ClearBridge Investments

Recovery Indicators Update: Economy Finding Firmer Footing

August 3, 2020

Key Takeaways

- Two positive signal changes re-affirm the overall green signal of the ClearBridge Recovery Dashboard: Financial Conditions to green from yellow and Housing Starts to yellow from red.
- Stimulus, arriving quicker and more amply than in the past, has been a primary driver of the rapid market and economic recovery.
- Prospects for further stimulus are bright as long as COVID-19 remains a threat, particularly given the greater challenges faced by Main Street.

Economic Data Continues to Suggest Recession Already Over

The weeks following an overall signal change on ClearBridge's economic dashboards tend to be some of our most sleepless. Often, an overall signal change hovers close to an inflection point, meaning incoming data could push the overall signal to break either way shortly after the initial change. Fortunately, we have been getting more sleep lately as strengthening economic and market trends in July caused two signals on the ClearBridge Recovery Dashboard to improve, further confirming the green overall signal. In other words, our cautiously optimistic view from last month — that the recession has ended, a new economic expansion has begun and a financial market bottom has formed — has gained further validation (Exhibit 1).

The first positive signal change on the dashboard was Financial Conditions, which improved from yellow to green. It seems longer, but only several months ago financial markets were seeing historic volatility, credit issuance was at a standstill and oil futures briefly went negative. The Federal Reserve's quick and decisive actions have more than restored market function and order. Our Financial Conditions indicator tracks approximately 100 market-based metrics. Taken together, they are signaling that financial conditions have improved as liquidity has been restored, primary capital markets have re-opened and volatility has declined. With this signal change, the "Financial" section of the dashboard now has two green signals and one yellow signal, making it the strongest of the three sections. This appears consistent with a recovery taking hold on Wall Street before Main Street.

Exhibit 1: ClearBridge Recovery Dashboard

		July 31, 2020	June 30, 2020	May 31, 2020
Confidence	Consumer Confidence	↑	↑	↑
	Business Confidence (ISM)	↑	↑	✕
	Investor Sentiment	✕	✕	✕
Economic	Housing Starts	●	✕	✕
	Initial Jobless Claims	●	●	●
	Philly Fed	↑	↑	↑
Financial	Credit Spreads	●	●	●
	Fed Policy	↑	↑	↑
	Financial Conditions	↑	●	✕
	Overall Signal	↑	↑	●

↑ Expansion ● Improvement ✕ Recession

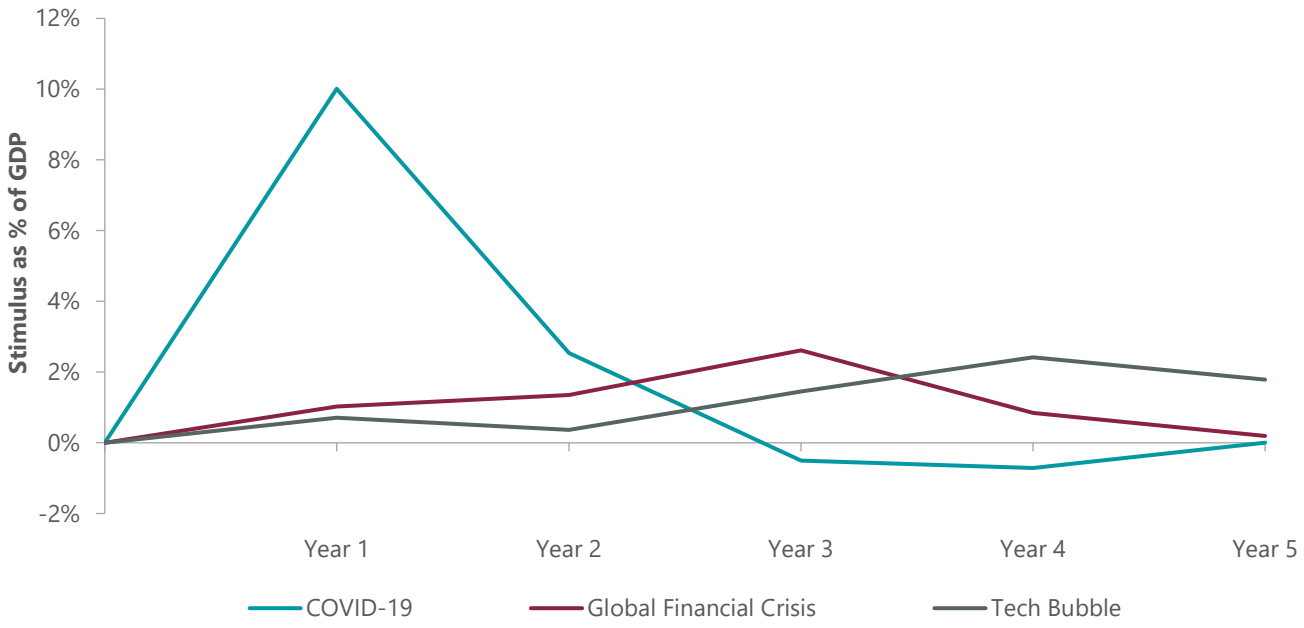
Source: ClearBridge Investments.

