Market Watch with RMH

The Rubber Meets the Road Part Deux (2)

-

In our last RMH market Watch, we mentioned now is the time to find out how we are going to recover, and titled accordingly, “The Rubber Meets the Road”.

Friday’s mornings surprise 2.5 million rise in payroll employment from last month suggests the process of rehiring began sooner than the jobless claims suggested. With more states expecting to loosen restrictions, especially in the U.S. Northeast, it is expected the labor market will keep rebounding to the upside. The big question will be how long it will take the country to get back to previous employment levels? The consensus answer seems to be late 2021. The following chart from Refinitiv shows how far the level of employment fell as a result of Covid-19. “Green shoots” starting a comeback.

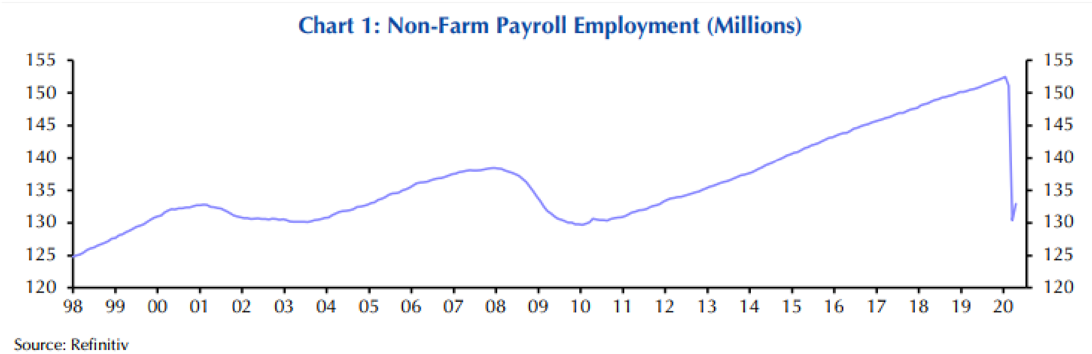


Table: Labour Market Data

	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
Non-Farm Payrolls (000s)	182	194	207	208	185	261	184	214	251	-1373	-20687	**2509**
Unemployment Rate (%)	3.7	3.7	3.7	3.5	3.6	3.5	3.5	3.6	3.5	4.4	14.7	**13.3**
Ave H’rly Earnings (%m/m)	0.3	0.3	0.4	0.0	0.3	0.4	0.1	0.2	0.3	0.6	4.7	**-1.0**
Ave Hourly Earnings (%y/y)	3.4	3.5	3.5	3.1	3.2	3.3	3.0	3.1	3.0	3.4	8.0	**6.7**
Ave Weekly Hours Worked	34.4	34.3	34.4	34.4	34.4	34.3	34.3	34.3	34.4	34.1	34.2	**34.7**

Source: Refinitiv

While almost all industries registered payroll gains, the hardest hit industries came in as follows:

- Leisure & Hospitality up 1.24 million jobs
- Construction up 464,000 jobs
- Retail up 367,000 jobs
- Manufacturing up 225,000 jobs
- Government jobs went down 585,000 jobs reflecting local layoffs of teachers?

A good start to reopening the economy from the forced lockdown. We will be watching this very closely in the months ahead, and expect some powerful changes to be determined from Covid-19.

