

9/18/2020 Risks Coming into Focus for Investors A Corona Virus Update from Chris Phelps, Advisor

Here in San Diego while we are heading into the fall season, we are nevertheless, in the midst of fire season. The Valley fire is mostly contained, and the smoke here appears to have almost cleared. Unfortunately, I cannot say the same about our County's status under Governor Newsom's color chart. Based on what I heard at the San Diego County Supervisor's meeting this past week, if the State tries to move the County into a more restrictive status, they may be some push back. Stay tuned.

In San Diego County daily new case level seven-day average dropped to about 287 per day in from 309 over a week ago. Hospitalizations continue to drop, albeit slowly, and both the seven-day and fourteen-day averages are currently at their all-time low of 280 patients. California state reported new daily case levels continue to trend down dramatically with the current seven-day average at 3,377 compared to 6,070 three weeks ago. About a 45% drop. Also, hospitalizations continue to trend down significantly with total positive and suspected cases hospitalized standing at 3,570 as of September 17, 2020. This compares to 5,267 three weeks ago (a drop of about 1,700) or a decline of 33% which represents continuation of the trend in the decline of hospitalizations over prior similar periods. In California daily new case levels continue to drop and fewer people are requiring hospitalization and extreme life-saving measures. This trend continues to be a positive development both medically and economically as California begins to re-open.

Volatility continues to be the watchword of the day as the markets appear to still be fretting about the pace and strength of the economic recovery. Weekly unemployment numbers continue to improve incrementally, and consumer confidence as measured by the University of Michigan's Index of Consumer Sentiment improved to 78.9 compared to 74.1 last month. For context at this time last year the index was at 93.2. Obviously, the current level is not where we want it to be, but the trend continues in the right direction. The Philadelphia Federal Reserve's Manufacturing Business Outlook Survey for September was released yesterday. It showed that general activity, new orders, and shipments remained positive for the fourth consecutive month. The employment index improved for the third consecutive month and all the future expectation indexes increased, suggesting widespread optimism among business firms about growth over the next six months. Federal Reserve policy continues to be extremely supportive for the foreseeable future. There also appears to be some movement happening in the latest round of stimulus bill talks. The upcoming election cycle in November appears to be putting some pressure on vulnerable congressional Democrats. All these developments continue to indicate that the economic recovery is on track and expanding. Market reaction in the short-term reflects the impact of developments on current expectations. Longer-term, it is the economy's growth that drives markets forward and that is what we need to be focused on. Remember, assets you will need in the near-term need to be conservatively positioned. Assets with a longer time horizon (i.e. four to five years) should continue to remain positioned with the risk level appropriate for your objectives and ability to tolerate volatility. Volatility will always be with us, but I believe the U.S. economy and consumer will also continue to grow. The financial markets will ultimately reflect this reality.

I have attached this week's letter by Brad McMillan, Commonwealth's Chief Investment Officer. He remains concerned that virus statistics have slowed or paused to some extent and how that may affect re-openings in various states. He further states that risks remain, but they appear to be under control. I continue to agree that we are on the right track both economically and with respect to containment of Covid-19.

I am always available to you via phone, zoom conference or in person. 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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Risks Coming into Focus for Investors

Presented by Christopher Phelps

Although the case growth rate has remained low over the past week, we've seen signs that the case count may be rising—especially as post-Labor Day infections start to register and as schools and universities reopen. While the pandemic remains under control and while the control measures are still working, conditions are changing. The steady improvement in both the case growth rate and case growth itself has paused and may be starting to falter.

Nationally (as of September 17), the daily spread rate is 0.6 percent per day, up slightly over the previous week. The seven-day average of the daily number of new cases was up to just under 39,000, from just over 37,000 last week. While case growth remains well below July and August levels, the continued improvement has paused.

