8 FORECASTS FOR 2020 (REVISED)

1. **US. GDP growth** will **turn negative** as early as March 2020 but most likely in 2Q. We think the **decline could be as steep as 9%** or more, without a fiscal stimulus rescue plan. The current plan of $1.5 trillion could result in two negative quarters in a row – 2Q and 3Q, both down about 4%. We note, though, that **even the Federal Reserve has stopped giving economic forecasts**, due to the uncertainty of the country’s response in controlling the spread of the virus.

2. **The unemployment rate**, currently historically low at 3.5%, will **jump toward 8%** due to job losses in retail, leisure and manufacturing.

3. The **Federal Reserve** has acted aggressively to **cut rates 2X**, launch a QE **program**, reinstate the Commercial Paper Funding and the Primary Dealer Credit Facilities, and now **guarantee all money market funds**. Additional steps could include more QE, buying municipal bonds or corporate bonds or equities. We expect the **10-year Treasury yield** to average **1.0%** in 2020.

4. The **Federal stimulus plan** will include **direct checks** to households; **tax, rent and mortgage holidays**; and **bailouts** to specific industries, among other steps. There will be **strings tied to the bailouts**, such as a **higher minimum wage** and **restrictions on future stock buybacks**.

5. **U.S. corporate earnings** will decline. Our initial take is a **10% drop** for the year, but expect **further revisions**.

6. The **economic sectors hit the hardest** will be **Energy, Financial Services, Consumer Discretionary, Information Technology and Industrial – Aerospace**. Of these sectors, **Tech**, which led the economic expansion over the past few years, will **be the first to recover**. **Energy may never recover**. We think Financial Services will recover, as the banks had much stronger balance sheets in 2019 than they did in 2007.

7. **Stock valuations have plummeted** along with stock prices and interest rates. On our valuation model, stocks had been at a modest premium to fair value into February 2020. Now they are selling at a **9% discount**, assuming our EPS estimate holds. This is about 1.3 standard deviations from normal. During 2008-2009, the discount was 3 standard deviations from normal. Our revised 2020 S&P 500 target price is **2800**.

8. Our concern over **stock market returns in an election year** has proven accurate, if not for the exact reason. We noted early in the year that the investors were complacent. That is no longer the case, as the **VIX has soared** from 12 to 80. The **headlines will be negative** – virus cases, political debates over bailouts, job losses, recession – for many more weeks. From a tactical standpoint, look to **reduce stocks of financially weak companies** and pocket the tax-loss carryforwards. Look to **hold onto financially strong companies** with capable management teams that are innovative, follow best ESG practices and grow their dividends. Stocks will recover before the economy.
ECONOMIC AND MARKET OUTLOOK

GDP TRENDS & OUTLOOK (% CHANGE)

Source: Bureau of Economic Analysis; Argus Economics

WEEKLY CLAIMS & NONFARM PAYROLLS

Source: Federal Reserve Board of Governors

FED BALANCE SHEET (FED ASSETS - $ MIL.)

Source: Federal Reserve Board of Governors

BOND V STOCK BAROMETER (STANDARD DEVIATIONS)

0 = STOCK/BOND EQUILIBRIUM

> 0, FAVOR BONDS

< 0, FAVOR STOCKS
We have reduced our 2020 EPS forecast to $146, from $180
• Formerly assuming 10% growth, now assuming 10% decline
• 30%+ EPS declines: Energy, Financials, Discretionary
• Best relative sectors: Staples, REITs
• Quarterly: 1Q tail-off, 2Q & 3Q slammed, 4Q new normal

We have reduced our 2021 EPS forecast to $162, from $196
• Assuming 11% growth, vs. 9% prior
• Potential for rebound growth: 2010 EPS rose 48%
• Assumes significant gov’t relief for “sick” sectors:
  » Energy, Discretionary, Materials, parts of Industrial

CHANGES ARE HIGHLY PRELIMINARY
SECTOR IMPACTS ON EPS

■ Energy
  • Sector will be structurally smaller
  • Tightened focus on domestic low-cost extraction (Permian)
  • Will require massive government intervention

■ Materials
  • Chemicals: low petro feedstock cost, rebounding China
  • Paper: accelerated secular shift to digital
  • Mining: dependent on recovery in resource economies

■ Discretionary
  • Travel, lodging, leisure crushed; 4Q recovery earliest
  • Housing & auto: potential for 2H growth
  • B&M retail permanently downsized; online replacement
SECTOR IMPACTS ON EPS

- Financial Services
  - Not a replay of 2008, when banks caught holding toxic assets
  - “Hunker down” mode; consolidate weak players
  - Insurance: better combined ratios

- Industrial
  - Aerospace: echo of 9/11, w/o defense build-up
  - Rails, shippers: volumes will come back

- Healthcare
  - Carte blanche & funding to develop treatments, vaccines
  - Sharply lower elective procedures & lifestyle
SECTOR IMPACTS ON EPS

■ Staples
  • Stay-at-home a lifeline to fading grocery chains
  • Over time, online further erodes the power of brands

■ REITS & Utilities
  • Income amid crash in fixed income yields
  • Utilities lowest risk; REITs need 2H win over disease

■ Technology & Comm Services
  • Pandemic accelerates shift to digital
  • The technology factory (China) stabilizing
AT TIMES THE HOLY GRAIL, AT OTHER TIMES, NOT

S&P 500 WITH 200W AVERAGE

BULL MARKET RSI SUPPORT 45
S&P 500 STOCKS ABOVE THEIR 200-DAY AVERAGE

GENERALLY NEED SUB 45% FOR MAJOR TROUBLE
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