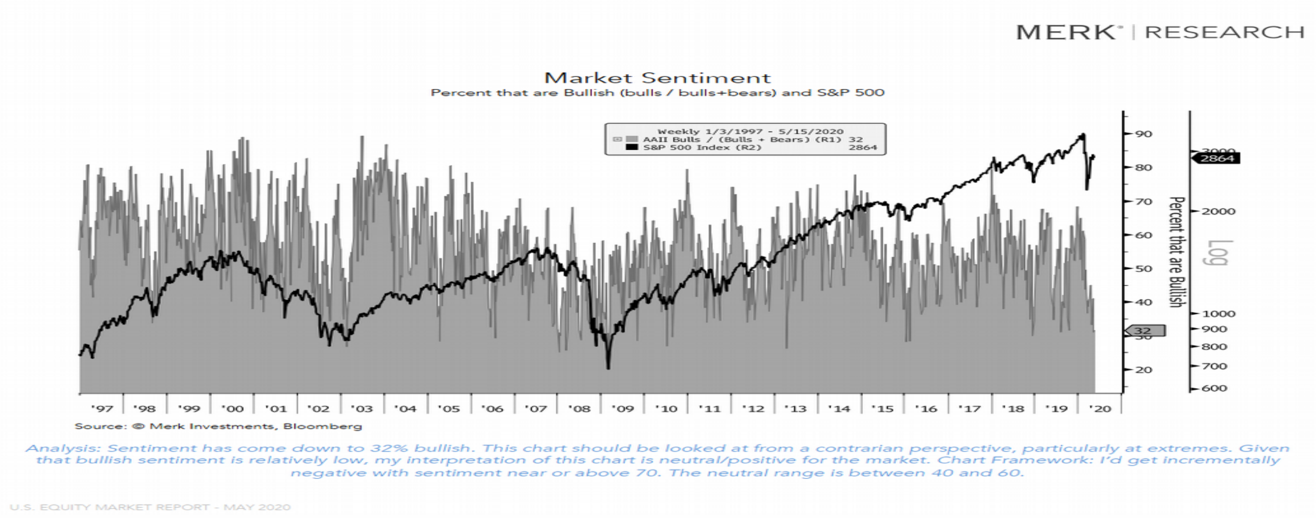
One of my favorite monthly reads comes from Nick Reese, CFA Senior Analyst & Portfolio Manager for Merk Research.

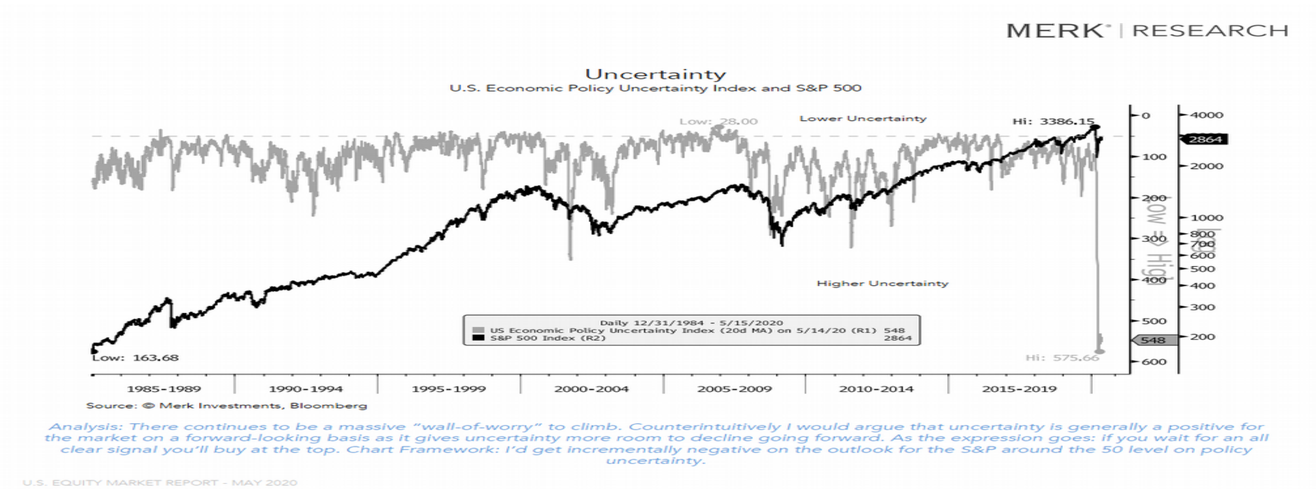
In his latest U.S. Equity Market Report from May 2020 he summed up his thoughts on the market as follows:

