6/5/2020 Consumers Moving Back into the Economy-Risks Remain

A message from Christopher Phelps, Advisor

What a week eleven it has been. Massive protests accompanied by vandalism and violence have shocked America and a good portion of the world. The good news is that justice does appear to be forthcoming and the darker aspects of the protests look to be receding. Despite this week's events, the general market news has largely been positive capped off by a totally unexpected May jobs report that saw a 2.5 million jobs increase, and the unemployment rate reduced from 14.7% to 13.3%. This is an excellent sign that people are beginning to access the economy. In San Diego county testing for coronavirus has continued with seven-day average testing positive rates falling below 3.00% which is well below national averages. Hospitalizations of Covid-19 positive patients continue to remain stable in both San Diego County and California at large despite ramped up testing. As Brad notes in the attached letter coronavirus case levels have stabilized at around 20,000 per day and positive testing rates are declining. Further, we are finally seeing daily recoveries exceeding new cases. This should portend good news for an economic recovery over the next weeks and months.

Economic activity is slowly improving from April lows best shown through substantial increases in demand for restaurants and auto sales. In a shocker, May unemployment levels came in at 13.3% well below the expected range of 18% to 20%. Combined with improving consumer and business sentiment this provides a level of confidence to believe that the recovery will be strong albeit bumpy depending on the timing and degree that states reopen. Risks remain including the emergence of a second wave of the coronavirus, however, even that is beginning to look less likely. With respect to the financial markets, volatility is still king as uncertainties are resolved but the trends are moving in the right direction. I continue to remain optimistic for the long-term.

In the latest commentary from Commonwealth's Chief Investment Officer, Brad McMillan, has decidedly moved towards the optimistic side of things conspicuously noting positive trends in both coronavirus and economic metrics. Brad's optimism is somewhat tempered by concerns about a second wave of virus infections and consumer spending. I believe the consumer will be fine because as I noted in last week's email, private sector cash levels and savings rates hit dramatic highs in April and May while demand was significantly depressed over the same time frame. This means there is a lot of pent-up demand and postponed consumption that is likely to be resumed. You can do something to help by contributing to the economy. Let us work together to save jobs. By the way, if you are curious to see Brad in person, take a look at his short video discussing his analysis of the pandemic and the economy at https://vimeo.com/425943350. Let me know what you think.

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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Principal

Consumers Moving Back into Economy—But Risks Remain

Presented by Christopher Phelps

Over the past week, the biggest news in the coronavirus crisis has been what's not happening; that is, we're not seeing any signs of a second wave of infections as a result of the ongoing reopening of the economy and the loosening of social distancing measures. In fact, the data reveals that social distancing had been subsiding in many areas even before the formal loosening. So, we're three weeks or more into the start of a new environment for the spread of the virus, and there has not been a significant increase in the case growth rate. In fact, case growth itself has trended back down to around 20,000 per day.

The real question is whether recent public protests will generate a second wave of infections. We won't know the answer for at least another two weeks, but this possibility is something we must keep an eye on through June.

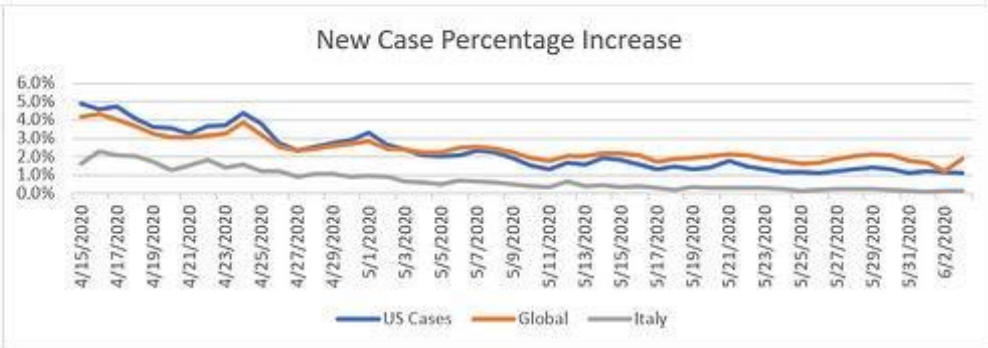
In other good news, the reopening is still on track as consumers move back into the economy. Mobility and restaurant demand have continued their substantial improvement, and auto sales have bounced back strongly. Plus, consumer and business confidence appear to have bottomed and started to recover.

