

Prepare for a Deep Recession

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In brief:

- Even with fiscal stimulus and government transfer payments in the works, household income will likely plummet and consumption will probably fall off an (empty) shelf.
- We can't predict the pace of recovery until we know the depth of the economic hole.
- Volatility is what we've been waiting for. And despite the seriousness of the pandemic we feel confident about what's to come with regard to investment opportunities.

The impact of coronavirus is likely to deliver the most precipitous destruction of economic activity in US history. Economic data for March, April and perhaps May will probably be abysmal. Unemployment in the United States will in all likelihood skyrocket and could eclipse the global financial crisis peak. Already, early indications of initial unemployment claims are highlighting the coming dislocation. Even with fiscal stimulus and government transfer payments in the works, household income will likely plummet and consumption will probably fall off an (empty) shelf. Despite tax credits, the availability of very cheap financing and the forbearance of other business expenses, many small and midsize enterprises may well be hit hard.

This isn't like 9/11 — when people were soon back on planes, staying in hotels, working and shopping — or so it seems to us. By way of example, at least 40 companies have closed their retail outlets, a list that seems sure to grow. Many of them may not survive. To be fair, many shouldn't have made it this far to begin with, and the virus is simply the catalyst for their extinction. It's ironic that it may take a pandemic to kill off zombie companies.

Life will probably revert to normal in a few months, though it may take longer. However, it's difficult to quantify the magnitude of damage that will have taken place between now and then. We can't predict the pace of recovery until we know the depth of the economic hole.

But there's a tremendous positive in all of this. It was possibly best alluded to by US tech sector leader Tim Dittmer in Wednesday's sector meeting, when he opened with one of the many great quotations of Andy Grove, former CEO of Intel: "Bad companies are destroyed by crisis. Good companies survive them. Great companies are improved by them." Every sector meeting is anchored around this maxim.

Volatility is what we've been waiting for. Risk assets will recover, but not the zombies. The recovery may take longer than those of the past, and if so, that's fine, because we anticipated some level of dislocation at the end of a long, tired cycle. And despite the seriousness of the pandemic, we feel confident about what's to come with regard to investment opportunities.

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