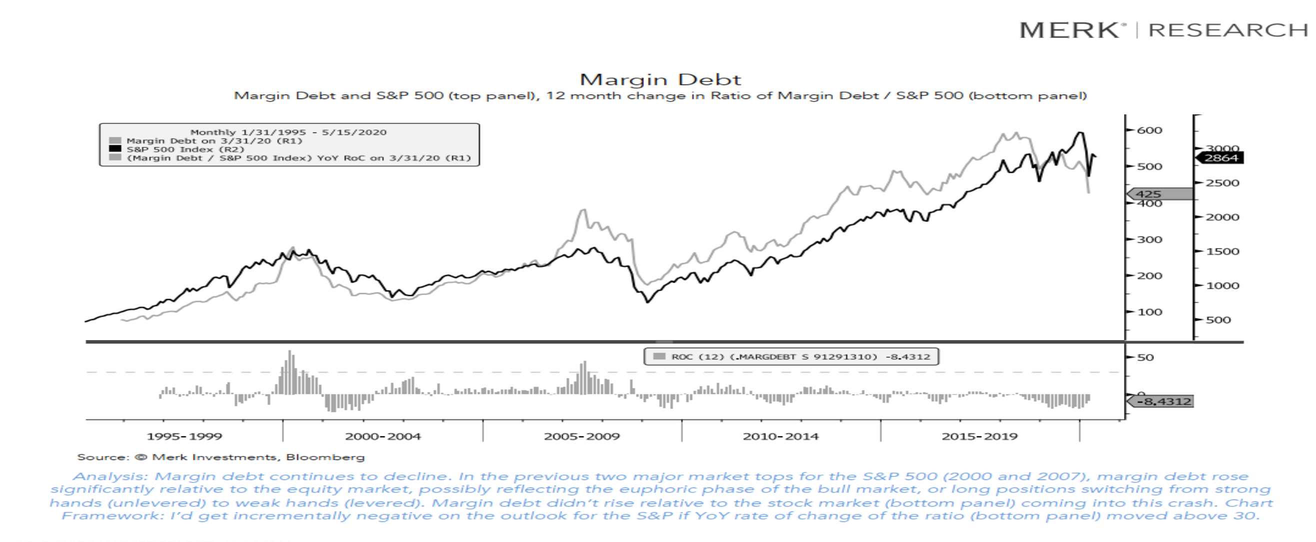
- **The market moves in the way that creates the greatest amount of frustration for the greatest number of people.**
- Many suggest the market is currently overvalued. Forward price/earnings ratios available from Bloomberg and FactSet do look relatively high. But we don't know how far out the market is looking, and how much near-term earnings pain it has already priced-in and is willing to look through. Stocks are long duration assets (perpetual securities as long as companies remain going concerns). With interest rates at historic lows, and very near zero, what's a reasonable valuation? The estimated forward 12 month dividend for the S&P 500 is about 3x higher than the yield on U.S. Treasuries.
- In his view, overvaluation was not key factor in the February-March decline. NASDAQ outperformance continues, which suggests the market was not a "bubble looking for a pin" in February. The most "overvalued" stocks have continued to outperform the broader market. That's different from the 2000 dotcom bust.
- While recession bear markets tend to be bigger than the -34% S&P 500 peak to trough decline seen so far, it's also the case that markets tend to bottom before recessions end. And given the mandatory shutdown and current reopening timeline, this may be a short recession (albeit deep). We could already be coming out of it in Q3.
- Legitimate concerns center on a possible second wave of infections, the specter of insolvencies, and the shape of the recovery in the real economy. The outlook is mixed and highly uncertain. Currently, the market sees the glass half full. The dominating narratives are:
    - reopening's of business, manufacturing and retail
    - commitment from the Fed
    - a vaccine.
- Nothing is obvious. We may still be in the midst of a bear market rally. I think it's important to keep an open mind and consider a wide range of possible outcomes from here. The outlook requires constant reassessment. And everyone needs to put probability and reward to risk assessments into their context of their strategy, process, and time horizon

The following 3 charts from Nick Reese's presentation show the contrarian point of view in my opinion.

