End of the Beginning

Scott Love, CAIA®, CIMA® | SVP Economic and Equity Research
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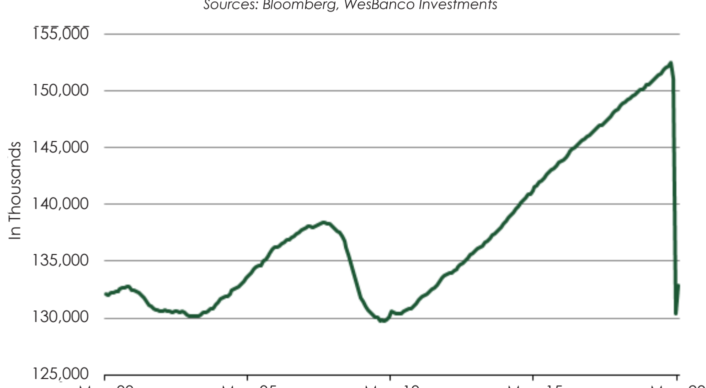
After the second battle of El Alamein, Winston Churchill delivered a speech at the Lord Mayor's Luncheon addressing the recent victory. He said, "Now, this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning."

That statement seems fitting as different regions are beginning their reopening phases. The government-mandated shutdown to combat the spread of COVID-19 resulted in the greatest economic disaster since the Great Depression. The economic data from March and April has broken a number of records. In fact, most of the reports begin with "lowest reading on record" or "biggest decline ever." The "Great Lockdown" or "Great Shutdown," as it is being referred to, may be the deepest and quickest recession on record. However, we are starting to see green shoots of economic recovery. As a result, we believe we are at the end of the beginning.

Labor Market Reflecting Green Shoots

Over a two-month period, U.S. nonfarm payrolls declined by 22 million, erasing all the jobs added over the past decade. Nearly 20.5 million lost their jobs in April, the largest monthly drop in the 81-year history of tracking payrolls. The decline in jobs pushed the unemployment rate to 14.7%, well above the 10.0% posted during the Great Financial Crisis. Two months prior to the April reading, the unemployment rate stood at a 50-year low of 3.5%.

U.S. Total Nonfarm Payrolls
Sources: Bloomberg, WesBanco Investments



Our favorite employment indicator, weekly jobless claims, rose sharply as the lockdown accelerated. At the end of February, initial filings of weekly jobless claims stood at 211,000. By mid-March, the number of filings rose to 6.8 million, setting the largest increase on record. Over the next several weeks, the number of initial filings slowed, ending May with 1.8 million. Since mid-March, 44.2 million have filed for unemployment benefits, or 26.9% of the total U.S. labor force.

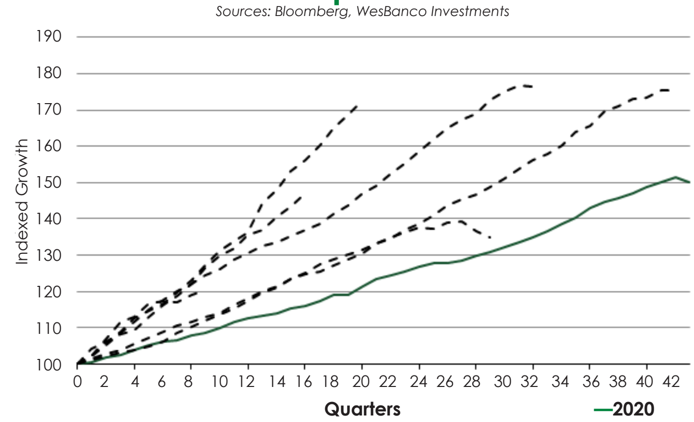
However, the May nonfarm payroll report suggested that employees were returning to work. The consensus estimate forecasted a decline of 7.5 million jobs for the month. Instead, the U.S. labor market added 2.5 million in May. The result was a drop in the unemployment rate to 13.5%. Although, within the footnotes of the May report, the Bureau of Labor Statistics (BLS) noted that ongoing clarification errors caused the unemployment rate to be understated. As a result, the BLS believes May's unemployment rate would have been 16.6%, falling from 19.8% in April. The error will remain as the BLS investigates, but the report will likely be revised at a later date.

Regardless of the final number, the impact on the labor market has been dramatic. With a quarter to a tenth of the U.S. labor force out of work, even temporarily, economic activity will be affected in the coming months. The U.S. economy is not a light switch. Simply removing restrictions will not allow us to get back to business as usual. In our view, the unemployment rate will remain elevated for the remainder of 2020, ending the year between 6.5% and 8.5%.

Recession Officially Began in February

On June 8th, the National Bureau of Economic Research (NBER) declared that the U.S. reached peak economic activity in February 2020 and began a recession. The peak marks the end of the expansion which began in June 2009. Totaling 128 months, it was the longest expansion on record. We are not surprised about this announcement, but rather the timing. In the prior three recessions, the NBER announcement arrived an average of 10 months after the downturn began. The NBER is largely an academic body that identifies turning points in the economy for future studies. As a result, the committee waits long enough so that the existence of a peak or trough is not in doubt, and it can assign an accurate timestamp.

U.S. Economic Expansions - Since 1970
Sources: Bloomberg, WesBanco Investments



Using the past seven recessions as a guide, on average, they have lasted 12 months, with the shortest at six months. Currently, the economic data (both real time and leading) is not reflecting a sharp recovery. The data is suggesting that the worst is past us, and we anticipate a reacceleration in economic activity.

In our view, the U.S. should post growth numbers that break all-time records in the third quarter, led by impressive consumer spending. A pent-up demand supported by stimulus checks, along with a return to work, will likely cause activity to skyrocket in the third quarter, but it will still not quite offset the disastrous second quarter. Disrupted supply chains and uncertain recovery in demand will likely curtain business spending and investment until the fourth quarter.

