Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

Portfolio Manager Investing Insights

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A Visionary View of the U.S. Economy

The Covid-19 global pandemic is wreaking havoc on many (but not all) parts of the U.S. economy. It remains to be seen how quickly the economy can ramp back up once the virus is contained and restrictions are lifted. For investors, I think it's important ***not to wait for positive news as a signal that we're in the clear***. As I've written before, stocks are likely to rally into the next bull market *before* economic data actually improves. It's important to remember that during the last economic crisis the market bottomed in March 2009 but unemployment did not stop rising until October 2009.[1]

For all of the negative outcomes this virus and recession are creating and revealing, I think it's also important to consider how the U.S. and global economy are likely to evolve, grow, and strengthen as a result of everything we learn from this experience. As a starting point, consider if any of the below apply to you:

- You are one of the millions of Americans working from home;
- You have children or grandchildren getting lessons through 'online schooling;'
- You communicate for work and/or with friends and family using an online platform like Facebook, Zoom, Skype, Instagram, FaceTime, etc.;
- Entertainment at home sometimes (or usually) involves a streaming service like Netflix, Disney+, Hulu, YouTube, Amazon Prime, etc.;
- Groceries and other goods are being delivered to your doorstep by your local retailers or Amazon.

Answering 'yes' to any of these questions means you're relying on the *digital economy* and the United States' digital infrastructure to live and work. In order for these tools and applications to work and function smoothly, the government and corporations across all sectors will need to make significant investments in cloud, enterprise software, 5G, and all of the hardware needed to make sure a business can hum in the digital economy. For better or worse, the American consumer also needs these investments to happen given that we increasingly shop, connect, and work online.

It should perhaps come as little surprise, then, that the biggest players in technology are actually *hiring* right now. Apple, Google, and Amazon are all looking for software engineers, data scientists, product designers, and other highly skilled workers. Facebook said this week that usage has soared during this crisis, and given they expect robust activity through the election, they are hiring more than 10,000 people this year for key roles in product and engineering teams. Amazon said that as of April 10, it has *20,000 open tech jobs*.[2] The list goes on.

The stock market is well aware of the technology sector's relative strength in the current climate and for the economy at-large. In Q1 2020, the S&P 500 declined -19.60% while the US Technology Sector fell much less, -11.77%. This relative outperformance makes sense given that Microsoft, Apple, Amazon, Google, and Facebook are the five biggest contributors to overall index returns. This performance trend reflects the realities of the current economy, but it is not unique to this crisis. Over the last 10 years, the *annualized* return of the S&P 500 is an impressive +10.53%, but the Technology sector has posted an annualized return of +14.84% over the same period.[3]

The transition to the digital economy is ongoing and likely to accelerate in the wake of this crisis, in my view. I could see more companies in more sectors speeding-up their ability to operate online, which means moving to cloud and investing in software and infrastructure. But I could also see astounding and generation-defining changes coming to the biotechnology and life sciences industries as well. Walter Isaacson, a biographer, positions these pivotal moments in history in three phases.

In the early 1900s, discoveries helped spur the invention of transistors, radar, semiconductors, spaceships, GPD, and lasers– all of which are invaluable to the US economy today. By mid-to-late century, the economy was riding the information technology wave, encoding information into binary digits, or bits. Human progress in this field led to the invention of the computer, internet, smartphone, and everything mentioned above that is currently powering growth in the digital economy.

In the wake of this global pandemic, Isaacson argues that we could see a revolution driven by advances in biotechnology. Developing our knowledge and technology in the biotech field could lead to breakthroughs in cancer treatment, vaccines, new medicines to treat viruses and other illnesses, deployment of Artificial Intelligence-powered computer modeling for early detection and treatment, and so on.[4] In a time of crisis, it is important to remember that throughout our country's history, we have often emerged from the worst of times stronger, more resolved, and more advanced and diverse economically than ever before. I don't think this time will be different.

Bottom Line for Investors

The rapid spread of Covid-19 has put incredible strain on the U.S. healthcare system, and it has also exposed weaknesses in the government's "grasp of complex supply and distribution chains for life-critical medical equipment and other goods," according to former Google CEO Eric Schmidt.[5] Technology companies like Amazon can help fix this issue. There is also a burgeoning opportunity to further develop additive manufacturing (3-D printing), which in the current crisis is helping some hospitals manufacture respirator valves to use on patients and to potentially save lives. The list goes on.

Many of the 'evolutionary' economic changes I discuss in this week's column have actually been underway for some time across the global economy, but this crisis is making many of us more acutely aware of them. Companies have been gradually moving to the cloud, developing digital infrastructure to run a business, shifting sales to e-commerce, running virtual meetings on Zoom and via webcasts, and so on down the line. If anything, this crisis is likely to *accelerate* a trend that was already happening, encouraging more sectors to move more quickly in the digital economy's direction.

