

**6/26/2020 The Recovery Continues!
A Message from Chris Phelps, Advisor**

I sincerely hope that you find Brad McMillan's letters and my commentary helpful in understanding what is going on in the economy, how the financial markets are responding and ultimately, the impact of the corona virus on both. The observations and analysis I give you in this email are, for better or worse, my own.

This has been an interesting week in the world of corona virus. What has been clearly reported is an uptick in case levels with some notable increases in hospitalizations in localized areas. The good news is that at the national level the curve is still flattened and we are well within capacity to handle localized outbreaks and surges in hospitalizations. Various states are taking some measured steps to try to rein in the hotspots and to encourage people to continue implementing safe distancing, etc. According to Worldometer deaths per day in the U.S. continues to plummet below 500 per day indicating both that the virus is weakening and is spreading to the healthier part of our population. That means we are beginning to develop some level of herd immunity as a country which is a significant positive for both the medical system and the economy. Finally, the CDC for the first time this year is reporting that as of June 13, the U.S. has not experienced to date any "excess deaths", meaning more deaths from all causes than what would have otherwise been expected. Here in California hospitalizations of Covid-19 positive patients have increased week-over-week by about 1,000 to 4,500 but are well within the 25,000 to 30,000 hospital bed capacity of the state, not counting surge capacity. In San Diego county we still only have about 350 Covid-19 positive patients in hospitals, which is well within our 8,000 to 10,000 hospital bed capacity.

As Brad points out in his letter there are a number of good economic indicators that point to the continued recovery. Most notable is the declining trend in continuing unemployment claims which means more people are heading back to work. Also, consumer spending is upticking and trending in the right direction. Monetary policy and fiscal stimulus are clearly behind the stock markets second quarter surge along with consumer confidence of a recovery of the economy. However, given the potential risks associated with this corona virus, an upcoming political election and potential valuation issues, I expect the markets to trade in a range over the next few months as these issues work themselves out. A correction may occur however, I believe it is unlikely to veer into a bear market as the economic recovery looks solid at this point. Long-term I still believe the economy is solid and the stock market compelling.

I have attached last week's letter by Brad McMillan, Commonwealth's Chief Investment Officer. He remains optimistic about the economy and the path of the corona virus, although risks remain. I encourage you to remain optimistic and to do what you can to contribute to growing the economy.

I look forward to talking with you over the next few weeks. If you have any questions or if we can be of any help, please do not hesitate to contact Linda or me.

As always, stay safe and healthy!

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Localized Outbreaks Heighten Fears of National Second Wave

Presented by Christopher Phelps

Over the past week, localized outbreaks in several states continued to get worse, increasing the chances of a national second wave of infections. Arizona, California, Florida, and Texas have shown significant spikes in cases in recent days, with the Carolinas also under pressure. Further, multiple other states have experienced expanded case growth. Overall, the virus remains under control in many states, but the breadth and magnitude of the outbreaks have increased the risk at a national level.

As of June 24, the four states most affected (Texas, Florida, Arizona, and California) reported 20,247 new cases, up by 67 percent over the prior week. At the same time, new cases elsewhere were up by 28 percent. While the four headline states are showing more infections, the case growth in the rest of the country is also substantial. Supporting the idea that national risks are rising is that the rate of positive tests has ticked up substantially.

