5/15/2020 Are the Coronavirus Risks Receding?

Welcome to week nine of continued and not significantly modified lock downs here in southern California. In San Diego county testing for coronavirus has ramped up to over 3,500 per day with positive rates averaging below 4% and dropping. Hospitalizations have remained relatively stable averaging between 350 to 400 at any one time. In California, hospitalizations have trended down to around 4,500. Nationally, more states across the country are re-opening and so far, we are not seeing any significant flare ups or outbreaks. Assuming these trends continue this bodes well for the U.S. economy and financial markets in the future.

Manufacturing, employment, and auto sales numbers are already worse than the 2008/2009 recession and I expect more of the same with retail sales, housing starts and industrial production. However, state economies with decelerating daily Covid-19 cases account for 72% of national GDP. Assuming continued coronavirus good news I expect April to be the low point for this recession. GDP fell 5% in the first quarter and the average estimate for the second quarter is a drop of 25%. However, expectations for the second half of the year range from 10% to 30% gains depending on a lot of assumptions. First quarter corporate reports indicated flat sales and about a 15% decline in earnings. More fiscal stimulus will likely be done later this summer and the Federal Reserve continues to shovel liquidity into the monetary system. The stock market appears to be trading in a range waiting to see what paths the re-opening and the coronavirus take over the next weeks and months.

In the latest commentary from Commonwealth's Chief Investment Officer, Brad McMillan, discusses his view of the current state of the virus pandemic. Trends are positive and we are making real progress at the national level. As far as economic impacts Brad highlights two significant risks; (1) a large second wave of virus infections that may require revisiting the shutdown, and (2) consumer fear about normalizing their spending habits. No one really knows whether a second wave sufficient to re-engage shutdowns will appear, so we will just have to wait and see what develops as we re-open. Consumers however, I have more faith in and based on what we see happening in states already re-opening, I believe they will return quickly as long as they believe they can control the risk of exposure (i.e. masks and social distancing) to an acceptable level. I know I am anxious to get back to normal as fast as possible.

I remain confident in the economy and financial markets over the long-term, but volatility lies ahead. It is important that your investment strategy reflects your current and long-term needs. Funds you need in the next two years should have minimum risk exposure. Assets with a longer investment time horizon can be exposed to more risk commensurate with your goals. If you have any concerns about meeting your needs or your ability to tolerate volatility, please do not hesitate to contact me. It is important for your financial and physical well-being that we get your strategy right.

Linda and I continue to be in our office during normal business hours and are available to meet in whatever way you are comfortable with. Please do not hesitate to contact me if you have any questions or would like to discuss your individual situation. There are many reasons to be positive as well as many reasons to be concerned. The good news is that given enough time, we ultimately overcome all obstacles and usually end up better than we were before. For better or worse, this too shall pass.

As always, stay safe and healthy!

Christopher L. Phelps, CPA/PFS, CFP®, AIF®
Principal

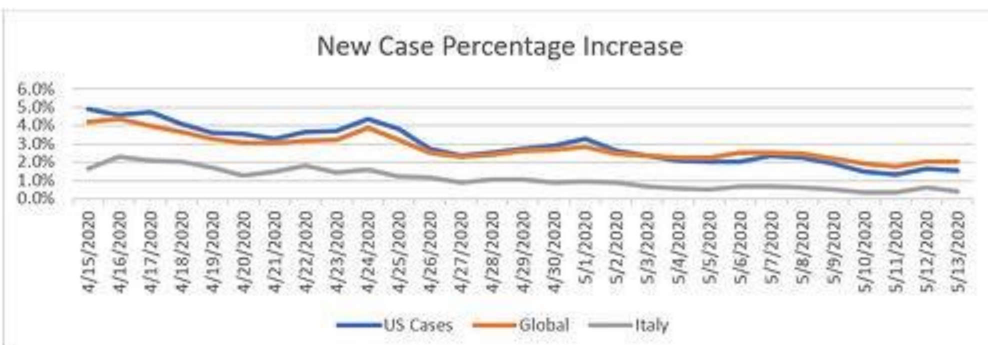
Pandemic Slowing, Economy Reopening, and Markets Reassessing

Presented by Christopher Phelps

In the past week, we've had some good news. To start, there has been continued and even accelerated progress with the pandemic, and it looks like we could be approaching "phase 2." Plus, the economy has started to reopen, resulting in some positive effects. But the news for the financial markets hasn't been so good, as they've experienced volatility as the prospect of reopening has turned into reality. Let's take a closer look.