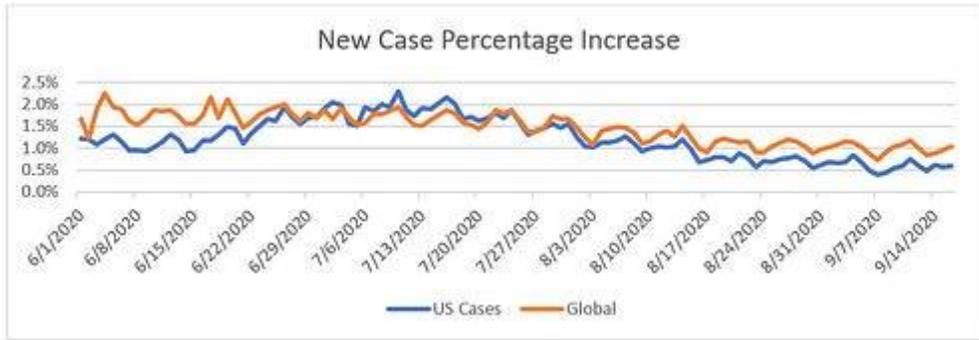
The testing news was similar. The number of tests bounced around over the past several weeks, but it has remained generally steady at around 700,000 per day. This testing level is likely insufficient, but with the drop in new and active cases, the positive testing rate has continued to decline and is now around the recommended 5 percent. This is a metric that will need to improve; nonetheless, signs are it may be sufficient at the moment to keep the virus under control.

Beyond the headline numbers, state-level data is generally good, although concerns remain about states in the Midwest. Overall, the national risks remain under control.

With the medical news better, the economic recovery remains on track, albeit with some areas of concern. One worth watching is consumer confidence and spending, with signs of weakness. Financial markets continue to show turbulence, as investors process the headlines. Let's take a look at the details.

The Virus: Growth Rate Remains Low

Growth rate. The daily case growth rate has risen slightly, ending the reporting period at 0.6 percent per day, up from 0.5 percent per day the previous week. The rise in the spread rate is small, but it suggests that the medical effects of the Labor Day gatherings, as well as school and university reopenings, may be starting to show in the data. That said, this is still very close to the lowest growth rate so far in the pandemic and leaves the infection curve flat at a national level, with low risk to health care systems.



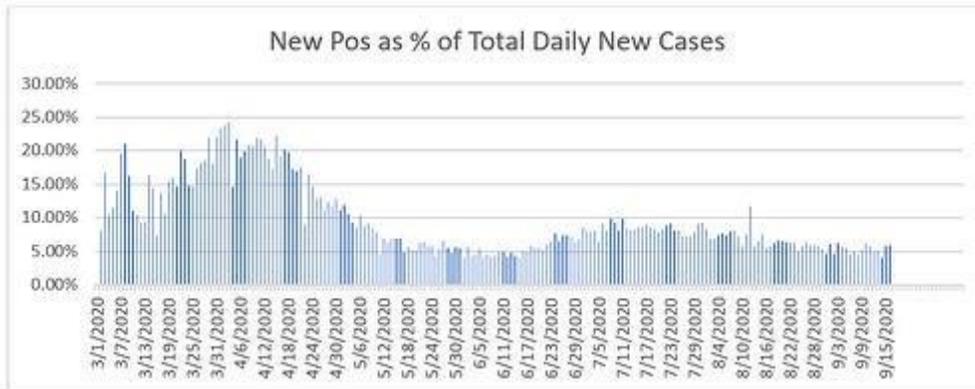
Source: Data from worldometer.com

Daily testing rate. As infections have dropped, testing remains steady although variable, and it has stayed in the range of around 700,000 per day. This appears to be below the level of testing needed to develop a full understanding of the pandemic, despite the recent improvements in the spread rate.



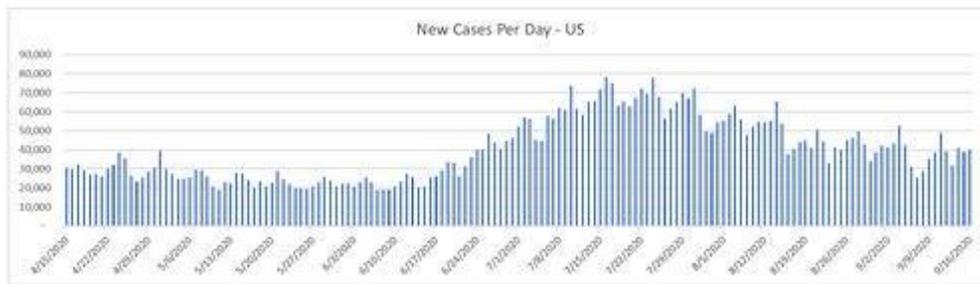
Source: Data from the COVID Tracking Project

Positive test results. That said, the positive rate on tests remains around 5 percent, which is close to an acceptable level. If we look at the percentage of each day's tests that are positive, lower numbers are better, as we want to be testing everyone and not just those who are obviously sick. The World Health Organization recommends a target of 5 percent or lower, which we are getting close to achieving again. If the case growth rate remains low, the pandemic spread may be approaching the level where current testing is adequate.