More recently, many have been assigning probabilities to the shape of the U.S. economy. However, economic outcomes from this point on significantly depend on the evolution of the pandemic.

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Economic Outlook *(Cont'd from pg. 1)*

Economic forecasting is a difficult proposition in the best of times; building forecasts that are contingent on vaccine trials is extremely problematic. Whether the recovery is "W," "L," swoosh, "U," checkmark or "V" shaped, we have incorporated several possibilities into our investment plans.

Equity Markets Quickly Recover

To this point, equity investors have settled on a V-shaped recovery. The S&P 500 Index has gained 42% from the cycle lows posted on March 23rd. The recovery has been driven by the expansion of the multiple, not earnings growth. Due to the virus-related weakness and uncertainty about the timing of the recovery, several companies have pulled earnings guidance forward. In addition, the recession has resulted in a drop in expected earnings for 2020. The earnings forecast for S&P 500 Index companies was $178 per-share in mid-March, or 12.7% above 2019's results. Currently, the forecast sits at $125, or a decline of 20.4%. This drop in earnings is in line with the average decline of 20% during recessions.

The trailing Price-to-Earnings (P/E) ratio for the S&P 500 is 21.8x, or somewhat above the long-term average of 17.9x. During the selloff in March, the trailing P/E ratio reached a low of 14.7x. It did not stay there for long, however, and it quickly recovered to be above the long-term average. Over the past four months, the P/E ratio traded below the long-term average for 16 days.

Elevated valuation levels are more clearly highlighted in forward P/E ratio levels (i.e. 24.9x compared to the long-term average of 15.8x). The decline in expected earnings, coupled with the rebound in equity prices, places the forward P/E ratio in the top 10% of its history. In contrast, the U.S. economic data is in the range of the bottom 10% of its history.

Lower Yields for Longer in Fixed Income Markets

Supporting the rebound in equities is the extremely low levels of interest rates.

To support companies and stimulate growth during the COVID-19 shutdown, the Federal Reserve was aggressive in lowering rates and implementing support programs. In a series of acts, it lowered the Federal Funds Target Rate to 0.25%. It took similar steps in the six years following the Great Financial Crisis. It appears that it is looking to take a similar long-term view of rates with the most recent economic slowdown.

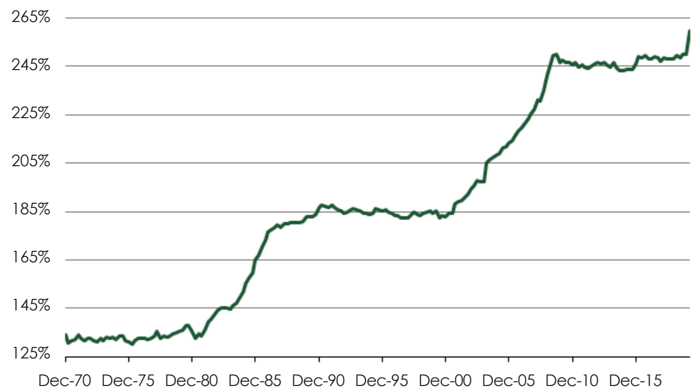
During a recent press conference, Fed Chairman Jerome Powell said, "We're not even thinking about thinking about raising rates." In addition, the Federal Reserve believes that the damage from the economic lockdown, coupled with the potential impact from a subsequent reemergence of the virus, will have a lasting impact. However, it has been very clear that negative interest rates are not the answer to stimulate growth. The implementation of negative rates, currently ongoing in Europe, has not aided the region's growth over the past several years.

Within the U.S., the prior low-interest rate period encouraged borrowers and governments to increase debt to stimulate growth. However, reviewing the past economic expansion, it is unlikely that low-interest rates accelerated economic activity. In February, the U.S. ended the longest economic growth period on record; however, its indexed growth trailed a number of other expansions.

The Federal Reserve and Treasury's expanded support for credit markets and corporate borrowers have significantly reduced the downside risk in pricing. Liquidity provided by the Federal Reserve will keep prices in check for a wide range of securities, and it will potentially remove some of the hazards that lead to default. While some of the tools are new, the policy from the central bank has been in place since the 1930s. The idea that the central bank can push interest rates down and make more credit available to smooth the business cycle is designed for an economy that operates with fewer recessions, less severe recessions and ultimately longer periods of growth. This policy has worked, but it has created a debt super cycle. This process has worked in the past; however, it is not sustainable in the long run. Given the current debt burden, it appears that the impact on growth has lessened. As a result, the Federal Reserve will likely need to find new tools in subsequent recessions.

U.S. Nonfinancial Debt to GDP

Sources: Bloomberg, WesBanco Investments



Going Forward

In the rest of his speech, Churchill said that with steadfast cooperation the Allies would prevail, but not without struggle. The global shutdown of travel and non-essential activities likely helped impede the growth of COVID-19. The coordinated monetary and fiscal stimulus from central banks and governments has helped to blunt the economic downside. In the U.S., total stimulus is close to 44% of overall GDP, which may accelerate growth as regions reopen. The recovery will not be without its fits and starts. Already, states are reporting increases in cases. Still, it is important to note that the initial reason for the lockdown was to prevent hospitals from being overwhelmed, not to eradicate the disease. This will only come with a vaccine, clear treatment options and time.

The level of uncertainty that we are facing regarding the next several years rivals that of any period in the past 50. Our job is to understand this wide range of outcomes and create portfolios that are attractive in as many scenarios as we can manage. To that end, we will continue to evaluate economic data, weigh possible consequences and change investment portfolios as necessary to reflect our most likely scenario.

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