After a slowdown in testing growth, as well as questions about the underlying data, the news here was better than last week. Testing moved back up and the rate of positive tests stayed low, suggesting that the data continues to trend favorably.

Overall, conditions continue to improve, although at a slower rate. So far, the reopening is proceeding smoothly from both a medical and economic perspective. Let's take a look at the details.

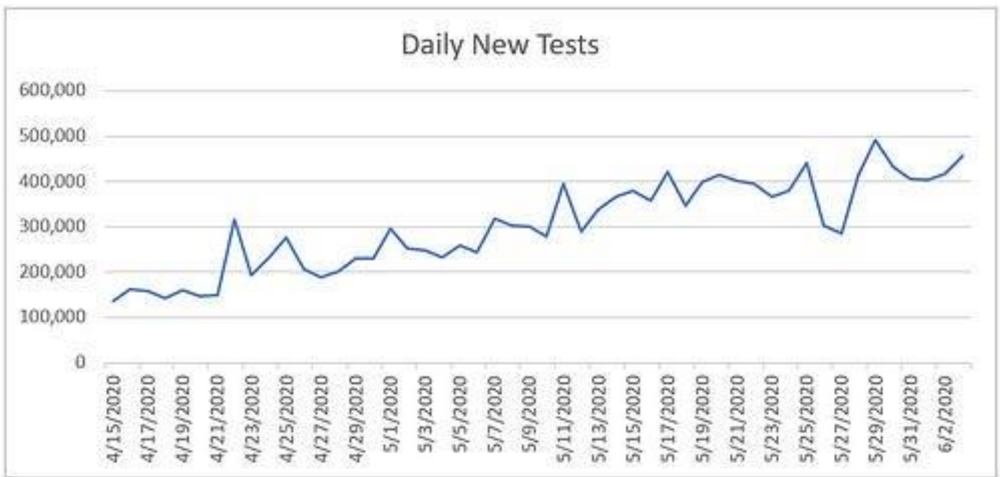
The Pandemic: Growth Remains Slow

Growth rate. Over the past 10 days, the growth rate has held between 1.1 percent and 1.4 percent per day, with most in the 1.1−1.2 percent range. At this rate, the curve has been flattened. If that growth rate holds, the number of cases will double about every eight to nine weeks. While the virus continues to spread slowly, given the reopening of the economy, this slow growth rate is good news in that we have not seen any significant increase over the past couple of weeks.



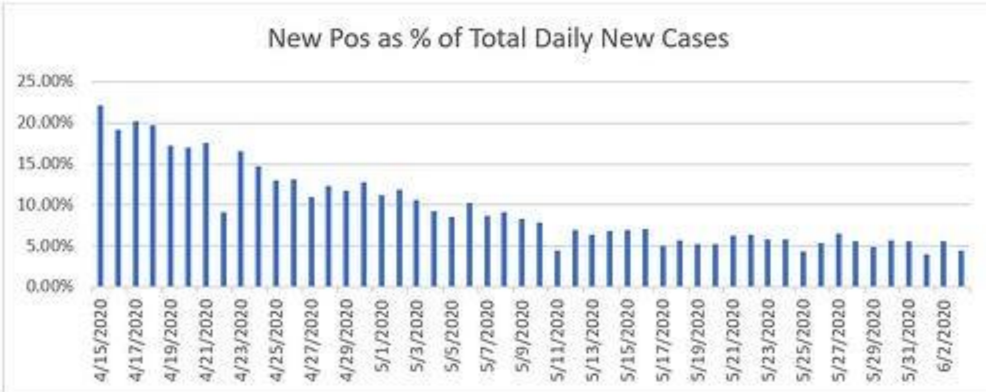
Source: Data from worldometer.com

Daily testing rate. After a drop, testing rates have recovered in past days and look to be increasing steadily. We have seen slowdowns like this before, and the recovery suggests this rate should continue to improve in coming weeks.



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, we can see that the positive level remains low, suggesting that we are getting to the point of having enough tests in place to get a reasonable grasp of how the pandemic is spreading.