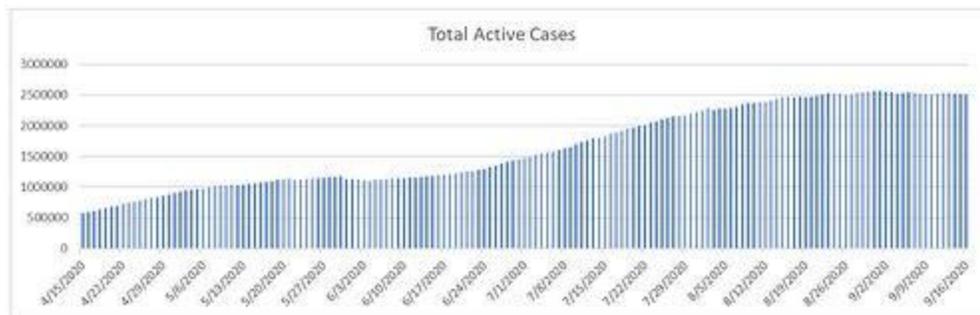
Source: Data from the COVID Tracking Project

New cases per day. The most obvious metric for tracking the virus is daily new cases. Here, we see more signs that Labor Day gatherings, as well as school and university reopenings, may be increasing viral spread. The seven-day average number of new cases per day rose from just over 37,000 per day last week to just under 39,000 per day. This is a reversal of the improvement seen in previous weeks, and it will need to be watched.



Source: Data from worldometer.com

Total active cases. That said, a positive development is that as the number of new cases has slowed, the number of active cases has stabilized and even shown signs of declining. If case growth remains stable, new infections will continue to lag recoveries, and the number of active cases would continue to decline, which would be a very positive sign.



Source: Data from worldometer.com

Overall, the pandemic is under control at the national level. But improvement has paused, and there are some signs of increased viral spread. At the state level, the health emergencies have largely passed, although concerns remain in some states. The good news here is that policy and behavioral changes have taken effect, as they did in the first wave, and that while risks are rising, we still largely have the virus under control.

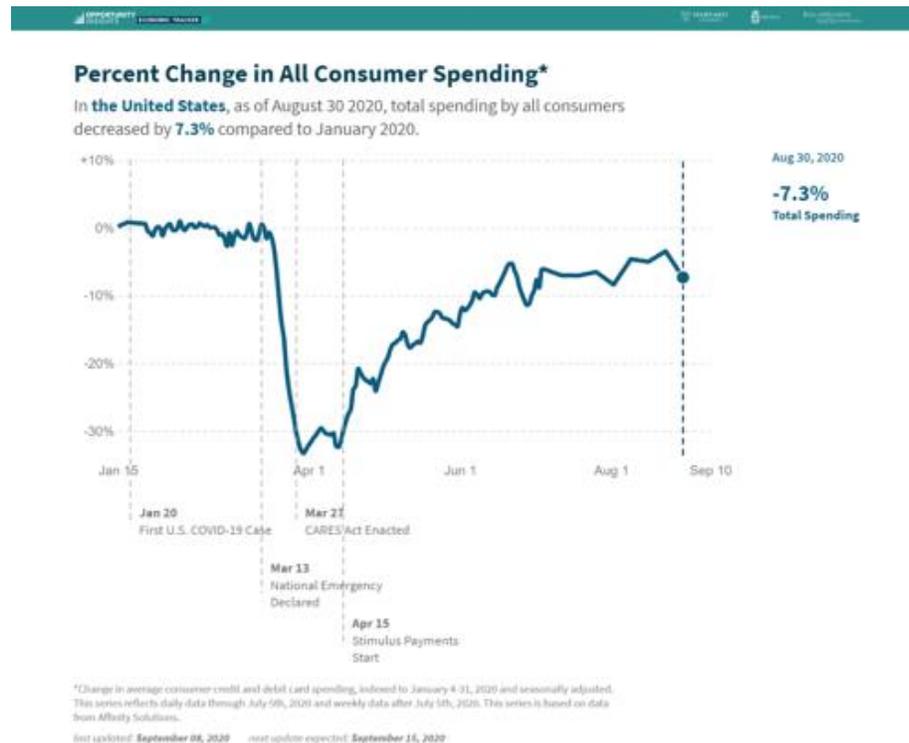
Looking forward, the question is whether the improvement will continue into the fall. As noted above, the recent Labor Day holiday gatherings, combined with the ongoing reopening of school

districts and universities, may well have increased the spread rate based on the most recent data. Given the lags between infection and detection, if that is the case we still have several weeks to go before the full effect will be seen, so the risks remain material. These will be something we need to watch.