At the end of the day, experiencing job losses and a recession causes many folks to think very short term, focusing only on the economic pain happening *now*. But if we keep focus on the long term and how we will make progress and innovate, it is easier to envision an economy that is bigger, stronger, and more resilient in the years ahead.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] The New York Times, April 10, 2020. https://www.nytimes.com/2020/04/10/upshot/virus-stock-market-booming.html

[2] The Wall Street Journal, April 14, 2020. https://www.wsj.com/articles/looking-for-a-job-big-tech-is-still-hiring-11586712423?mod=djem10point

[3] BlackRock, Benchmark Returns Comparison, March 2020.

[4] The Wall Street Journal, March 26, 2020. https://www.wsj.com/articles/a-spur-to-the-biotech-century-ahead-11585238908?mod=djem10point

[5] The Wall Street Journal, March 27, 2020. https://www.wsj.com/articles/a-real-digital-infrastructure-at-last-11585313825

IN FOCUS THIS WEEK

- When is the right time to reopen the economy?
- Big tech is hiring & innovating
- Inside the landmark oil deal struck this week

When is the Economy Going to Reopen?

Perhaps the most important and contentious question in the United States and across the world today is, when is the right time to reopen the economy? Epidemiologists, economists, and politicians all likely have different answers to the same question. The answer to the question is a delicate dance between all three, and getting it wrong – whether that means opening too early or too late – can have serious consequences. Epidemiologists and economists may not differ as much in opinion as many might anticipate, however. Epidemiologists consider the public health risk of reopening too early, potentially resulting in another severe outbreak. Economists, similarly, might consider the cost of enduring another massive shutdown versus the short-term cost of waiting longer. As it stands today, states on the East Coast and West Coast have formed coalitions to study a gradual, rolling reopening, and there is an apparent tension between the federal government and states over who has the authority to make decisions. Regardless, Americans should reasonably expect that a return to work will not look like it once did. Social distancing requirements will likely remain, and there is likely to be increased monitoring of employees and customers, including temperature checks and blood tests to determine if a person is ready to return to work.[1]

Economic Silver Lining: Big Tech is Still Hiring

As most sectors in the US and global economy come under intense pressure, technology companies are proving to be leaders in growth and progress, as they did throughout the 11-year economic expansion. Apple, Google, and Amazon are all looking for software engineers, data scientists, product designers, and other highly skilled workers. Facebook said this week that usage has soared during this crisis, and given they expect robust activity through the election, they are hiring more than 10,000 people this year for key roles in product and engineering teams. Amazon said that as of April 10, it has 20,000 open tech jobs! The list goes on, and is merely a reflection of a trend that has been going on for the better part of a decade – companies are moving operations into the cloud, e-commerce, and online. It follows that companies building, servicing, and growing the digital economy's infrastructure are seeing steady demand. Meanwhile, demand for PCs increased in the first quarter given a surge of people working from home, but supply chain disruptions impeded the production needed to bring enough new computers to market.[2]

Major Cuts to Oil Production

In a landmark deal struck this week, Saudi Arabia, Russia, and the United States led a coalition to reduce global supply by 13%. The coalition of oil producers was able to make 23 countries agree to withhold a total of 9.7 million barrels of oil from the market per day,[3] which is designed to help reduce the current oil glut fueled by sinking global demand. Even with the cuts, however, the price of oil is not likely to see much support, in our view. According to the International Energy Agency, global oil demand is expected to fall by 9.3 million barrels a day this year, which would mean production cuts may only serve to keep prices consistent with the current supply and demand balance we see today. The US energy sector has been pummeled relative to other sectors in the economy, as production cuts may ultimately bankrupt many smaller players in the industry. Pipelines, refiners, and storage facilities are filling up across the US and Canada.

[1] The Wall Street Journal, April 13, 2020. https://www.wsj.com/articles/the-coronavirus-economic-reopening-will-be-fragile-partial-and-slow-11586800447

[2] The Wall Street Journal, April 14, 2020. https://www.wsj.com/articles/looking-for-a-job-big-tech-is-still-hiring-11586712423

[3]The Wall Street Journal, April 12, 2020. https://www.wsj.com/articles/opec-allies-look-to-resolve-saudi-mexico-standoff-and-seal-broader-oil-deal-11586695794

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[1] The Wall Street Journal, March 9, 2020. https://www.wsj.com/articles/bear-markets-arrive-in-some-u-s-sectors-and-european-indexes-11583781509?mod=djem10point

[2] Wikipedia, March 9, 2020. https://en.wikipedia.org/wiki/Black_Monday_(1987)

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