HilltopSecurities
A Hilltop Holdings Company

Outlook Muddled as Economy Begins Long Climb Toward Recovery

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Director
512.481.2012
greg.warner@hilltopsecurities.com

Analysts and economists are struggling mightily with their forecasts and it's tough to conclude that current outlooks are anything more than educated guesses. This is abundantly clear when looking at the quarter-by-quarter GDP forecasts and the range of outlooks. The May Bloomberg survey showed a Q2 average plunge of -32.7%, with significant rebounds in Q3 (+14.8%) and Q4 (+7.5%). Within the Bloomberg responses for Q2, Barclays and JP Morgan both called for massive -40% declines, while Mizuho and Piper both expect lessor -20% drops. Staying with just these four firms shows Barclays (+25%) and JPM (+23%) rebounding significantly in Q3 from lower lows, while the forecasted rebounds at Mizuho (+10%) and Piper (+9%) are much smaller…but from higher Q2 low points. The Congressional Budget Office is calling for a -37.7% annualized drop in Q2 GDP, followed by a +21.5% jump in the third quarter. Regardless of who's most right, it's likely we'll see the largest single quarter contraction in GDP growth followed by the largest single quarter advance in history.

This degree of volatility and uncertainty in economic forecasts is unprecedented…like so much of what's happened in the last few months. The one thing all of these forecasts seem to indicate is that the worst has passed, but exactly how the recovery plays out in the coming months is anybody's guess.

Regardless of who's most right, it's likely we'll see the largest single quarter contraction in GDP growth followed by the largest single quarter advance in history.

The data itself has missed forecasts wildly in many cases. This morning, personal income for month of April, expected to tumble -5.9%, actually skyrocketed by +10.5%. The biggest monthly advance in the 60+ year history of the series reflected the distribution of CARES Act payments. At the same time income soared, household spending dropped a record -13.6%, resulting in absurd 33% savings rate in April. *Clearly, no one anticipated this.* Earlier this week, April new home sales, expected to fall by -23.4%, actually rose by +0.6%. However, any hopes that housing could stabilize in the near-term were dashed yesterday morning as pending home sales plunged -21.8% in April following a -20.8% drop in March. The anchor weighing down on housing is not only record unemployment, but also a prevailing sense of job unease, recently depleted savings and the waning credit availability.

In this holiday-shortened week, an enormous amount of data has been released, but given how quickly things are evolving and the high likelihood of significant future revisions, it's probably a fool's errand to read too much into any one number. What is worth watching is the employment data. In a consumer-driven economy, the key to sustained recovery is job growth. If you're not working, you can't spend. The brisk Q3 economic recovery that many are expecting suggests companies will quickly rehire workers. The workers themselves seem to be certain of this. The April employment report indicated almost 90% of those who've lost their jobs believe the layoff is temporary. A recent survey released by Salary.com reported 66% of employers reduced their company workforce or employee pay in response to COVID-19; but only 10% expect the layoffs to be permanent.

In this holiday-shortened week, an enormous amount of data has been released, but given how quickly things are evolving and the high likelihood of significant future revisions, it's probably a fool's errand to read too much into any one number.

Yesterday, initial jobless claims rose as another 2.1 million Americans filed for unemployment benefits bringing the 10-week cumulative total above 40 million. This represents roughly 27% of total workers at the beginning of March. Several upbeat economists have pointed out that weekly claims have been declining for eight straight weeks, but in all fairness, even last week's filings would have easily been the highest on

Please see disclosure on page 2.

record in the pre-coronavirus era. *However*, continuing (or ongoing) claims fell for the first time since February as employees gradually return to work. With lockdown restrictions being lifted across the country, the total number receiving unemployment benefits is expected to creep even lower in the coming weeks. However, as many have pointed out, the generous unemployment benefits provided through the CARES Act will present some challenges to employers looking to rehire as the financial benefit to staying home exceeds that of working. Also, if schools don't reopen in the fall, many parents will have little choice but to remain at home with their kids…And, no one seems to be acknowledging the effect a possible second wave of the virus would have on hiring.

The generous unemployment benefits provided through the CARES Act will present some challenges to employers looking to rehire as the financial benefit to staying home exceeds that of working.

Fed Chairman Jay Powell testified in front of the Senate Banking Committee last week with an emphasis on the employment outlook. Many have suggested the Fed has more insight than the nation's economists, so the fact that Powell's still quite concerned is important. Powell cautioned that small and medium businesses could fall into bankruptcy and destroy "the work of many families and generations" if not supported. The Fed Chairman has been a strong advocate of additional aid from Congress. Even though the CARES Act tally is nearing $3 trillion, Powell believes additional spending would go a long way in ensuring these businesses survive to reopen in the future. The Fed's $600 billion Main Street Lending Program, intended to help small and medium sized businesses, is not yet operational eight weeks after being unveiled. In the Fed's defense, this is another massive program with no instruction manual.

