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Americas CIO View

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Marketing Material

DIGGING IN FOR A LONG FIGHT: CUTTING S&P 500 EPS ESTIMATES AGAIN

David Bianco

Chief Investment Officer, Americas

IN A NUTSHELL

_ Shutdowns in New York City and other big / dense U.S. cities likely go into May
_ Fiscal and monetary policy is rushing to respond to this health and economic crisis
_ Central banks are only constrained by their inflation targets or tolerances
_ Cutting 2020E and 2021E S&P 500 EPS again on longer big U.S. city lockdowns

SHUTDOWNS IN NEW YORK CITY AND OTHER BIG / DENSE U.S. CITIES LIKELY GO INTO MAY

New York City reports over 100,000 and New York metropolitan area 250,000 coronavirus infections as of April 12. Still essentially only people suffering symptoms are being tested, but nearly 1.25% of the NYC population and tristate area is confirmed infected. About 2.5% of New York State has now been tested with 40% to 45% of the tests being positive. Nearly all tests were taken in the past 30 days, but epidemiologists think the virus has been in NYC for about 60 days. For the last two weeks, the state trend has been fairly consistent with 20,000 to 25,000 tests a day and 8,000 to 10,500 positive cases. While the growth rate of positive tests in New York is down from up over 10% a day two weeks ago to about 5% now, this is due to a rising denominator and not yet a falling numerator. New York state deaths are 10,000 or 5% of positive tests, but twice that is expected for this group. It is sadly evident that the virus ravaged the New York metropolitan area over the past 60 days, despite a lockdown for the past 30 days. The United States now reports 560,000 cases, more outside the New York area than inside and faster growth. While New York is the world's hardest hit city with a percentage of population infection rate 5x that reported by Wuhan, China. Other large and dense U.S. cities, including Detroit, Philadelphia, Chicago, New Orleans, Boston, Baltimore, Washington D.C., and San Francisco, are hot spots at high risk. New York and these other cities will likely keep non-essential businesses and schools shut and ban crowded events through May.

FISCAL AND MONETARY POLICY IS RUSHING TO RESPOND TO THIS HEALTH AND ECONOMIC CRISIS

The Coronavirus Aid, Relief, and Economic Security (CARES) Act delivers over two trillion dollars of fiscal aid. The Act's Paycheck Protection Program of 349 billion dollars will likely be increased to over 500 billion dollars. The Act's Unemployment Insurance boost of 250 billion dollars will need to be raised if jobless claims exceed 20 million. Most politicians are clamoring to raise the aid allocated to the States and virus related federal spending. Thus, CARES Act top-offs could soon be an additional one trillion dollars; causing this fiscal year's deficit to be three to four trillion dollars. CARES provided 454 billion dollars to fund credit facilities run by the U.S. Federal Reserve (Fed). Treasury funding facilities are investments that should not be counted as deficit spending unless losses occur. The Fed is rolling out multiple facilities that indicate its intention to leverage these funds about tenfold. Last week the Fed announced its Main Street lending terms. Loans up to 25 million dollars originated by banks to mid-size firms with 500 to 10,000 employees. The Fed will then buy up to 95% of the loans. For the Fed to buy, total firm debt including this loan must not exceed 4x last year's Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). Banks will share the credit risk proportionately. The loans are four years at interest of 400 basis points (bps) above Secured Overnight rates. These are not forgivable and the banks and the Fed will pursue legal available recourse.

CENTRAL BANKS ARE ONLY CONSTRAINED BY THEIR INFLATION TARGETS OR TOLERANCES

We expect the Fed's balance sheet to be 10 trillion dollars at 2020 end, up from four trillion dollars at 2019 end. The Fed is running wartime monetary policy. The nature of its balance-sheet expansion is different than during the last cycle. Last time, the Fed bought mostly existing financial assets to drive down interest rates. This time, its purchases will be mostly of new financial assets to fund a ballooning federal deficit and municipal and corporate debt to cover expenses while revenue is depressed from the pandemic. Modern Monetary Theory (MMT) is not new. The concept is as old as ancient seigniorage or any debased coinage by a sovereign to fund wars or royal excesses. And so like a king, only problematic inflation constrains the Fed or causes it to run out of bullets. If inflation is running below target the Fed can expand money supply. However, inflation is an effect that lags its causes and it's uncertain how much inflation might come relative to the quantity of money. That said, it is important that both the fiscal stimulus and the Fed's credit providing facilities be effective and efficient in their resource allocation to contain the risks of problematic inflation in the years after the recession.

CUTTING 2020E AND 2021E S&P 500 EPS AGAIN ON LONGER BIG U.S. CITY LOCKDOWNS

The virus is striking New York hard and other cities with more infections are probably still to come, combined with fiscal policies providing financial assistance to help households and businesses isolate or shut down for spring makes 60 to 90 day in total non-essential business closures likely for most big cities. Thus, we cut our 2020E[1] S&P 500 earnings per share (EPS) to 110 dollars from 125 dollars and our 2021E S&P 500 EPS to 150 dollars from 160 dollars. Our rough 110 dollars 2020E S&P 500 EPS is down a third from 2019, but it is a very uncertain estimate, down 30% to 40% easy. 2020 S&P 500 EPS of roughly 100 dollars likely if New York and other big cities lock down into June. We cut our S&P 500 dividend per share (DPS) to 50 dollars or down 15% from 2019. Banks should signal distribution and capital plans very soon.

[1] Estimate (E)

GLOSSARY

A balance sheet summarizes a company's assets, liabilities and shareholder equity.

One basis point equals 1/100 of a percentage point.

A budget deficit is created whenever the spending in a public budget exceeds the income within a given time period

The business cycle is the oscillating movement of gross domestic product around ist long-term trend during expansions and contractions

A corporate bond is a bond issued by a corporation in order finance their business.

Dividend per share (DPS) is the sum of declared dividends issued by a company for every ordinary share outstanding.

Earnings per share (EPS) is calculated as a company's net income minus dividends of preferred stock, all divided by the total number of shares outstanding.

EBITDA (earnings, before interest expenses, taxes, depreciation and amortization) is an accounting measure calculated using a company's net earnings, before interest expenses, taxes, depreciation and amortization are subtracted.

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Leverage attempts to boost gains when investing through the use of borrowing to purchase assets.

Modern Monetary Theory (MMT) is the macroeconomic theory and practice that describes the uses of fiat currency by central banks

Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

Municipal bonds (Munis) are debt securities issued by a state, municipality or country.

A recession is, technically, when an economy contracts for two successive quarters but is often used in a looser way to indicate declining output.

The S&P 500 is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

The Secured Overnight Financing Rate (SOFR) is a secured interbank overnight interest rate based on the Treasury repurchase market

Seigniorage is the difference between the value of money and the cost to produce and distribute it

The U.S. Federal Reserve, often referred to as "the Fed", is the central bank of the United States.

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