April 24, 2020

US Strategy Snapshot

The Actual Earnings Number May Not Matter

Historical Earnings Trajectories From Bear Market Troughs Reinforce Recent Low

As society prepares for the inevitable re-opening of the economy (yes, it will re-open), baseline sentiments remain predominantly defined by trepidation and anxiety. Unprecedented historical events tend to generate such emotions, so investors and society alike need to cut themselves some slack, in our view, and trust the wherewithal of individuals, companies, economies, and governments. There is no doubt that angst surrounding coronavirus (COVID-19) is literally dictating every step of society – as it should. However, the focus from an investment standpoint – while still held hostage by the yet to be determined absolute trajectory of the virus – has firmly transitioned to what the triple whammy facing stocks means for today, tomorrow, and next week.

What's the triple whammy? 1) A 22-day cyclical bear market in stock prices; 2) earnings recession; and 3) economic recession. The first issue we take with this notion is that way too much investor focus is being defined by what we like to refer to as "point in time analysis." Namely, most investors we speak with are fixated on today, tomorrow, and next week with respect to stock prices, earnings, and the economy. Nothing like stating the obvious, earnings and the economy are weak right now, today, and tomorrow. But investors continue to underappreciate how, when, and why recoveries eventually occur. Recoveries transpire because the trajectory changes – from despair to hope and from negative to positive. So much has been made of analyzing the curve of the virus; our recommendation is that investors need to the same with earnings. When we do this and focus less on the actual number for first and second quarter EPS for the stock market, we see that trailing 12-month earnings trends are following the traditional script when faced with the "triple whammy."

So yes, we are sticking with our call that stocks bottomed on March 23, 2020. And yes, we believe akin to the unprecedented nature of the sell-off, investors should not be surprised if stocks ultimately rally 40-50% from those lows. Yes, we are sticking with our call that US stocks remain in a 20-year secular bull market. No, our views are not binarily bullish, nor are they driven by flippant Pollyanna optimism. It is very clear that growth and economic activity will be different as the curve changes and society re-opens. However, this is not unlike any other trajectory change or shift from despair to hope. As such, investors should avoid focusing on any incessant need to know the exact earnings and GDP number and instead believe in the stock market's changing trajectory and the historical parallels of earnings facing the triple whammy. If the trajectory does indeed reverse and head in the opposite direction, we will act accordingly.

Main Points:

- **If Earnings Deterioration Is the Ultimate Worry, Bottom Is Likely Already In Based on Historical Data**
- **Our Outlook Is Reasonable Considering Prior "New" Bull Market Trends**
- **A Recovery This "Fast" to New All Time Highs Is Not Unprecedented**

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Major US Indices Price % Performance

Sector	1M	YTD	6M	12M
DJ Industrial Average	22.4	-19.6	-12.4	-11.4
DJ Transportation	14.7	-28.7	-27.0	-28.6
DJ Utilities	24.5	-12.6	-7.9	4.3
NASDAQ 100	23.9	-5.7	10.0	12.3
NASDAQ Composite	23.5	-9.5	4.8	6.0
Russell 1000	21.8	-16.4	-7.2	-4.7
Russell 1000 Growth	23.8	-10.1	3.4	6.3
Russell 1000 Value	19.2	-23.3	-18.0	-15.9
Russell 2000	18.5	-28.7	-22.5	-23.0
S&P 500	21.4	-15.7	-6.6	-3.7
S&P 500 Growth	23.2	-10.6	1.3	3.2
S&P 500 Value	19.2	-21.7	-15.3	-11.7
S&P Mid Cap 400	20.2	-27.4	-22.3	-22.3
S&P Small Cap 600	15.6	-32.1	-27.3	-27.0

Source: BMO Capital Markets Investment Strategy, FactSet. Performance figures reflect close prices as of 4/22/20