- Market Sentiment chart for being Bullish is at a very low level, 32, and he would be negative above a reading of 70.
- The Uncertainty chart for the U.S. Economic Policy and S&P 500 shows a reading of 548, and he would get negative, when it climbs into the 50 range.
- With regards to Margin Debt, compared to the 2000 and 2007 – 2009 periods where margin debt rose euphorically, this time margin debt did not rise relative to the stock market.







Tel: 520-314-2300 Email: richard@rmhinvestment.com 5151 E. Broadway Blvd. Suite 1600 Tucson AZ, 85711

One of the things we must ask ourselves, is what happens next? People tend to stockpile cash during times of uncertainty, and as we have seen above, when confidence returns, they spend those stockpiles.

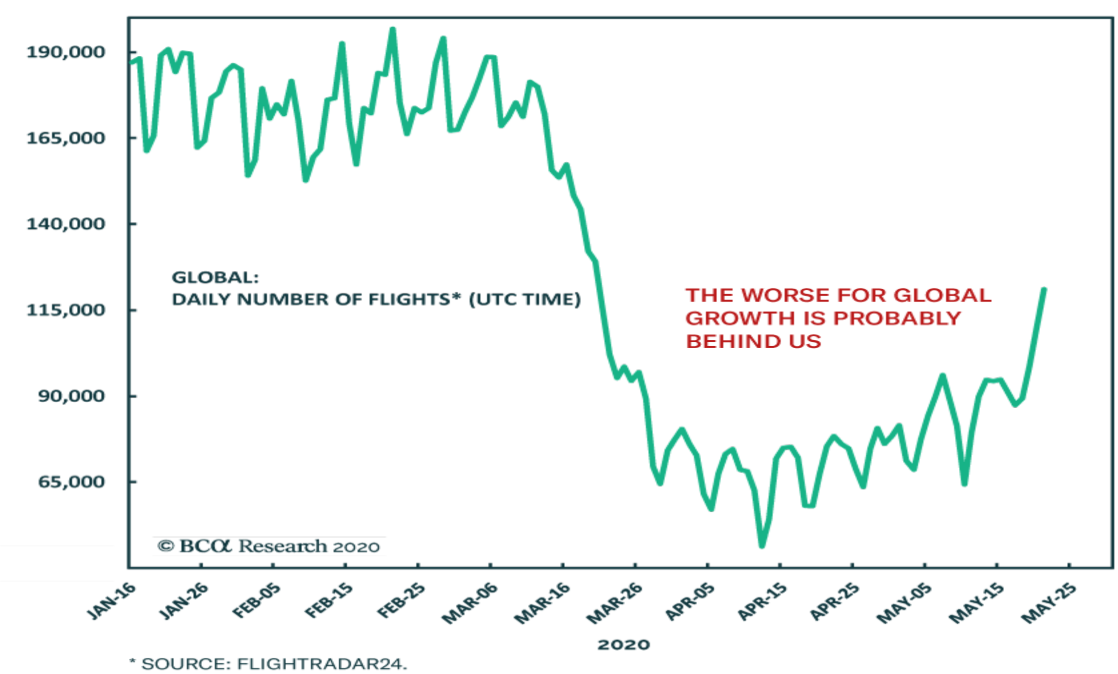
With increased signs that the economy is reopening and activity is increasing, it's quite likely that the demand for money will begin to decline as confidence slowly returns. Money that has been socked away in bank accounts is increasingly going to be spent on goods and services. The key questions to ask are: will the Fed be able to reverse its QE4 efforts in a timely fashion and will the public's desire to reduce their money balances lead to rising inflation? Currently, there are zero worries about inflation in my opinion, and that problem is for a later date after we get through this.

