LPL RESEARCH
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BIG NEWS AND NEW FORECASTS

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The last week of April was a big news week. A very weak first quarter GDP highlighted a busy economic calendar. Investors digested a flurry of earnings reports, including some of the biggest names, such as Apple, Amazon, Facebook, and Microsoft. Gilead Sciences released promising test results for a COVID-19 treatment, a positive step in potentially limiting the human and economic impact of the virus as some states began to reopen their economies. Finally, we heard from three major global central banks.

IN THE NEWS

Stocks bounced early the week of April 27, but limped to the finish. The S&P 500 Index ended the week about flat—but it wasn't because of a lack of news. Investors digested the initial estimate of first quarter gross domestic product (GDP), another top-tier economic report in the Institute for Supply Management (ISM) manufacturing Purchasing Managers' Index (PMI), meetings from all major central banks, and the busiest week of earnings season.

GROSS DOMESTIC PRODUCT

During first quarter 2020, GDP contracted by 4.8% on an annualized basis, the biggest quarterly contraction since 2009, even though most of the lockdowns from COVID-19 didn't kick in until mid-March. The contraction provided added confirmation that the economy almost certainly entered a recession in March. Consumer spending contracted a record 7.5% in March, while the business investment component of GDP fell 8.5%. The data is backward-looking, and Bloomberg consensus expectations for the second quarter are calling for a contraction of more than 25% on an annualized basis. The good news is GDP could bounce potentially more than 20% in the third and early fourth quarters as the economy opens back up. We remain focused on the timing and pace of the economy re-opening, but the depth of the contraction and staged recovery will likely translate into a sizable contraction in GDP in 2020.

INSTITUTE FOR SUPPLY MANAGEMENT

The May 1 report from the Institute for Supply Management PMI for manufacturing—the so-called official PMI—provided more evidence of the depth of the manufacturing downturn. The headline index fell 7.6 points to 41.5, better than Bloomberg's consensus forecast of 36, but a level consistent with prior recessions. That headline number, however, was inflated by the supplier deliveries component. Normally, lengthening supplier delivery times reflect strong demand, which prevents suppliers from keeping up. However, in this environment, it reflects global supply chain disruptions from lockdowns related to COVID-19.

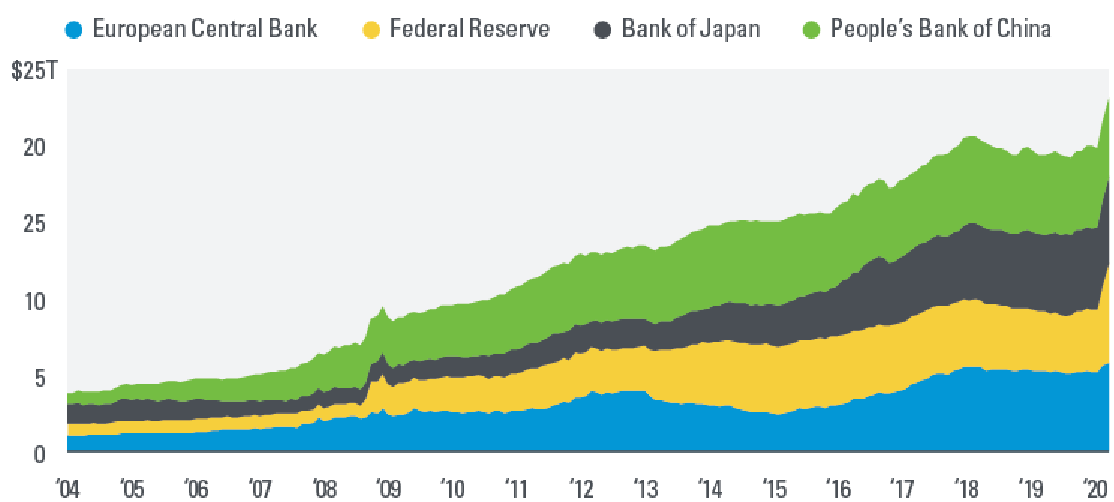
The new orders and employment components of the report, which both fell more than 15 points to around 27, are better indicators of where manufacturing activity in the United States is right now. The new orders number just missed the December 2008 level of 25.9, while the employment component set a new record low, putting the slump into proper perspective. Given the close relationship between manufacturing activity and corporate profits, earnings in the second quarter likely will take a significant hit before recovering in the second half of the year.

CENTRAL BANK ROUNDUP

Central banks have responded quickly and effectively to COVID-19. The Federal Reserve (Fed), the European Central Bank (ECB), and the Bank of Japan (BOJ) all met separately the week of April 27 and collectively reasserted their resolve to do whatever is necessary to support the global economy. Rates are being held about as low as they can go, significant new programs to enhance market liquidity and support lending are in place, and asset purchases have accelerated **[Figure 1]**. In fact, with April data not yet completed, central bank assets have risen more than $3 trillion the past two months, the biggest two-month jump on record. We do not think it's a coincidence that the S&P 500 bottomed the day after the Fed rolled out a wide range of emergency programs.

