CLARO ADVISORS

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Claro Market Insights
Hope Springs Eternal

Markets staged a dramatic rally throughout the month of April with the S&P 500 advancing +12.7%, helping to offset some of the losses from February and March. Although the S&P is still down -10% for the year, it certainly feels from an investor standpoint, that as bad as things have seemed, there is hope that things will get better. And that hope has carried over to other parts of the markets as well, with Small Caps advancing 13.7%, International +6.3% and Emerging Markets +9%.[1] Within fixed income, the Federal Reserve is providing much needed liquidity while also acting as a market participant allowing for bond markets to operate more smoothly. This has helped calm owners of government, municipal and corporate issues who have been nervous that some companies and municipalities are at risk of default. One market that has continued to struggle has been commodities and specifically the oil markets as prices plunged to historically low levels (even trading in the negative) as the supply of oil far outpaced demand. Precious metals, however, like gold, and even cryptocurrencies, such as Bitcoin, saw a continued rise in prices as investors flocked to safe haven assets likely anticipating the potential threat of inflation down the road if the unprecedented growth in money supply becomes an issue.

Financial Market Data					
	April	**April**	**Q2**	**2020**	**1 Year**
U.S Stock Markets	**Closing Price**	**Monthly**	**Quarter**	**YTD**	**Return**
S&P 500 Index Price	$ 2,912.43	12.7%	12.7%	-9.9%	-1.1%
Dow Jones Industrials	$ 24,345.72	11.1%	11.1%	-14.7%	-8.5%
NASDAQ Composite	$ 8,889.55	15.5%	15.5%	-0.9%	9.8%
Russell 2000 Index	$ 1,310.66	13.7%	13.7%	-21.1%	-17.6%
International Stock Markets	**Closing Price**				
MSCI EAFE Index	$ 1,657.69	6.3%	6.3%	-18.6%	-13.7%
MSCI Emerging Markets Index	$ 924.94	9.0%	9.0%	-17.0%	-14.3%
U.S. Fixed Income	**Closing Price**				
90 Day T-Bill	$ 203.17	0.0%	0.0%	0.5%	1.9%
Barclays Aggregate Index	$ 2,335.85	1.8%	1.8%	5.0%	10.8%
Barclays Municipal Index	$ 1,247.68	-1.3%	-1.3%	-1.9%	2.2%
	Closing Price				
Gold	$ 1,688.05	4.9%	4.9%	11.4%	31.6%
Oil (WTI Spot)	$ 19.47	-5.1%	-5.1%	-68.2%	-69.5%
Bitcoin	$ 8,717.76	30.8%	30.8%	21.2%	61.8%

The Good, the Bad and the Ugly

With such a sharp and quick market rally, one has to wonder if it's just a "bear market rally" and if valuations are already becoming extended? The market appears to be pricing in a V-shaped recovery for the economy that is expected to begin at the back end of 2020 and continue into 2021. The hope is that the economy can regain its footing and reach its previous high in both economic growth and earnings level for the market. This would be remarkable considering that the economy (forced into a mandated recession) has already shrunk by -$234 billion during the first three months of 2020 (-4.8% annualized). Hint, it's not going to get any better in the next few

[1] https://ycharts.com/indices

months either. The current GDP forecast calls for a further -16% decrease or an additional -$750 billion loss in GDP.[2] This would put the economy back to mid-2017 levels. Yes, there likely will be a sharp claw-back based on pent up demand once the economy starts humming again. However, it would be naïve to believe that the economy will be back to normal in such a short time period. Especially if consumers, feeling the after-effects of the virus shock, are reluctant to participate and with the threat of a coronavirus resurgence in the Fall of 2020, unless a vaccine becomes available. Unfortunately, it will likely take a couple of years to regain the past positive momentum. The current drop in GDP has been fierce and quick, and it would align with past recessions that when GDP loses a couple years-worth of growth, it takes a couple years to retrace its steps to its prior high.

In addition, the price level of the S&P 500 as measured by its price to earnings ratio (P/E) is currently trading at 20x expected earnings for 2020. This is high compared to its 25-year average of 16x. Looking out to 2021, the forward P/E is 17x earnings, also high relative to history.[3] Low interest rates and the continued support from the Federal Reserve and U.S. Treasury are allowing these valuations to persist. But is it sustainable? That is going to depend on a number of things, including companies' ability to grow earnings and justify their lofty valuations in the face of weakened demand and sharply higher unemployment. It's an uncertain proposition for sure, as the number of unemployed as measured by unemployment claims has already skyrocketed to over 30 million in just the past six weeks. This could amount to a greater than 15% unemployment level when the Department of Labor issues it's next report on Friday, May 8th.[4] Another thing to keep in mind is that earnings, as robust as they have seemed over the past couple of years, have benefited from a lowered corporate tax rate and an increased percentage of share buybacks.[5] With an election coming up in November, if anything were to change legislatively and with buybacks coming under greater scrutiny, these could prove as headwinds to future earnings growth.

A bright light at the end of the tunnel

That's about as negative as I can possibly get just looking out over the next couple of years. As dire as the near-term may sound, I actually have no doubt concerning the resiliency of the U.S. economy, or its people. There is for certain a very bright light at the end of the tunnel. The economy has faced many challenges in its more than 230-year history and has overcome each and every one. And despite all of our disagreements on policies, it still is the most robust country on earth where freedom and innovation thrive. This translates to the U.S. stock market as well, which also has overcome every headwind it has faced. Companies are one of the rare assets that have the ability to perpetually grow. As long as they produce something that people want, they can grow profits and grow their business. This makes the company even more valuable over time especially when you consider the compounding effect of growth. So, as long as people are able to formulate new ideas, create new technologies, and work and consume in a free market society; businesses will grow, employment will grow, wages for workers will grow, and the overall standard of living for its citizens will be higher in the future than it is today. Yes, there will be hiccups along the way and disagreements on topics such as the distribution of wealth, but overall people will benefit as long as our free market economy remains intact.

The Bottom Line

In the meantime, we wish you and your family continued good health and safety. We are diligently at work updating and monitoring your portfolios so that your investments can help you attain your financial goals. Feel free to check in and update us on how you are doing and if you need help with anything. We are here, ready and able. Wishing you and your families all the best!

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[2] https://www.frbatlanta.org/cqer/research/gdpnow

[3] Standard & Poor's

[4] https://tradingeconomics.com/united-states/unemployment-rate

[5] Standard & Poor's, J.P. Morgan Asset Management