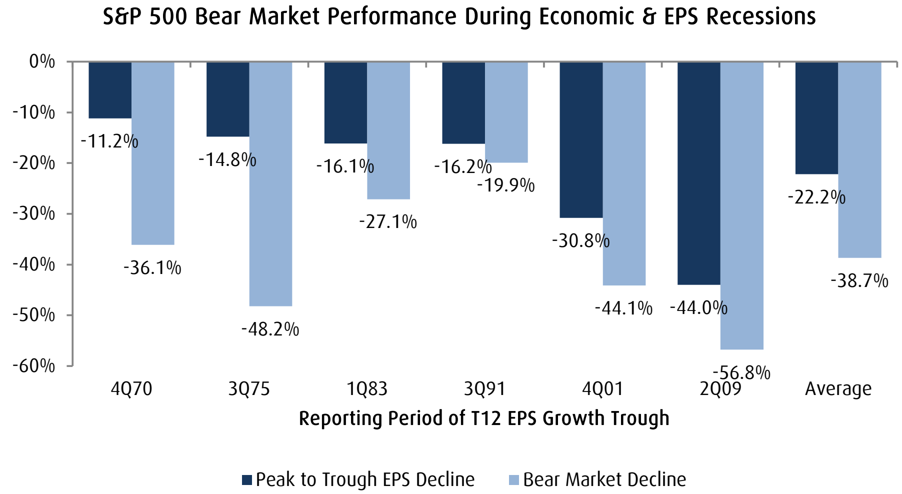
S&P 500 GICS Sector Price % Performance

Sector	1M	YTD	6M	12M
Communication Services	17.0	-15.4	-4.7	-3.2
Consumer Discretionary	27.4	-9.6	-5.3	-3.8
Consumer Staples	16.6	-8.7	-3.8	2.8
Energy	32.1	-41.3	-41.0	-49.5
Financials	14.3	-30.2	-24.2	-21.0
Health Care	25.1	-6.0	7.9	15.3
Industrials	18.7	-26.8	-22.1	-22.1
Information Technology	22.8	-10.2	8.6	12.3
Materials	20.8	-18.9	-14.2	-14.6
Real Estate	23.2	-16.0	-16.5	-4.9
Utilities	24.6	-12.6	-8.2	3.2

Source: BMO Capital Markets Investment Strategy, FactSet. Performance figures reflect close prices as of 4/22/20

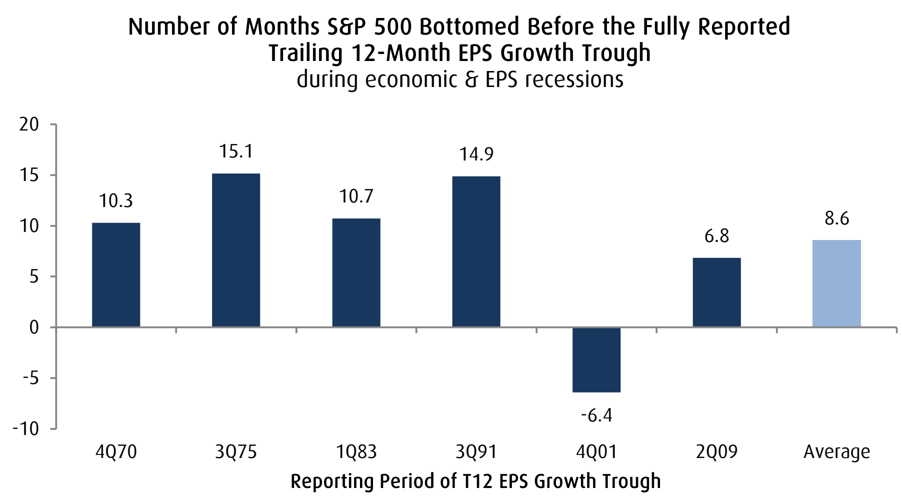
If Earnings Deterioration Is the Ultimate Worry, Bottom Is Likely Already In Based on Historical Data

Bear Market Price Decline Is Typically 1.7x Greater Than Eventual Trailing 12M EPS Drop



Source: BMO Investment Strategy Group, FactSet, IBES.

Historically, S&P 500 Price Bottoms Roughly 9 Months Prior to Trailing 12MEPS Growth



Source: BMO Investment Strategy Group, FactSet, IBES.

- Our work shows that earnings recessions which have coincided with economic recessions have seen S&P 500 trailing 12-month EPS growth deteriorate in ranges from -11% to -44% (Great Financial Crisis).

  - ✓ Historically, the average peak to trough decline in trailing 12-month EPS during these time periods has been ~22%.

- Within these periods, bear market performance has ranged from -20% to -57% for the S&P 500 index with an average decline of ~39%. During the Great 2007-08 Financials crisis, US stocks dropped ~57% heavily influencing the average decline.

- These two data points suggest that a bear market price decline is typically 1.7x greater than the eventual trailing 12-month EPS decline with stocks hitting their bear market bottom roughly nine months prior to the fully reported trailing 12-month EPS growth trough.

- Using this analysis to put current trends into context suggests the price decline has been much more severe in relation to the expected EPS decline – 2.4x versus 1.7x or a nearly 40% greater drop than historical averages. This is based on current consensus estimates that suggest 4Q20 will represent this cycle's trailing 12-month EPS growth trough at -14%.

- It is for this reason that we believe it is reasonable to expect the bottom is in place roughly three months faster than historical averages. Assuming a 3/23/20 price low, US stocks would have bottomed roughly 12.5 months prior to the anticipated trailing 12-months EPS growth trough or about 45% quicker than average, which is appropriate given that price declines were about 40% more severe, in our view.

