1 June 2020

LEADING THOUGHTS

Why June May Be The Most Important Month Of The Year

We'll have a substantially better picture of how quickly global demand may recover.

Buckle up. This is it. We are about to find out if our damaged global economy will shift into a sharp recovery or, rather, if a long and relentless recession lies ahead. June will deliver answers.

The initial COVID-19 outbreak has now swept the planet, and the economic readings so far have mainly measured the breadth and depth of the wounds. Ghastly readings on industrial production, unemployment and table bookings were -- in some cases literally – off the charts. Over the next few weeks, the sharpest investors will be watching for the second waves of the disease, second waves of macro data and second waves of corporate earnings. All three sets of readings will begin to deliver a sense of the early recovery rather than a measure of the global lockdown itself.

With much of the supply side coming rapidly back on line, the biggest questions remain around how quickly demand will return. The likeliest answers will paint a highly differentiated picture across regions, industries and companies. Currently, the outlook is much better in Asia than in Europe and the United States and brighter for industries such as health care and technology than it is for retail and leisure.

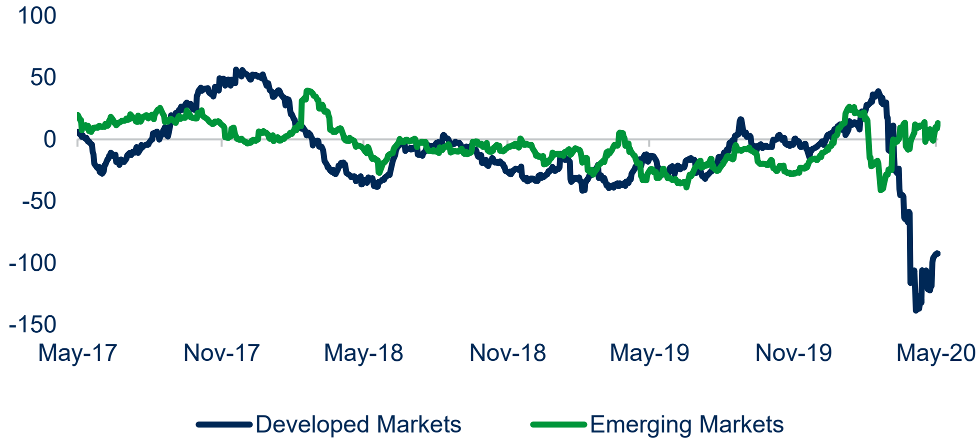
But June will confirm or confound these expectations. We should not be surprised to be surprised.

The second wave of infections will clearly be most important. The base case remains that a relaxation of government restrictions on movement in recent weeks will lead to isolated, but manageable, outbreaks. Still, we should retain some humility about just how little we know about COVID-19 itself, how it spreads and who is vulnerable. Steepening curves could shatter the early optimism that is already deeply rooted in financial markets.

Meanwhile, although the early word that numerous research teams are closing in on vaccines sounds encouraging, investors know better than most that the early word is rarely the final word. Even an immediate breakthrough will still require months or years of more limited patterns of work, social gathering and travel before there can be widespread protection.

On the macroeconomic side, worryingly, the second wave of data so far continues to surprise on the downside in developed markets, even if it's in line with predictions in emerging markets. Watch for better alignment of expectations as patterns return to normal, but watch closely.

CITI ECONOMIC SURPRISE INDEX



Source: Bloomberg. As of May 28, 2020.

DRIVING MOBILITY

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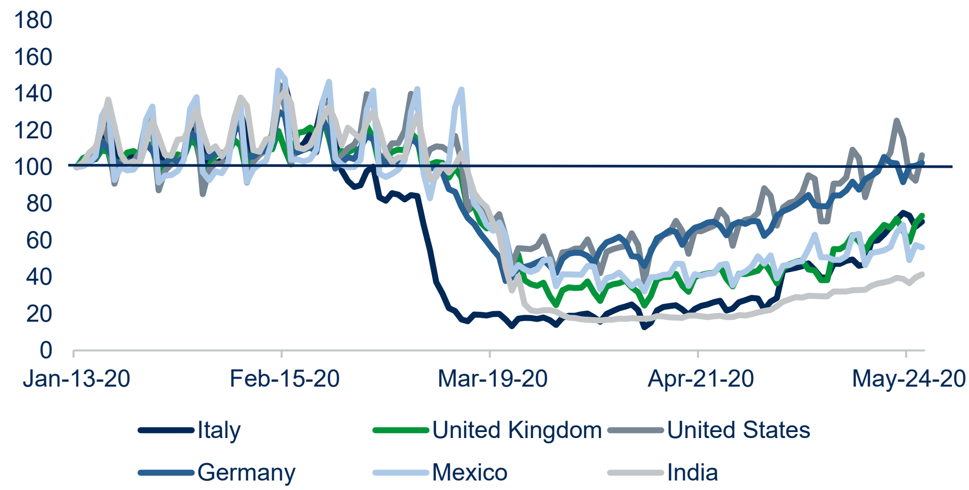

Source: Google. As of May 27, 2020.

China, as ever, was first-in and first-out of the crisis, so it is encouraging to see factories and offices resuming activity quickly. But this month's retail numbers will give a sense of just how confident consumers feel about the risks of a shopping spree. The Japanese data will be less meaningful since its lockdown came late.

European numbers will measure different paths to recovery, with Germany least affected among the major economies and most likely to deliver a rebound in manufacturing. Spain announced a reopening to international tourists, but look for others to follow suit based on their confidence that the worst has passed. The mounting political heat will also give an early sense for the prospects of the European Union's dramatic plan for grants and loans backed by joint debt issuance.

Second waves of data in the United States will be most important in assessing the labor market. Weekly initial jobless claims should continue to trend lower, but the headline unemployment numbers will likely rise as many return to work and find their jobs are no longer actually there. Low interest rates and tight supply may reinforce strong patterns in the housing sector, but slippage there would be especially worrying.

June will also close out the second quarter for public corporations, even if we won't get formal earnings reports until July. Meanwhile, the second wave of corporate news will revolve around ratings downgrades, bankruptcy filings and rolling announcements of layoffs in aviation, travel and leisure sectors that few expect to recover quickly.

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The second half of the year, of course, will bring its own surprises and important news, but the first few steps for anyone following traumatic injury offer vital signals about just how long the road to recovery may be. Risk assets clearly seem confident the patient will walk again, especially with all the money that governments and central banks have lavished on surgery, physical therapy and medication.

June will deliver an early reading on that judgement as investors process these second waves of data. Summer and fall will then test their confidence in what happens when the hospital sends them home.

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*As of March 31, 2020

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