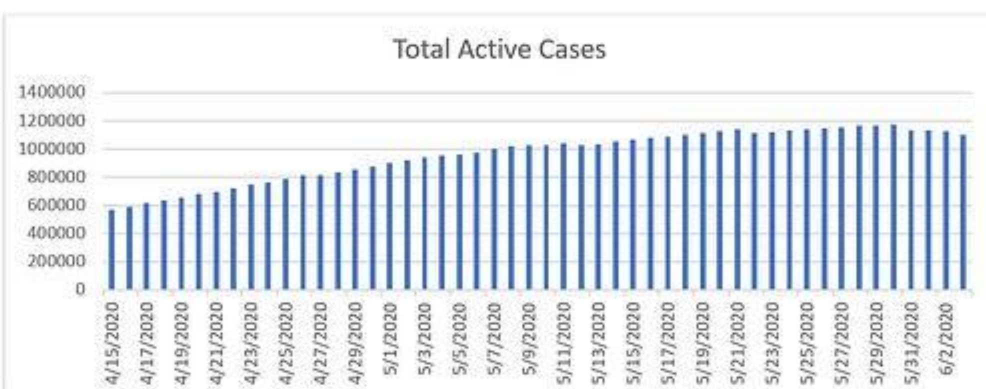


Source: Data from the COVID Tracking Project

New cases per day. Despite the reopening, the number of new cases per day has declined again, after a brief bump, to around 20,000 per day. This number is, again, somewhat better than it looks. With the reopening, other things being equal, we would expect reported cases to increase—which has not happened. Stabilization, in this context, continues to be positive overall.

Source: Data from worldometer.com

Total active cases. Active case growth has shown the most improvement in the past week and may actually have reached a peak, as case resolutions now exceed new infections on many days. This improvement is another sign that we have successfully flattened the curve.

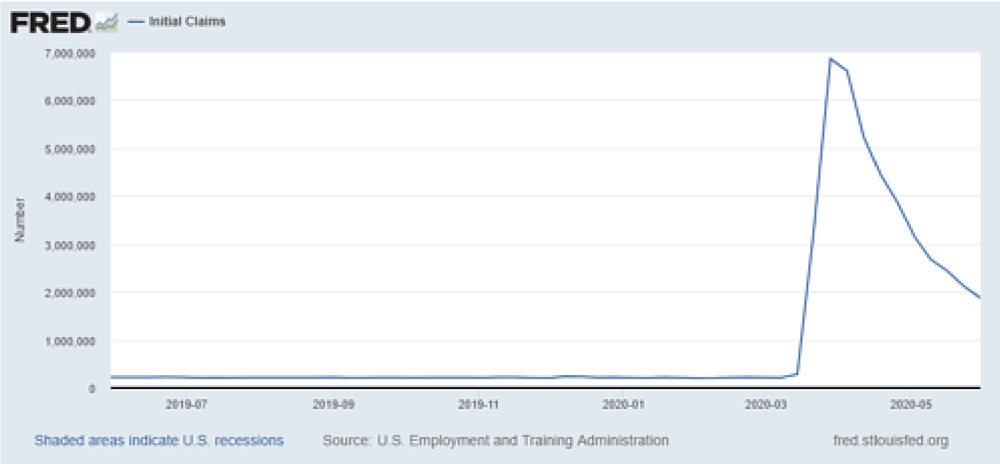


Source: Data from worldometer.com

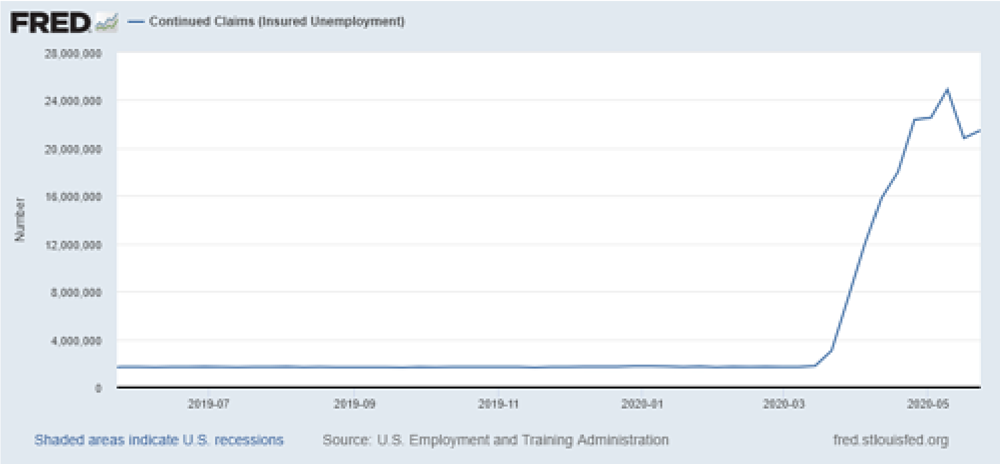
Overall, the pandemic continues to be largely under control, with no signs yet of a major second wave of infections despite the reopening. This possibility remains something we need to watch for, especially given the risks imposed by the protests. Still, given the reopening, the news on the pandemic front remains quite positive.