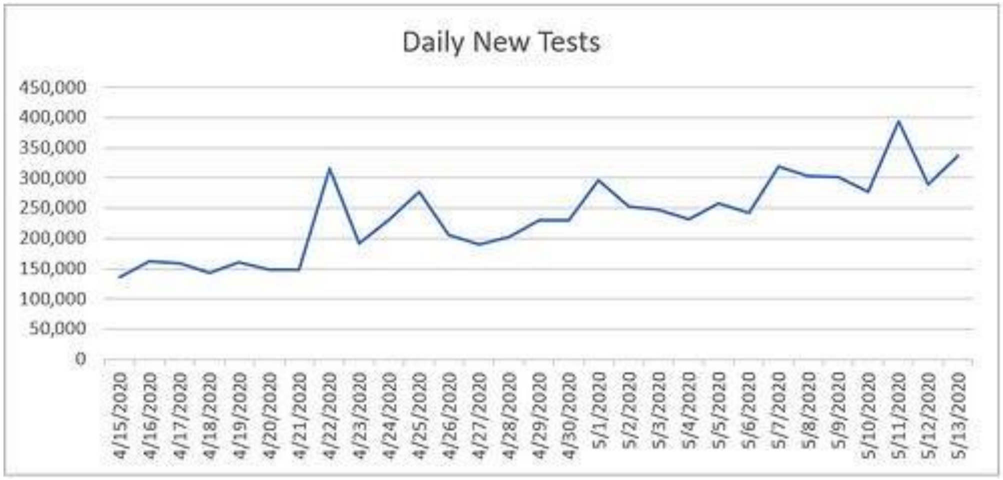
Pandemic Continues to Slow

Growth rate. You can see from the chart below that, over the past month, the new case growth rate has declined from about 5 percent per day to the present level of less than 2 percent per day. Put another way, the number of new cases went from doubling in about two weeks a month ago to doubling in about seven weeks now. This shift represents significant improvement—we have succeeded in flattening the curve even further at a national level.



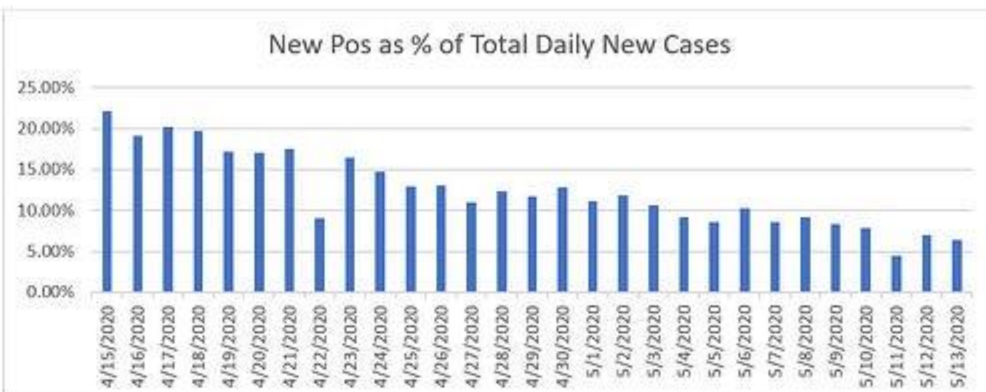
Source: Data from worldometer.com

Daily testing rate. We have also made further progress on testing. The daily test rate is up from just about 150,000 per day in the middle of April to 300,000 per day and more in the past several days. While this level is still not where we need it to be, it represents real progress.



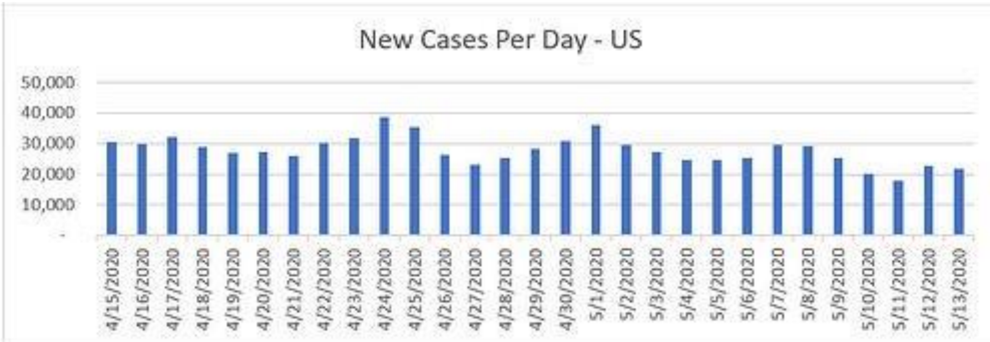
Source: Data from the COVID Tracking Project

Positive test results. Another way of seeing this progress is to look at the percentage of each day's tests that are positive. Ideally, this number would be low, as we want to be testing everyone and not just those who are obviously sick. The lower this number gets, the wider the testing is getting. Here again, we can see the positive level has halved from the peak. More people are getting tests, which means we have a better grasp of how the pandemic is spreading.