Our Outlook Is Reasonable Considering Prior "New" Bull Market Trends

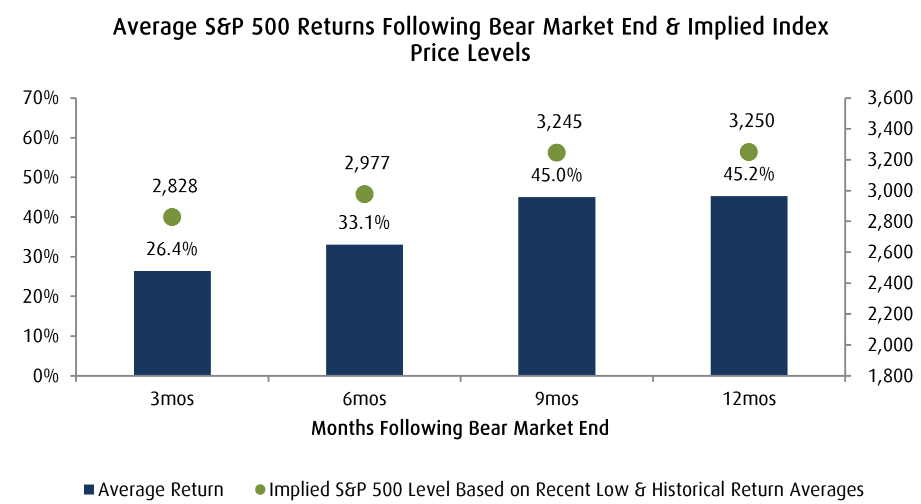
S&P 500 Posts Strong Gains in the Months Following Bear Market Bottoms

S&P 500 Performance Following End of Bear Market

	Months Following Bear Market End			
Bear Market End Date	3-Months	6-Months	9-Months	12-Months
5/26/1970	17.2%	22.8%	39.6%	43.7%
10/3/1974	13.5%	30.9%	51.5%	38.0%
8/12/1982	62.4%	52.6%	60.4%	58.3%
10/11/1990	6.7%	27.8%	27.6%	29.1%
10/9/2002	19.4%	11.5%	29.0%	33.7%
3/9/2009	39.3%	52.7%	62.0%	68.6%
Average	**26.4%**	**33.1%**	**45.0%**	**45.2%**

Source: BMO Investment Strategy Group, FactSet.

Our Prior 2020 SPX Price Target of 3,400 Could Still Be Achievable if History Is Any Guide



Source: BMO Investment Strategy Group, FactSet.

- Our analysis of S&P 500 price performance in the months following these recessionary periods suggests healthy returns in the subsequent months.
  - ✓ For instance, the S&P 500 posted average price returns of ~26% and ~33% in the three and six months following the bear market bottoms, respectively.
  - ✓ In addition, in the first nine and 12 months following the end of bear markets, US stocks logged gains of ~45%, on average.
- This suggests that our previous 2020 year-end target could still be achievable if history is any guide. More important, the lowest nine-month price return during these periods was ~28%, which would still imply gains from current levels (i.e., 2864 year-end level or ~2.4%). By contrast, the strongest nine-month gain was ~62%, a level that should it occur would push the S&P 500 past our previous year-end target (3624 vs. 3400).

A Recovery This "Fast" to New All Time Highs Is Not Unprecedented

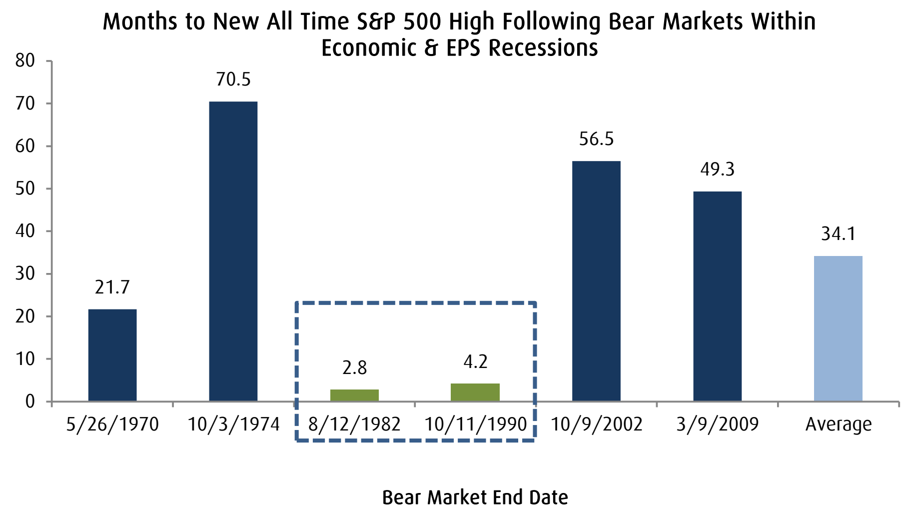
It Typically Takes an Average of 34 Months From the Trough to Hit a New All-Time High