The second signal to improve is Housing Starts, which has moved from red to yellow. This change likely reflects the fact that lockdowns have now been lifted across most of the country. With restrictions being eased, an improvement from trough levels is hardly a surprise. Housing starts appear to have bottomed in April at an annualized rate of 934,000, rising modestly in May to 1.01 million. June, however, showed a more solid improvement to 1.19 million, strong enough to drive the signal into yellow territory.

Historic Stimulus Has Shortened Economic and Market Response Function

The coronavirus recession has been unique in that policymakers have been afforded unprecedented visibility into the economy. Once lockdowns were implemented, a recession was largely a foregone conclusion. Further, the crisis was not caused by any "bad actor," making policy support less challenging politically. Against this backdrop, both the Fed and Congress acted swiftly to provide support on a scale previously unseen. As shown in Exhibit 2, the CARES Act along with several smaller packages are not only much larger than past support programs, they have also been enacted quicker. The PPP program was implemented and consumer checks distributed in a matter of weeks following the signing of the CARES Act. Such programs have historically taken much longer, with more than three months passing between the approval and the mailing of consumer checks during both the 2001 and 2008 recessions.

Exhibit 2: Fiscal Stimulus as a Percentage of GDP



Source: Congressional Budget Office, Bureau of Labor Statistics and Bloomberg. Data includes impacts from Economic Growth and Tax Relief Reconciliation Act of 2001 which was passed before the recession began. Stimulus is based on CBO bill scoring as a % of GDP peak prior to recession and only includes Congressional outlays.

Some provisions of the CARES Act have begun to expire, and Congress is actively working on a fifth stimulus bill. Even though the amount of government support may be shrinking, it is not going away entirely. Overall fiscal policy is set to remain accommodative through 2021 and then become a modest headwind in 2022. We believe policymakers will continue to find ways to provide support to their constituents so long as COVID-19 remains a major economic threat. While political wrangling and a wobbly economy driven by ongoing coronavirus fears could lead to periodic bouts of volatility, we continue to believe that the backdrop for longer-term investors remains robust.

About the Authors

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Jeffrey Schulze, CFA
Director, Investment Strategist
- 15 years of investment industry experience
- Joined ClearBridge Investments in 2014
- BS in Finance from Rutgers University

Josh Jamner, CFA
Vice President, Investment Strategy Analyst
- 11 years of investment industry experience
- Joined ClearBridge Investments in 2017
- BA in Government from Colby College

ClearBridge Investments
620 Eighth Avenue, New York, NY 10018 | 800 691 6960 | **ClearBridge.com**

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