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PROSPECTS FOR A SWOOSH-SHAPED RECOVERY

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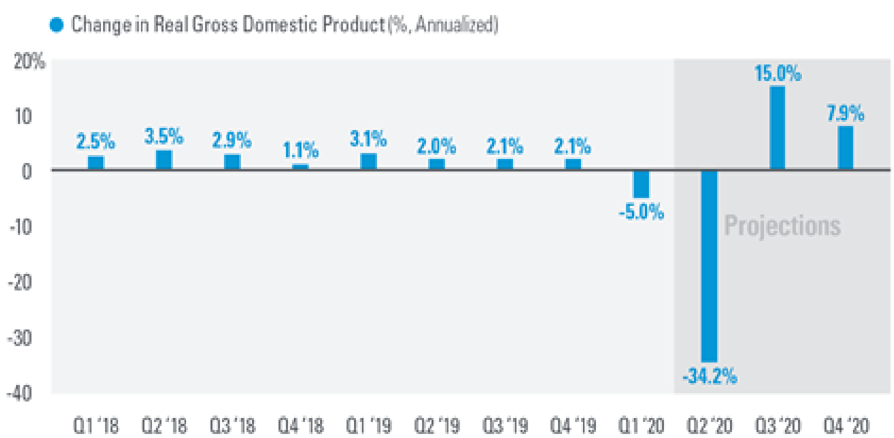
The strongest 50-day rally in the S&P 500 Index in over 70 years has sent a signal that the economic recovery is gaining steam and may look more like a "V" than a "U," a square root, checkmark, or swoosh. We assess the probabilities of these various scenarios for recovery and reiterate our 2020 economic growth forecasts.

AS GOES THE VIRUS, SO GOES THE ECONOMY

The US economy almost certainly entered a recession in March 2020 as a result of the lockdowns and business closures to contain the COVID-19 pandemic. After gross domestic product (GDP) contracted by 5% during first quarter 2020 on an annualized basis, consensus expectations for the second quarter are calling for a mindboggling 32% contraction on an annualized basis **[Figure 1]**. We see a strong second-half rebound in economic growth as more of the economy opens up, and this recession may end up as one of the shortest ever, but the recovery is unlikely to be strong enough to return economic activity to 2019 levels by year-end.

The path of the economy over the rest of the year depends on whether COVID-19 infection rates continue to fall, facilitating more and faster re-openings and a return to some semblance of normal consumer behavior. Alternatively, a potential second wave of the virus could lead to lockdowns being put back in place and consumers staying home. This recession has been consumer led and consumers—with help from the government, medical professionals, and perhaps Mother Nature—will have to lead us out.

1 MASSIVE SECOND QUARTER ECONOMIC CONTRACTION EXPECTED TO BE FOLLOWED BY SECOND-HALF SNAPBACK



Source: LPL Research, Bloomberg 06/03/20

GDP projections are median Bloomberg consensus forecasts.
Economic forecasts may not develop as predicted.

ENCOURAGING SIGNS, BUT NEXT PHASE GETS TOUGHER

Signs that the recovery is underway are encouraging. Policymakers have taken a depression off the table. Improvements in the timeliest data over the past several weeks are encouraging as states have moved their re-opening plans ahead. We have seen increases in vehicle and air travel, hotel occupancies, restaurant dining, and public transportation use, though from depressed levels. There is some pent-up demand.

But a large portion of the US economy cannot be easily socially distanced, which may limit the pace of the recovery by capping the amount of economic activity that can be recovered quickly. Capacity limits for restaurants and restrictions on large gatherings are two examples. Per the US Bureau of Labor Statistics, over 10% of US jobs are in leisure and hospitality, and some of those jobs unfortunately won't come back. More broadly, it will take time for stranded assets and affected employees to be re-tooled and re-deployed. More disruption may come as stimulus runs out.

Even with the surprising improvement in the June 5 employment report from the US Bureau of Labor Statistics, the true unemployment rate is likely several percentage points higher than the reported 13.3% rate after adjusting for those classified as employed but absent from work. For perspective, the unemployment rate peaked near 11% during the 2008-2009 financial crisis.

SWOOSH-SHAPED RECOVERY

The timing and pace of the economy rebound remains uncertain, but based on the depth of the contraction and a staged recovery, our 2020 GDP forecast is calling for a sizable contraction **[Figure 2]**. Drags on the pace of recovery suggest a swoosh-shaped recovery, or, if you prefer, a check mark. A quick, sharp decline and—after a small snapback—and gradual recovery over the next 12 to 18 months. We believe the square root symbol is too pessimistic by implying a flat phase of recovery after the initial bounce, and a U shape does not capture the multiple stages of recovery. This characterization assumes a COVID-19 vaccine is not widely available for another year or so. Verifiable progress on an earlier arrival could help sustain the momentum of the initial rebound and move the economy closer to a V-shaped recovery.