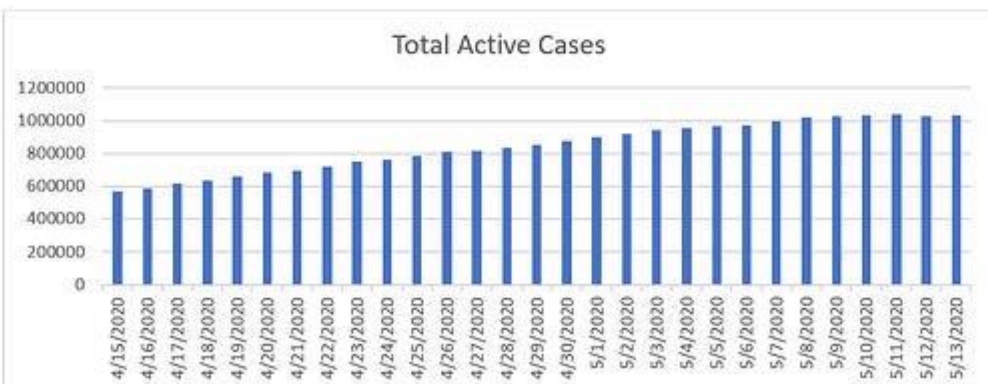
Source: Data from the COVID Tracking Project

New cases per day. As a result of these positive developments, the improvement in new cases per day is also substantial, down from 30,000 to about 20,000. And this number is even better than it looks. With the wider range of testing and the number of tests doubling, other things being equal, we would expect reported cases to increase in proportion to the number of tests. In fact, we have seen the number of daily cases ebb and flow with the testing data. Overall, however, the trend is down.



Source: Data from worldometer.com

Total active cases. The real news this week is that we are just about into phase 2, as we move from controlling the spread of the virus to starting to bring the number of active cases down. On May 12, with a combination of lower new cases and higher case resolutions, we saw the number of active cases drop for the first time in this pandemic. While that trend may not hold in the short term, the fact is that the active cases are stabilizing. This stabilization is the essential first step in taking the number of active cases down to zero—which is the phase 2 we are now approaching.

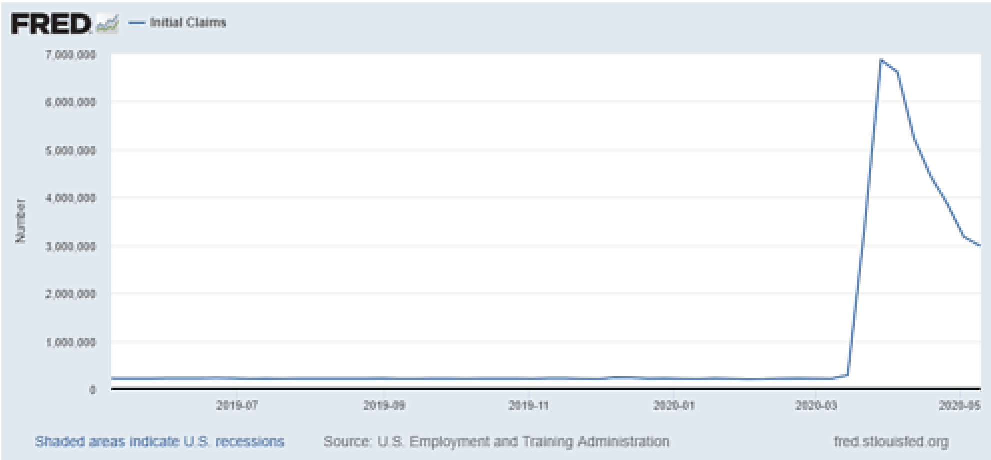


Source: Data from worldometer.com

We are getting close to controlling the coronavirus pandemic and even approaching a point where we can start to close it out. While we are not out of the woods yet, we are at the end of the beginning of the process—and moving in the right direction.