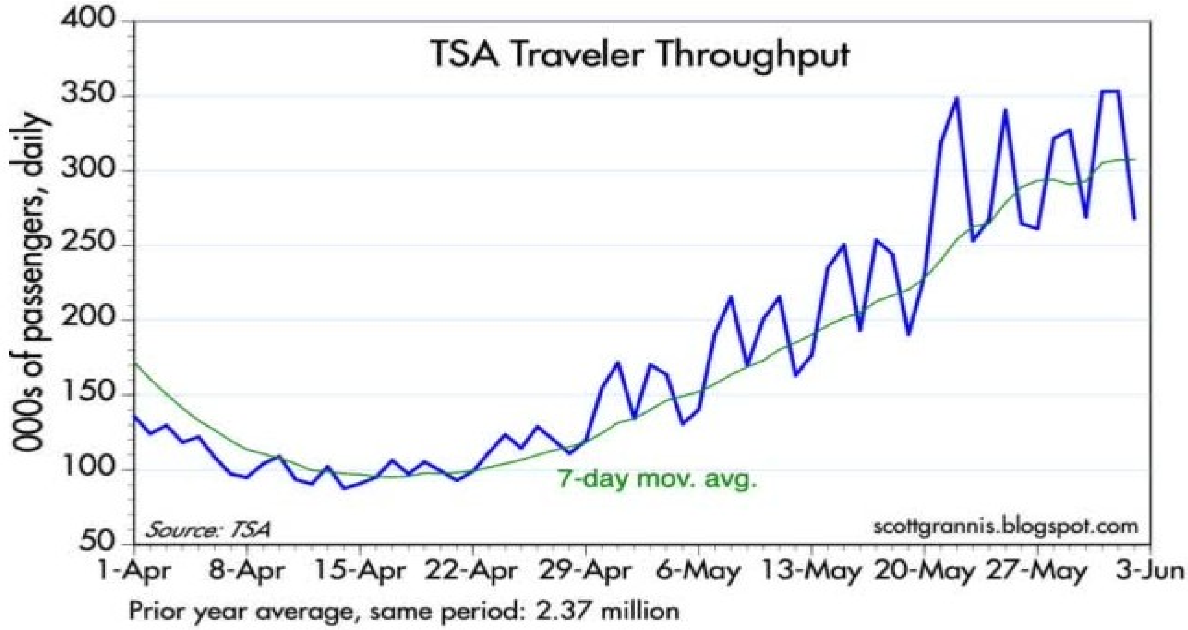
In my opinion and a number of others, we've seen the worst of the COVID-19 crisis. Looking ahead, the question that will be always asked and that will dominate the economic and financial landscape for the balance of the year, will be the need for the Fed to begin to reverse its massive monetary expansion of recent months. What I find worrying is that some analysts I read, worry that a Fed reversal will jeopardize the recovery. On the contrary, I think it would be very worrisome if the Fed did ***not*** realize that they need to raise interest rates as the demand for money begins to decline.