Bear Markets Coinciding With Economic & EPS Recessions

Peak Date	Trough Date	% Decline	Date of New All-Time High	Months: Trough To Recovery
11/29/1968	5/26/1970	-36.1%	3/6/1972	21.7
1/11/1973	10/3/1974	-48.2%	7/17/1980	70.5
11/28/1980	8/12/1982	-27.1%	11/3/1982	2.8
7/16/1990	10/11/1990	-19.9%	2/13/1991	4.2
3/24/2000	10/9/2002	-49.1%	5/30/2007	56.5
10/9/2007	3/9/2009	-56.8%	3/28/2013	49.3
	Average	**-39.5%**		**34.1**

Source: BMO Investment Strategy Group, FactSet.

However, Swift Recoveries Did Occur Following the Early 1980s and 1990s Recessions



Source: BMO Investment Strategy Group, FactSet.

- Admittedly, our market outlook suggests that US stocks would need to buck the historical average trend when it comes to recovery time during bear markets coinciding with EPS and economic recessions in order to achieve a new all-time high within the next year.

- For instance, within these recessionary periods, it has taken nearly three years, on average, for the S&P 500 to hit a new all-time high from the bear market bottom. However, given the speed of the current decline, we believe old frameworks may not necessarily be applicable especially as lockdowns start to ease and investors begin to get a glimpse of how much activity will return and how fast.

- Nonetheless, US stocks did manage to hit new all-time highs much faster than we are currently forecasting following the double dip recession in the early 1980s and the brief early 1990s recession. In each of those incidents, the S&P 500 hit a new all-time high roughly three and four months following the bear market bottom, respectively. And not so coincidently, the market declines in those episodes were less severe compared to others, making them more similar to the current period, in our view (less severe = quicker rebound).

Recent US Strategy Research Reports

Date	Title
	Comments, Snapshots, and Perspectives
4/23/2020	US Strategy Comment: Thematic Report - The Mobile Worker
4/17/2020	US Strategy Snapshot: Lamenting Over Corporate Leverage
4/9/2020	US Strategy Snapshot: Use Dividend Growth to Combat Uncertainty
3/30/2020	US Strategy Snapshot: The Cyclical Bear's Role in Our Secular Bull Thesis
3/24/2020	US Strategy Comment: Coronavirus Positioning and the Next Bull Market
3/19/2020	US Strategy Snapshot: Avoid the Temptation to "Make the Call"
3/17/2020	US Strategy Snapshot: Unprecedented Times Generate Unprecedented Charts
3/12/2020	US Strategy Comment: Our Conviction Is Resolute, Template Notwithstanding
2/27/2020	US Strategy Snapshot: Epidemic of Fear
2/27/2020	US Strategy Comment: Panic Is Not a Winning Investment Strategy
2/24/2020	US Strategy Snapshot: Coronavirus Impact on US Stock Performance and Earnings
2/10/2020	US Strategy Comment: Thematic Report – The Shifting Consumer
1/22/2020	US Strategy Comment: The Doubted Bull Returns Yet Again
1/17/2020	US Strategy Comment: Making the Case to Overweight Comm Svcs and Discretionary
1/15/2020	US Strategy Comment: Staying Selective Within Industrials
	Monthly Reports
4/3/2020	US Strategy: US Chartbook – April 2020
4/3/2020	US Strategy: US Factor Profiles – April 2020
	Podcasts
4/21/2020	Podcast - Contemplating a Reopening
4/14/2020	Podcast - COVID-19 Outbreak Reaching Peak in U.S., Canada
4/7/2020	Podcast - Outbreak to Peak as Mitigation Weighs
3/31/2020	Podcast - COVID-19 - Decrease in the Rate of Increase
3/27/2020	Podcast - Coronavirus Positioning and the Next Bull Market
3/24/2020	Podcast - As the COVID-19 Crisis Deepens, Dr. John Whyte Provides Insights
3/17/2020	Podcast - A BMO COVID-19 Update With Dr. John Whyte
3/13/2020	Podcast - Investors Have a Choice: Faith or Fear
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11/21/2019	Investment Strategy: 2020 Market Outlook
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Hold	Market Perform	52.9 %	18.1 %	44.0 %	51.2 %	42.8 %	37.5%
Sell	Underperform	3.8 %	15.0 %	2.6 %	3.1 %	1.5 %	4.8%

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(April 2013 - October 2016)
http://researchglobal.bmocapitalmarkets.com/documents/2013/rating_key_2013_to_2016.pdf

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