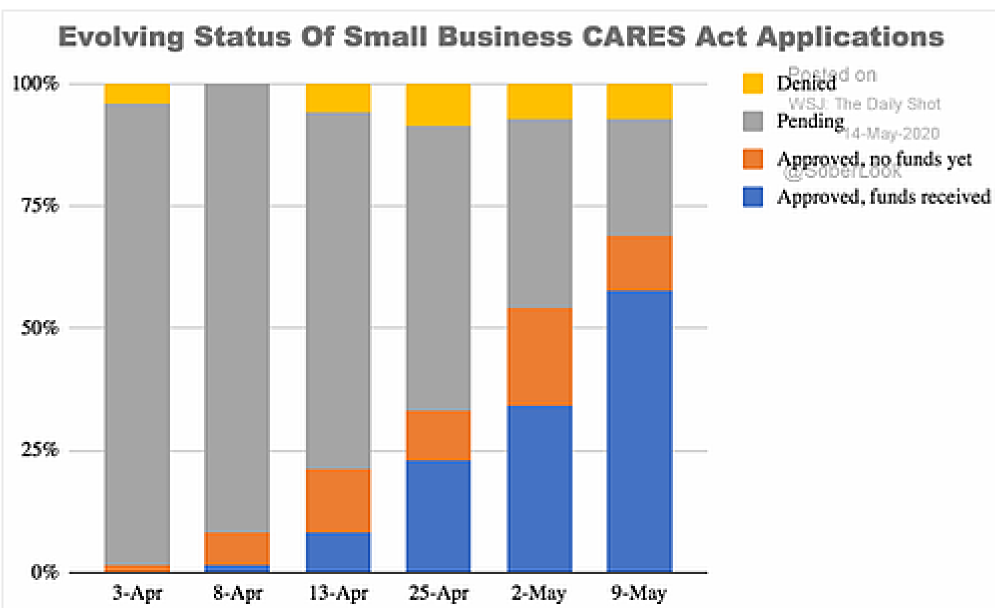
Economic Damage Declines, Risks Remain

Job market. While layoffs continue, there are signs that the damage may have peaked and has started to recede. Weekly initial unemployment claims continue to decline from the peak, suggesting that much of the damage has already been done.



Even better news is that the continuing claims number (i.e., those who received unemployment from previous weeks) increased by less than half a million, even as millions more lost their jobs. These numbers suggest that as the economy reopens, almost as many people might have returned to work as have lost jobs during the past week. Between the federal programs protecting employment and the reopening, jobs appear to be having a faster rebound than expected, which should have a significant positive effect going forward.

Federal stimulus. With the job market damage moderating, the federal aid is also mounting. As you can see in the chart below, the federal stimulus programs are now putting substantial amounts of cash into the economy. These funds should keep mitigating the damage and encourage the reopening.



Source: Wall Street Journal Daily Shot

Risks remain. Although the reopening is going better than expected and is clearly having some positive economic effects, we certainly face risks as we reopen. The biggest of these is a second large wave of the pandemic. Reopening means loosening the social-distancing restrictions and exposing more people to infection risk, which could certainly inflate case counts. We have not seen that increase yet, though. If people continue to do things like wear masks and maintain distance, that additional case growth might be acceptable. That will be something we will learn, and it seems probable that most people will act in a safe manner. The real test will come in two to four weeks, when any new cases arising from the reopening will start to show up. So, we won't really know about that risk until then.

Another potential risk is that, even with the reopening, consumers will be slow to return and spending growth will not return to what was normal any time soon. This outcome seems probable, especially in the early stages. Here again, spending growth is something that could end up doing better than expected. But early data shows that spending recovery has been fairly slow; if it continues to be slow, that will be another risk to the recovery.

Markets Get a Reality Check

For the financial markets, these risks are starting to come into focus. Until very recently, the reopening was a ways away, and the markets' assumption was that the reopening and recovery would go well and quickly. Now that the reopening is underway, markets are reassessing those cheerful assumptions, and we are seeing some volatility. That volatility is likely to continue over the next several weeks, until we get some data as to how bad a second wave of infections will be and how consumers return to spending. The good news is that when we get that data, markets will have a much firmer foundation.

What's the Takeaway?

The real takeaway from this past week is that progress continues, to the point that reopening now looks quite possible. We are not yet out of the woods, and there are certainly significant risks going forward—with a second wave of infections being the biggest. But the thing to keep in mind is that many of the biggest risks are moving behind us. It has been a good week.

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