Green Shoots We Are Seeing

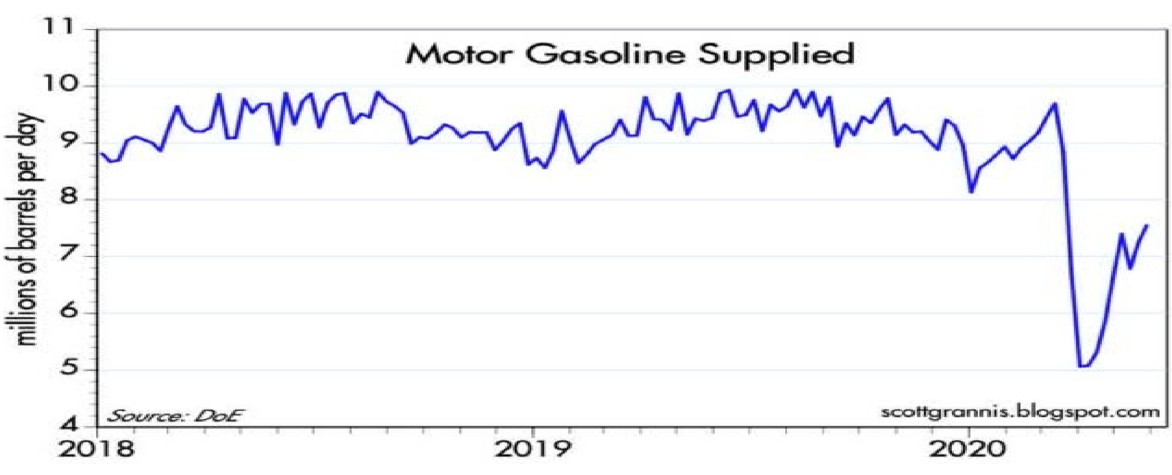
Improving Global Flight Numbers and increased TSA Traveler Throughput at U.S. airports.

Global flights collapsed by 71% between Mid-February and early April. Currently are up 162% from the bottom and suggests the global economy has started its difficult recovery process and that the deceleration of the past is behind us. We are thinking the loosening of lockdowns around the world will accentuate growth. The chart below from the Bank Credit Analyst (BCA) demonstrates this.

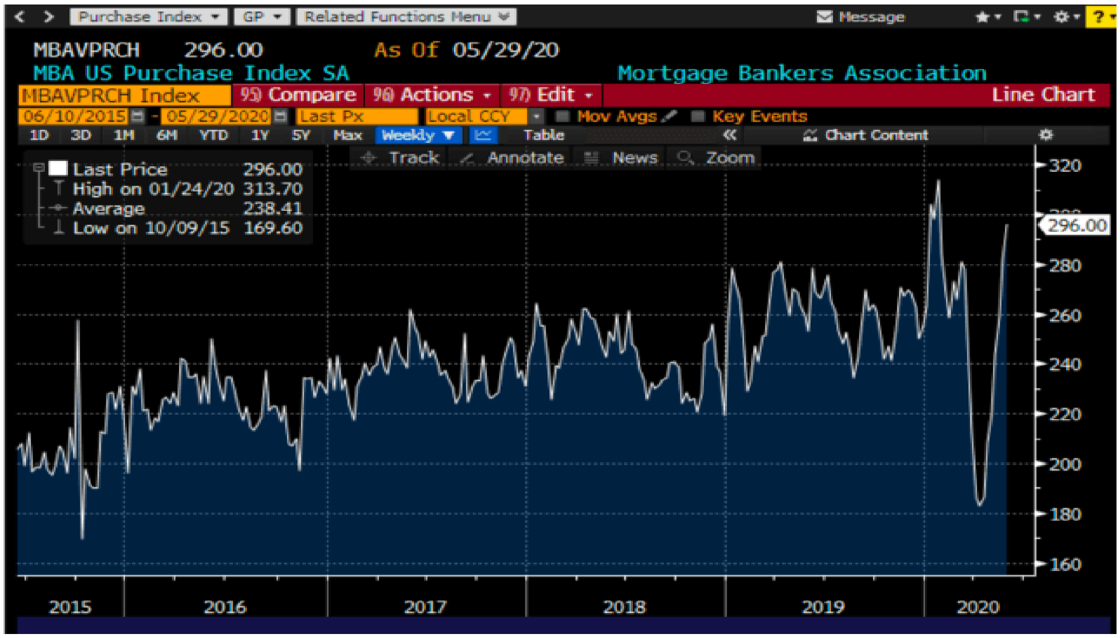




One of the more favorite quotes in our industry, **"stocks climbing a wall of worry"**. We have made a good move from the stock market bottom on March 23, and we have more to go. With the VIX index still at an elevated level and the 10 year U.S. Treasury still around 0.75%, investors are still cautious.