2 **2020 ECONOMIC FORECASTS— COVID-19 PANDEMIC HAS LIKELY RESULTED IN A GLOBAL RECESSION**

Real Gross Domestic Product Growth Forecasts (Year over Year)	2019	2020 Base Case	2020 Bear Case
U.S.	2.0%	-2% to -4%	-4% to -6%
Developed ex-U.S.	1.3%	-3% to -5%	-5% to -7%
Emerging Markets	4.3%	flat to 2%	-2% to flat
Global	3.5%	-2% to flat	-4% to -2%

Source: LPL Research, Bloomberg 06/03/20

Economic forecasts set forth may not develop as predicted and are subject to change.

CONSUMER OUTLOOK

Consumer spending composes about two-thirds of US GDP, which makes jobs, incomes, and consumer confidence vitally important for economic recovery. With higher unemployment than at any time since the Great Depression, and 22 million net jobs lost in March and April, the hit to consumers' spending power evident in recent economic data might have been significant. But stimulus efforts helped plug the hole, including direct checks to individuals, unemployment benefits, and financial support for businesses to help them keep employees on their payrolls. We saw the impact of the stimulus in the 10.5% increase in consumer incomes in April and record 33% consumer savings rate, according to the US Bureau of Economic Analysis. The stimulus has bridged many consumers to the other side of the crisis, but structural unemployment in industries more challenged in a socially distant society will delay consumer spending's return to 2019 levels.

BUSINESS INVESTMENT

In this uncertain environment, businesses are pulling back on investing in future growth. But we have seen encouraging signs here as well in terms of a solid rebound in small business confidence in the future, based on the latest National Federation of Independent Business (NFIB) small business survey of expectations. New orders components of the Institute for Supply Management (ISM) surveys for May improved for services and manufacturing as businesses reopen. However, as with unemployment, manufacturing data for May remained at recessionary levels and will probably remain there in June.

The road to recovery will be gradual, as businesses are thoughtful and deliberate about making long-term capital investment commitments and will need to learn more about how the restrictions impact their business as a vaccine gets closer. Moreover, decisions for some industries could also be delayed until they have greater clarity on the post-election policy environment.

POLICY STIMULUS

Policymakers prevented a deep recession from getting much deeper with an extraordinarily fast and bold response. The four stimulus packages passed already have totaled nearly $3 trillion, and a fifth package is in the works that could add another $1 trillion to that total. In total, that's potentially 16% of GDP in fiscal stimulus support as a bridge to the other side of this crisis and to help ensure the recovery is a strong one. The Federal Reserve has been similarly bold, increasing its balancing sheet by about 13% of GDP, and signaling that the central bank may hold its policy rate near zero well beyond 2020.

CONCLUSION

We remain optimistic about a gradual recovery in the second half, though forecasting in a COVID-19 environment remains very difficult. We are encouraged by recent signs of improvement in the labor market and some of the timeliest data on economic activity. However, there are constraints on the pace of recovery in the second half. The next leg gets tougher and a swoosh seems an appropriate shape.

Finally, we are maintaining our year year-end 2020 fair value target range for the S&P 500 at 3,150-3,200, based on a price-to-earnings ratio (PE) of about 19 and a normalized earnings figure of $165, even though the index closed within that range on Friday. We continue to believe stocks are pricing in an overly optimistic outlook for a second half economic and profit recovery and expect a pullback in the near term.

For long-term investors, we still find stocks more attractive than bonds at current valuations and recommend overweight allocations (and a corresponding underweight to fixed income).

IMPORTANT DISCLOSURES

This material is for general information only and is not intended to provide specific advice or recommendations for any individual. There is no assurance that the views or strategies discussed are suitable for all investors or will yield positive outcomes. Investing involves risks including possible loss of principal. Any economic forecasts set forth may not develop as predicted and are subject to change.

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The Standard & Poor's 500 Index (S&P500) is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Forward Price To Earnings (Forward P/E) is a measure of the price-to-earnings ratio (P/E) using forecasted earnings for the P/E calculation. While the earnings used are just an estimate and are not as reliable as current earnings data, there is still benefit in estimated P/E analysis. The forecasted earnings used in the formula can either be for the next 12 months or for the next full-year fiscal period.

All index data from FactSet.

Please read the full Outlook 2020: Bringing Markets Into Focus publication for additional description and disclosure.