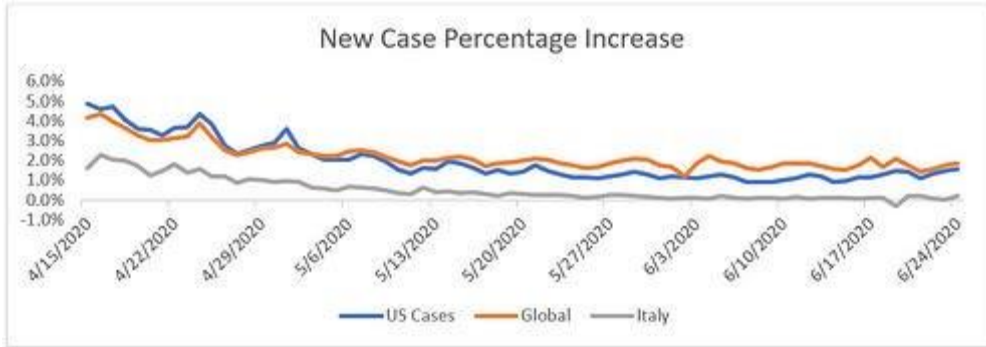
On the other hand, there is some good news. The economic reopening is still on track as consumers move back into the economy—although that may be at risk as local restrictions come back into play. Further, last week's data showed that housing continued to be strong and that the first quarter was better than expected.

Overall, from a medical perspective, the virus remains under control at a national level, but conditions are deteriorating and the risks are rising. From an economic perspective, the news remains good as the reopening continues.

Let's take a look at the details.

The Virus: Case Growth Picks Up

Growth rate. Over the past week, the daily case growth rate has trended up from 1.2 percent to 1.6 percent per day, due to significant accelerations in several states. At this rate, the case-doubling period has dropped from about 60 days to about 45 days. This rate leaves the virus under control and the curve fairly flat at a national level. But several states are now showing substantially higher growth rates that could threaten their health care systems. This is a rising risk in those states.



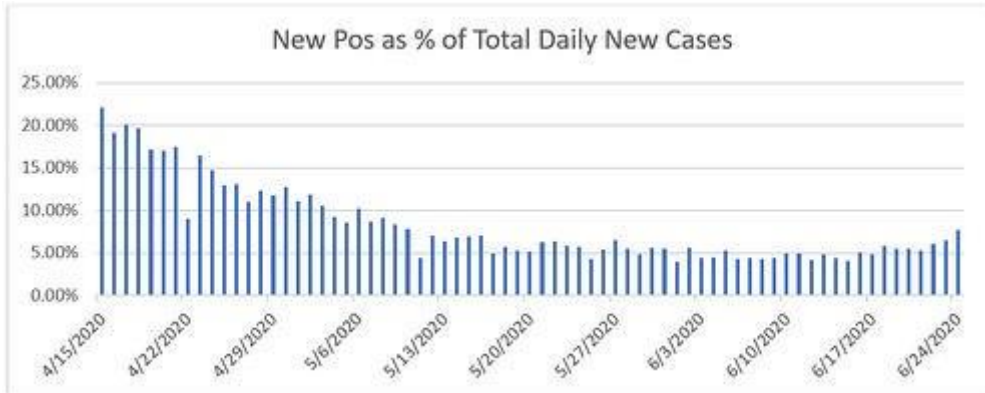
Source: Data from worldometer.com

Daily testing rate. After a drop, testing rates recovered in past days and seem to be steady at around 500,000 per day. The stabilization of testing is bad news, as it is not yet at the level needed to develop a full understanding of the pandemic, despite the outbreaks in multiple states.



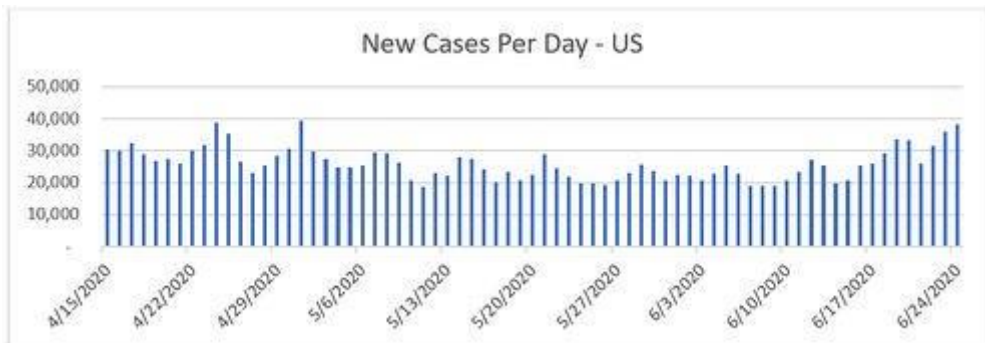
Source: Data from the COVID Tracking Project

Positive test results. Another way of seeing this lack of 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, we can see that the positive level has started to trend up, suggesting that we are getting back to the point of just testing the people who are sick. Again, this increase is likely due to the effects of the state-level outbreaks.



