BULL & BEAR BULLETIN

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VALICENTI ADVISORY SERVICES, INC.

400 East Water Street
Elmira, NY 14901
607-734-2665
Fax: 607-734-6845

447 East Water Street
Elmira, NY 14901
607-733-9022
Fax: 607-734-6157

24 West Market Street
Corning, NY 14830
607-936-1203
Fax: 607-936-0213

www.valicenti.com

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After All The Recent Action, Let Us Review

The COVID-19 pandemic has resulted in a shutdown of the economy, which by the numbers will almost certainly produce an economic recession. The falloff in activity late in March was significant enough to produce a contraction in real GDP for the first quarter on an annualized basis of -4.8%, as of the initial reading. Estimates for the second quarter look significantly worse as non-essential activity remains curtailed through the middle of May.

As of April 30, the unemployment rate had moved to a level of 14.7%, as measured by the household survey, from a February 28 low mark of 3.5%. At the end of February, nonfarm payrolls totaled just over 152 million. The establishment survey of labor indicates that over 20 million nonfarm payroll jobs have been eliminated very quickly through April. For context, in 2008 the peak to trough drop in payroll jobs was around 8.5 million. There may be significant differences with how the future plays out here. For starters, because the business cycle and economic contraction that we are living through at present was more orchestrated as a preventative health response to a pandemic, some of the job losses may reverse more quickly. On the other hand, full recovery could again take several years. It took about seven years to recover the aggregate job losses following the Global Financial Crisis. Regardless of how this cycle is different from the past, the economic shock to employment outlooks, company business models and aggregate supply and demand for goods and services will have to be managed in the real world just the same.

Without weighing in on the ultimate efficacy or merit of specific programs or legislative acts, one positive in the current environment may be the pace of the legislative and Federal Reserve actions in response to the crisis. We have seen a myriad of targeted new or expanded liquidity and funding facility programs. This is on top of reignited asset purchases and interest rate cuts. Legislatively speaking, we have witnessed the passage of the Coronavirus Aid, Relief, and Economic Security (CARES) act. The bottom line is that while political division and disunion seems all the rage these days, in response to winding down economic activity purposefully, there was a corresponding ability on the part of lawmakers and central bankers to attempt to help fill the voided incomes for businesses and individuals.

It is important to acknowledge that there are consequences to laws and policies. There certainly has been no lack of parties out there in the economy feeling enormously frustrated for a variety of reasons. It is possible, however, that we will look back once the current events have passed and see that there was rapid crisis management going on at various levels and in many different places of our society and that, it helped see us through the moment. It is not the critic that counts, as Teddy Roosevelt once said.

It may not at present be a typical binary Bull or Bear determination at the moment. We seem to be running in between them. For now, we can observe that a peak to trough movement of consequence has occurred in equity markets and one that is generally coincident with cycle contractions of this magnitude. Some momentum has been returned, at least for the time being, and we are now significantly off of those lows. In our view, it is important to assess how companies and sectors will fare in the various and most probable outcomes that we are likely to see. A delineation between secular growers and secular decliners may become more pronounced. Looking at cash flow expectations, buyback activity, and capital spending plans, in our view, will be important in the coming quarters in order to understand things like dividend sustainability. High fixed costs and operating leverage are a good thing if you are in a winning business, but maybe not so much if you reside in a company selling cramped stadium seating. Financial leverage is not an evil, but it can work against you if your company is staring at a difficult credit cycle and your services clean those stadium seats. It is a period where that 8% dividend you see may not be 8% in the shortness of time. While wanting to be respectful of the human cost and tragic difficulty for many individuals behind the macro data and the numbers, active investment allocators will have to endeavor to objectively look beyond that in an attempt to understand those company specific details as best as possible.

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