Federal Reserve. Prior to its policy announcement April 29, the Fed had expanded its program supporting municipalities by lowering the minimum size of the city or county to qualify. The Fed left its target rate unchanged at 0–0.25% and signaled that it is unlikely to remove its extraordinary policy support anytime soon. We believe the Fed may hold its policy rate near zero into 2022. Asset purchases are currently open-ended and have expanded to include corporate bonds, even including those packaged into investment-grade and high-yield bond exchange-traded funds. Interestingly, the Fed put the onus on Congress to use fiscal policy to help support the economy, something that was once unusual and is now commonplace.

1 MAJOR CENTRAL BANK ASSETS JUMP



Source: LPL Research, Bloomberg 04/29/20

European Central Bank. At its April 30 meeting, the ECB announced new refinancing operations and that it would ease conditions on long-term loans to banks, encouraging banks to increase lending. While some were disappointed the ECB did not add to its asset purchase program, President Christine Lagarde stressed that the program would continue at least until the end of the year and for as long as necessary, while leaving the door open to increase asset purchases quickly if needed. The ECB followed the Fed's lead and stressed continued fiscal policy is needed.

Bank of Japan. The BOJ met April 27 and announced that it would lift its cap on buying government bonds, making purchases open-ended, and triple the size of its corporate-bond commercial-debt purchases.

We offer more information on central bank actions in the *Street View* video, Central Banks Are All In.

REVISED FORECASTS

While forecasting in this environment remains very difficult, we now know more than we did in mid-March. In light of the severity of the COVID-19 lockdowns, recent economic data, and evidence of a more gradual recovery received in the past six weeks since we last adjusted our forecasts, we are sharply reducing our 2020 estimates for GDP growth and earnings. We have widened our ranges and provided bear-case forecasts to reflect the significant uncertainty **[Figure 2]**.

We have significantly lowered our US, international, and global GDP growth forecasts for 2020, and we are now forecasting a full-year contraction in the United States and developed international region. Our prior forecasts assumed a shallower economic contraction from the lockdowns and a quicker and stronger rebound

2 REVISED 2020 ECONOMIC & MARKET FORECASTS

COVID-19 IMPACT ON GLOBAL GROWTH, EARNINGS, AND INTEREST RATES IS SIGNIFICANT

		LPL Research 2020 Forecast		
Real Gross Domestic Product Growth Forecasts (YoY)	2019 Actual	Prior to COVID-19 Impact	Revised Base Case	Revised Bear Case
United States	2.0%	1% to 1.25%	-2% to -4%	-4% to -6%
Developed ex-U.S.	1.3%	0.75% to 1%	-3% to -5%	-5% to -7%
Emerging Markets	4.3%	3.75% to 4%	Flat to 2%	-2% to Flat
Global	3.5%	2.5% to 2.75%	-2% to Flat	-4% to -2%

U.S. Market Forecasts	Prior to COVID-19 Impact	Revised Base Case	Revised Bear Case
10-Year Treasury Yield	1.25 to 1.75%	1.25 to 1.75%*	0 to 0.5%
S&P 500 Earnings per Share	$138 to 142	$120 to 125	$110 to 115
S&P 500 Index Fair Value	3,150 to 3,200	3,150 to 3,200*	2,400 or lower

Source: LPL Research, Bloomberg 05/01/20

*No change at this time.

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

The opinions and economic forecasts set forth may not develop as predicted and are subject to change.

than we now expect. It is important to note that the midpoints of our forecast GDP ranges are all at or above Bloomberg's consensus forecasts and reflect our belief that the second-half economic recovery, while gradual and delayed compared with our prior expectations, may be a bit stronger than economists currently anticipate.

We also lowered our 2020 earnings forecasts given what we've learned from corporate America during earnings season. Consensus estimates have been reduced by 25% since March 1 and may have to come down further. While we continue to expect a strong second-half rebound, a later start to the recovery and a bigger hit to the economy than we had anticipated translates into our reduced earnings forecast, which reflects a decline slightly larger than the typical decline in recessions of about 20%.

Our S&P 500 fair-value target and interest-rate forecasts are under review but remain unchanged for now.

NEAR-TERM CAUTION

We continue to follow our Road to Recovery Playbook to help guide us through this challenging market environment. While we are encouraged by the stabilization of new COVID-19 cases and the massive stimulus put in place, stock market valuations are no longer as attractive. Our technical analysis work suggests we may be due for a pullback after the strongest bear market rally since World War II. We do not expect a full retest of the March 23 lows (2,237 on the S&P 500), which is 20% below the market's close on May 1, but a correction of 10–15% would not surprise us, based on the average pullback of 10% following a bear market rally. For tactical investors, we believe patience is prudent.

For long-term investors, we continue to believe stocks are more attractive than bonds at current valuations and, for now, we maintain our overweight equities recommendation and a corresponding underweight to fixed income assets.

Importantly, we have not changed our year-end 2020 S&P 500 fair-value target range of 3,150–3,200, roughly 11% from the May 1 market close at the low end of the range. We believe the stock market is appropriately looking ahead to normalized earnings, perhaps beginning in mid-2021. Though the timing of achieving some semblance of normal earnings is uncertain, and our fair-value target may not be reached by year-end, we believe a price-to-earnings multiple (PE) of 19 on $165 per share in S&P 500 earnings, which gets us to around 3,150, is a reasonable fair-value target once normalized earnings come into view.

IMPORTANT DISCLOSURES

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Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

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.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

All information is believed to be from reliable sources; however LPL Financial makes no representation as to its completeness or accuracy.

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

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