever surplus note coupon (3.75%)!

- This is an incredible outcome for our policy owners and strong market validation for the financial strength and resiliency of this 175-year-old institution.

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