The Economy: Signs of Slowing

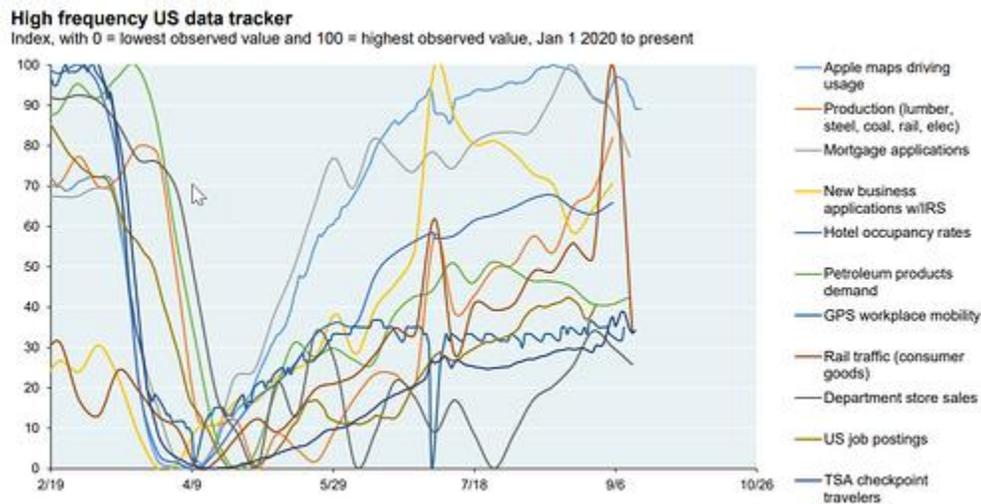
Jobs market. The economic news is also showing signs of weakness. While the recovery continues, there are signs of slowing. The good news is that the most recent initial jobless claims report shows slightly lower layoffs, and the continuing unemployment claims have also declined—showing that after last week’s weak reports that improvement has resumed. Improvement in the jobs market has been a relative bright spot, so it is good to see improvement resuming.

Consumer spending. Consumer spending has weakened. In the past two weeks, spending dropped from within 3.2 percent of the pre-pandemic level to 7.3 percent below. Consumer confidence has also shown declines. Much of the decline in both confidence and spending appears to come from lower-income workers, who are most affected by the expiration of federal income support payments and where the jobs recovery has been particularly weak. This metric remains something to watch.



Source: <https://tracktherecovery.org/>

Business sector. Even as there are signs of weakness in the consumer economy, the business sector continues to do well. Business confidence and investment are largely back to pre-pandemic levels. Further, specific higher-frequency indicators are showing improvement in many cases, as we can see in this composite of many of these indicators from J. P. Morgan.



Source: J. P. Morgan

The big picture is that the recovery is still on track but that signs of weakness bear watching. If the medical risks continue to rise, the economic risks will as well.

The Markets: Hit More Turbulence

Financial markets rallied last week only to hit more turbulence on rising worries about just how durable the economic recovery was. Given the data we reviewed above, those doubts seem reasonable, which suggests we might see more volatility ahead. That said, the fact that both the medical and economic risks are still relatively low should continue to provide support.

Risks Come into Focus

The real news this week is that the pandemic remains under control, although as noted, medical risks are starting to rise again. The effects of the Labor Day holiday exposures and school reopenings are starting to appear in the data, and we have a couple of more weeks to go until the full effects will be apparent. This will need to be watched.

The economic risks are also real, and we do see some slowing in the recovery so far. That will also need to be watched, especially if the medical risks rise. But at the moment, the recovery continues, and there is a real possibility it will accelerate again if the medical risks remain constrained or, especially, if another federal income support program is passed. The risks are real, but so are the opportunities.

Finally, markets continue to be turbulent as investors process the different risks and while more volatility is quite possible. But the fact that, as of now, the medical risks remain contained and the economic recovery continues should provide support.

Given all of this, over the next couple of weeks the most likely case appears to be some deterioration of the medical news (although likely to a limited degree) and continued slow improvement on the economic fronts. While there are certainly risks coming into focus and we need to be aware of them, for the moment, the news remains good.

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