Source: Data from the COVID Tracking Project

New cases per day. The most obvious metric for tracking the virus is daily new cases. Due to the state-level outbreaks, the number of new cases per day has edged up to just under 40,000 per day. This number is close to the high point for the pandemic thus far and well above the range of the past several weeks. It is also somewhat better than it looks at a national level, as it includes the effects of the outbreak states. Still, it's not much better, as we are also seeing accelerated case growth in many other states. As noted earlier, the new cases are largely from the outbreak states, but the rest of the country has also shown a substantial acceleration in new cases. The national numbers are no longer just about a handful of states.



Source: Data from worldometer.com

Total active cases. Active case growth has also ticked up over the past week and has moved above the prior peak. New infections are now outpacing recoveries, indicating that the burden on the health care system is getting worse.



Source: Data from worldometer.com

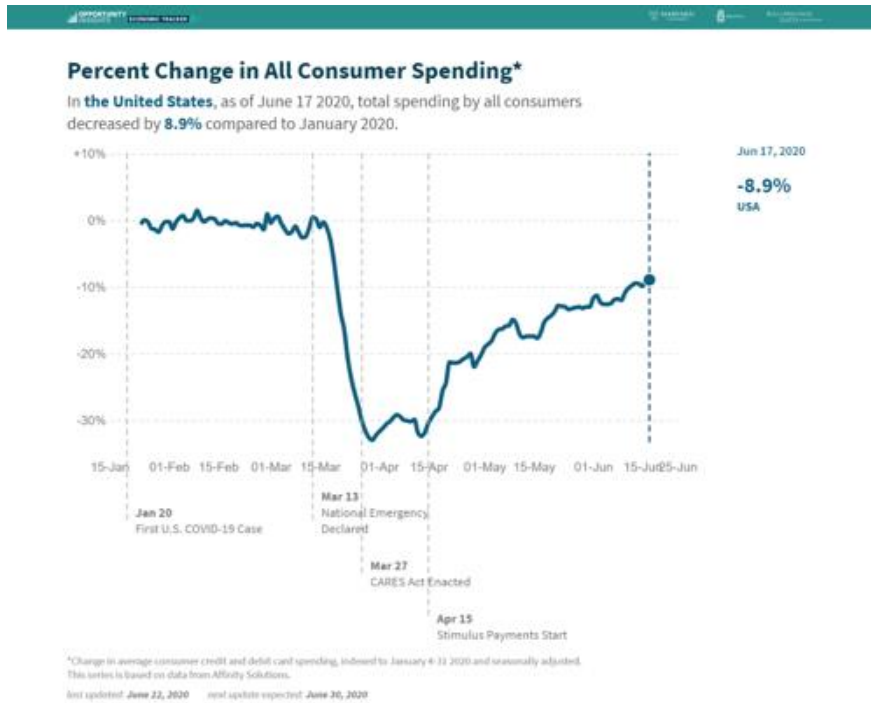
Major state outbreaks have risen to the level of threatening local health care systems, and case growth in other states is also accelerating. Overall, while the pandemic continues to be largely under control at the national level, the increasing breadth and speed of the state-level outbreaks are something we need to watch closely.