I have driven to Phoenix two of the last three weeks for meetings, and seen an increase of cars on I–10 and the freeways of Phoenix. Interstate freight has picked up as well, judged by the volume of trucks on I-10.



The above 2 charts show the dramatic increase in mortgage applications, and 30 year fixed mortgage rates at their lowest level ever in the history of the U.S. Time to buy a house or refinance at an opportune time. Both activities will lead to increased spending in the future.

In summary, we believe the worst is behind us with regard to Covid-19 and the issues it caused. Some are known, and a number of issues are unknown. **What we know for sure, is that Covid-19 is an agent of change, and has accelerated changes that were already starting to happen.** We expect a vaccine to be created, however that may not happen and we will have to live with it. We will deal with that when it happens.

The following is from our good friends at Imus Wilkinson:

The markets have seen first a 4.8% rise from the 1st of the year until February 19th, followed by a swoon of 33.9% in a little over a month to March 23rd. From there, as of the end of May we have risen 36% leaving us down 5.7% for the year. Do not ask the question of where we go next. The simple answer is up or down. Ask the better question: Where is the next 100% move in the market and how can I prepare my finances to be able to participate?

Ask anyone who came close to or actually lost their home in 2008/9 how they felt then compared to how they are doing now. We work with some of these people. Ask anyone how they felt after the attacks of 9/11/2001. They too have seen recovery from something that never happened before. If you don't remember ask your parents or grandparents how they felt when John Kennedy was shot or when Richard Nixon resigned. Every generation faces new challenges, new setbacks and throughout history there has been recovery and new achievements.

We stand firm in our belief that our best days are ahead of us. That tomorrow will be more prosperous then yesterday, that the world will continue to improve; and that Optimism is the only realistic view of the future. We continue to impress upon our clients the need to have a plan to follow in order to best prepare for that future. If you are concerned, if it has been awhile since we last updated your plan reach out and let's talk. It can be in person, over the phone or via video, but we are here and have been here through all that has happened in the last five months.

On a final note, here are some words of encouragement from history and pop culture to inspire in these challenging times.

“There is no better than adversity. Every defeat, every heartbreak, every loss, contains its own seed, its own lesson on how to improve your performance the next time.” Malcolm X

“Strength does not come from winning. Your struggles develop your strengths. When you go through hardships and decide not to surrender, that is strength.” Mahatma Gandhi

“The pessimist sees difficulty in every opportunity. The optimist sees the opportunity in every difficulty.” Winston Churchill

Things that we are keeping our eyes on include the following:

What steps are we doing at RMH?

- We are looking at the portfolios and rebalancing where necessary.
- We are taking advantage of tax loss selling to lower future capital gains.
- We are looking at what insiders are doing with some of the stocks we have purchased.
- We are talking with portfolio managers on a one to one basis and participating in conference calls.

If there are ever any topics you wish us to explore, please let us know. ***We are here to help and guide you through these times.***

We thank you all for taking the time and reading "Market Watch." It is meant as an educational piece on the always evolving markets. It is something we plan on providing every month, and your feedback is very important to us.

On a personal note, RMH is now in the position to bring on new clients and please be sure to share this informational letter with whomever you wish. RMH's focus is on the customizable investment needs of individuals, families, and foundations. We enjoy working with our clients to better understand their goals, values, and passions for what is important in their lives. In expanding our client base, we look forward to working with people who share these same desires

Richard Mundinger, CFA

Capital Economics, June 5, 2020 U.S. Economics
Nick Reese, CFA Senior Analyst & Portfolio Manager Merk Investment, LLC Research, May 20, 2020
Calafia Beach Pundit – May 20, 2020 Demand for Money: What Went Up Will Soon Come Down

BCA May 25, 2020 – Improving Global Flight Numbers

Calafia Beach Pundit – June 4, 2020: Lots of Green Shoots