Airlines, which have received roughly $60 billion in CARES Act support are still treading water. TSA data indicates airline travel is starting to increase, but is still down roughly 85% to 90% from historical norms. And getting people back on planes is another challenge. Demand is the key to recovery, not simply a reopening of the economy. A recent study by "The Points Guy" travel website indicated four of 10 Americans won't board a plane until there's a COVID-19 vaccine available. On a related note, hotel occupancy rates have climbed for five straight weeks as Americans remerge from the their homes and cautiously venture out. The occupancy rate for the week ending May 16 was the highest in nine weeks at 32.4%. This is up from a 21% low point, but still well below the 61.8% rate reported in early March. It'll be a while before a majority of airline and hotel workers return.

Demand is the key to recovery, not simply a reopening of the economy.

The near-term retail outlook appears a bit brighter. Apple plans to reopen about 100 U.S. stores this week. Most will offer only curbside or storefront services, but *Genius Bar* appointments will be accepted at all reopened stores. Apple closed all 270 U.S. stores in March, but has been gradually opening up in limited capacity and expected to have roughly half of its locations in service by the end of this week. Macy's, the nation's largest department store operator, has reopened nearly 200 Macy's and Bloomingdales stores and hopes to have all 775 of its stores open by the end of June. Macy's, already teetering on the edge of bankruptcy, has little choice. Most restaurants are now opening at 50% capacity and holding their collective breath. So far, so good. But, with so many Americans emerging at the same time on Memorial Day weekend, the next two weeks will be telling. If the number of COVID-19 cases doesn't increase in early June, the economy will continue waking up.

Americans are optimistic about the future despite the damage done in the past few months. This is particularly evident in the stock market recovery. Although the DOW is still well below its highs, the Nasdaq is actually up nearly 400 points for the year and is now just 450 points below its all-time high.

And while analysts calculate and recalibrate data as the economy plunges and recovers, everyone's graphs are being absolutely destroyed. The high point on the y-axis for quarterly GDP over the last 40 years was +9.4% while the low was -8.4% for a spread of almost 18. Over the last 10 years ending in December, the high-low spread narrows to 6.6. If the CBO is correct with GDP dropping by -37.7% in Q2 and jumping by +21.5% in Q3, the y-axis will be forever stretched. The story will repeat itself in almost all the major data series, and the new scales will make it nearly impossible to see the normal data, whenever it returns, without a magnifying glass.

Most restaurants are now opening at 50% capacity and holding their collective breath.

Market Indications as of 9:10 A.M. Central Time

DOW	Down 134 to 25,266 (HIGH: 29,551)
NASDAQ	Down 18 to 9,346 (HIGH: 9,817)
S&P 500	Down 8 to 3,022 (HIGH: 3,386)
1-Yr T-bill	current yield 0.16%; opening yield 0.16%
2-Yr T-note	current yield 0.16%; opening yield 0.17%
5-Yr T-note	current yield 0.32%; opening yield 0.34%
10-Yr T-note	current yield 0.67%; opening yield 0.69%
30-Yr T-bond	current yield 1.45%; opening yield 1.45%

This paper/commentary was prepared by Hilltop Securities (HTS) and/or Hilltop Securities Asset Management (HSAM). It is intended for informational purposes only and does not constitute legal or investment advice, nor is it an offer or a solicitation of an offer to buy or sell any investment or other specific product. Information provided in this paper was obtained from sources that are believed to be reliable; however, it is not guaranteed to be correct, complete, or current, and is not intended to imply or establish standards of care applicable to any attorney or advisor in any particular circumstances. The statements within constitute the views of HTS and/or HSAM as of the date of this document and may differ from the views of other divisions/departments of HTS or HSAM. In addition, the views are subject to change without notice. This paper represents historical information only and is not an indication of future performance. Sources available upon request.

Hilltop Securities Asset Management, LLC is an SEC-registered investment advisor. Hilltop Securities Inc. is a registered broker-dealer, registered investment adviser and municipal advisor firm that does not provide tax or legal advice. HTS and HSAM are wholly owned subsidiaries of Hilltop Holdings, Inc. (NYSE: HTH) located at 1201 Elm Street, Suite 3500, Dallas, Texas 75270, (214) 859-1800, 833-4HILLTOP.

© 2020 HilltopSecurities Inc. | All rights reserved | MEMBER: NYSE/FINRA/SIPC