The Economy: Signs Say Damage Starting to Recede

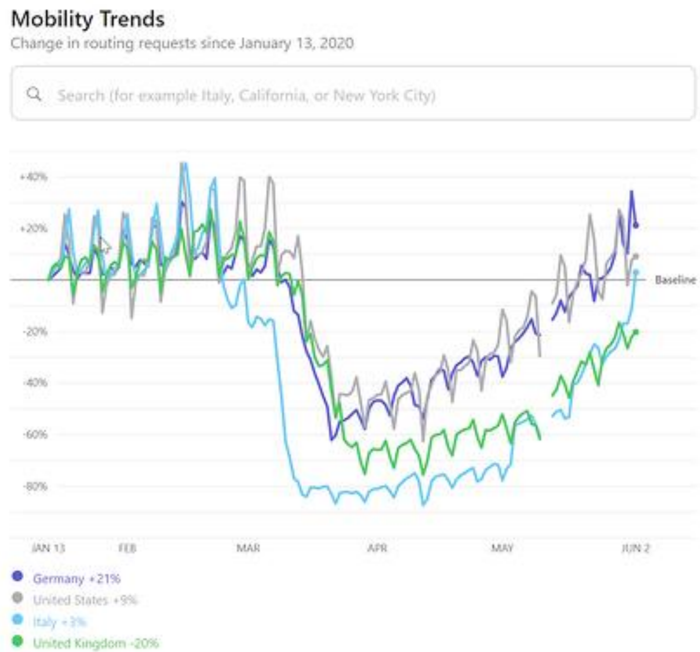
Jobs market. While layoffs continue, there are signs that the damage may have peaked and has started to recede. Weekly initial unemployment claims continue to decline from the peak, suggesting that much of the damage has already been done.



Continuing unemployment claims also seem to have peaked and actually declined last week, suggesting many people are starting to move back to work. Also supporting this idea was the most recent jobs report from ADP (a large payroll company). It showed 2.76 million jobs lost, down from 20.236 million jobs lost in the prior report and well below the 9 million expected. As this report represents actual payrolls, it is a solid indicator that the job market is now improving.



Consumers on the move. With the lockdown easing, Apple mobility data has continued to trend higher and is now above the level of early March. This jump is a significant improvement, suggesting people are now coming out of their homes again. We also see this improvement in one of the hardest hit areas of the economy, restaurants, which have started to come back in many areas. There is still a long way to go, but the process has started. Consumers are also buying autos again, with a significant bounce in sales last month.



Source: apple.com

The risks. Although the reopening is going better than expected and is clearly having some positive economic effects, we certainly face risks. The biggest of these is a second large wave of infections. We have not seen that yet, which is a positive sign, as it suggests that most people are continuing to act in a safe manner. That said, the recent protests have significantly increased the risk of a second wave.

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 early signs remain positive, as restaurants continue to come back faster than expected. Another positive sign is that auto sales have rebounded significantly. While risk of a slow spending recovery still exists, the data so far shows that spending is coming back at a substantial pace.

The Markets: Positive Trends Emerge
Now that the reopening is underway, financial markets have been reassessing the risks, and we have seen some volatility. While that risk remains, the good news is that as we get that data, markets will have a much firmer foundation. The past two weeks of data has been positive on the whole, and markets have responded—a trend that will likely continue if the news remains positive.

Biggest Risks Behind Us?
The real takeaway from this past week is that progress continues, to the point that a continued successful reopening over the next several weeks looks likely unless something significant

changes. We are not yet out of the woods, and there are certainly significant risks going forward—with a second wave of infections from the protests being the most significant. But the thing to keep in mind is that many of the biggest risks are moving behind us.

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