The Economy: Reopening Continues Despite Outbreaks

Job market. While layoffs continue to decline, they are doing so by less than expected. This suggests either that the damage is spreading beyond the initial sectors affected or that the state-level outbreaks have started to show up in the employment data. In better news, the continuing unemployment claims have continued to decline. They remain well below the recent high, despite the continuing layoffs, suggesting many people are starting to move back to work.

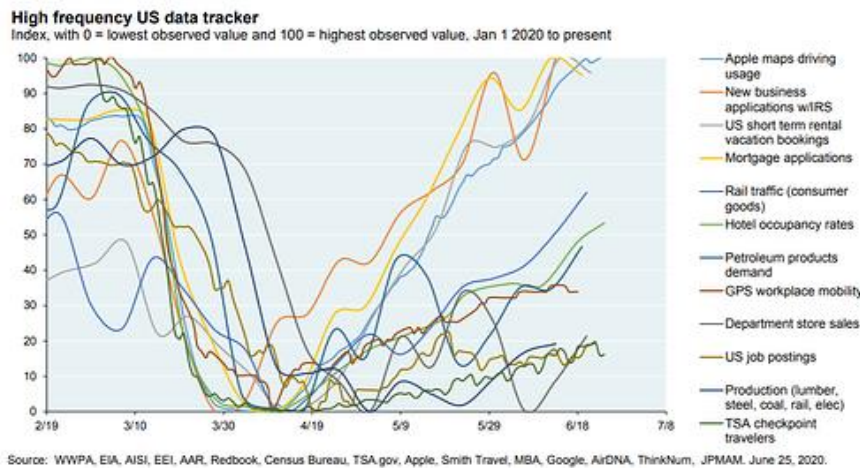
Also supporting this idea was the most recent employment report, which showed 2.5 million jobs created on a net basis in May, above the 7.5 million losses expected. As this report represents actual payrolls, it is a solid indicator that the job market is now improving. While there are some questions about the details of the data, the direction—improvement—seems to be holding.

Consumers on the move. We also see this improvement in many other indicators. The most recent retail sales report showed spending up by 17.7 percent, well above expectations, as consumers return to work and shopping. The chart below illustrates higher-frequency spending data, showing consumer spending down by 8.9 percent from January, which is an improvement from the 11.3 percent decline last week. This improvement supports the retail sales report and shows that economic progress continues despite the rising infection rate.



Source: tracktherecovery.org

And finally, we can see this terrific composite of many indicators from J. P. Morgan showing the substantial recovery in many metrics, which continues despite the outbreaks.



Source: *J. P. Morgan*

The risks. 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 if the local outbreaks turn into a national second large wave of the pandemic. At this point, that is not the case, but it is an increasingly likely possibility.

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

possible, although the signs remain positive, as we have not yet seen a decline in spending due to the outbreaks.

The Markets: Volatility on Pandemic News

For the financial markets, we continue to see volatility around fears of local outbreaks going national, but markets remain supported by the ongoing positive economic news. While risks remain, the good news is that as we get more data, markets could end up with a much firmer foundation. Overall, the medical news has been showing rising risks, so far the economic data has been positive on the whole, and markets have responded.

Virus Remains a Major Risk

The real takeaway from this past week is that the virus continues to be the major risk. If the outbreaks continue to worsen and spread, it could put the recovery at risk—but so far we do not see that. The most likely case appears to be continued recovery, despite the rising medical risks.

Also supporting that idea is the fact that states with outbreaks are starting to take the necessary measures to control the outbreaks. We will certainly see more damage, but the playbook to bring the outbreaks under control was well established earlier in the pandemic and just needs to be implemented. As states do so, we should see the outbreaks subside.

Risks are rising, and we are not yet out of the woods. There are certainly significant risks going forward, with localized outbreaks turning into a national second wave being the most significant. At the same time, in some sense this situation was inevitable and just part of a necessary process to figure out how to reopen effectively while still keeping the virus under control. Even as we go through that learning process (with the consequent pain), the thing to keep in mind is that many of the biggest risks are still moving behind us.

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