5/22/2020 Reopening Going Better Than Expected

At the end of week nine here in San Diego we have finally begun opening up restaurants to dine-in and stores to walk-ins. I was able to go out last night with my wife and son to Hunter Steakhouse in Mission Valley for a great steak dinner. Mmmmmm! In San Diego county testing for coronavirus has continued to ramp up to over 4,500 per day with positive rates averaging 3.24% over the last week which is well below national averages. Hospitalizations of Covid-19 positive patients have remained stable to dropping slightly despite ramped up testing which indicates health authorities are finding more asymptomatic individuals which will significantly reduce the infection fatality rate. In California, hospitalizations of Covid-19 positive patients have dropped significantly to 3,000 with about 1,000 of them in ICU. Nationally, more states across the country are continuing to open up and we are not seeing any signs yet of a second wave. Only time will tell but given results seen in South Dakota (e.g. never closed down) Georgia and Florida (i.e. opened up weeks ago) of no significant flare ups, there is reason to hope for the best. I will say it again, assuming these trends continue this bodes well for the U.S. economy and financial markets in the future.

Earlier this week the Federal Reserve presented a dire forecast whose main highlights were a high level of uncertainty and potential significant downside risks associated with reopening the economy. The good news is that this means the Federal Reserve will continue to maintain an easy monetary policy in support of the economy and markets. Credit markets remain stressed but with Federal Reserve intervention are continuing to improve. Corporate earnings will continue to struggle as about one-third of the S&P 500 has suspended giving earnings guidance. Economic data continues to be negative but is trending in the right direction. I still believe April will be the low point as most of the damage appears to have been done and is beginning to reverse as we reopen. The next fiscal stimulus package is likely weeks or months away as the House passed $3T package has almost no chance of passing the Senate.

The risk to stocks seems to be fairly well-balanced. On the plus side the Federal reserve is easing monetary conditions, more fiscal stimulus appears to be coming, infections rates are falling as testing ramps up, economic news is getting better and there are few alternatives to stocks. On the negative side of things, the economic damage is significant, more earnings disappointments are likely, prices have risen and valuations are less attractive and an infection surge is still a possibility, although re-locking things down will prove difficult to impossible. Near-term, expect more volatility as uncertainties begin to resolve themselves. Longer-term the positives continue to outweigh the negatives and the markets will begin to reflect the fundamentals of a recovering economy.

In the latest commentary from Commonwealth's Chief Investment Officer, Brad McMillan, discusses his view of the current state of the virus pandemic and its effects on the economy and markets. Brad continues to be concerned about a large second wave of virus infections but appears to be more optimistic about consumers normalizing their spending habits. The bottom line is that things are progressing well towards recovery and there are many reasons to be positive.

I urge all of you that as our economy begins to open up, take advantage of the opportunity to patronize your favorite stores and restaurants. Just as we did our part to “flatten the curve” we need to step up and do our part to “flatten the unemployment rate”. Do so with appropriate precautions and use every measure you deem necessary to avoid risk of infection. 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

Early Signs Suggest Reopening Going Better Than Expected

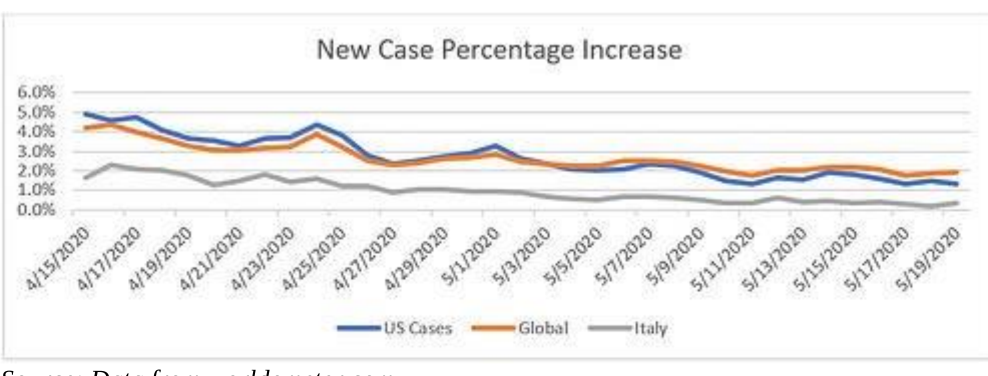
Presented by Christopher Phelps

In the past week, we had some mixed news on the coronavirus pandemic. Testing continued to rise, although improvement in slowing the spread rate and case growth seemed to stall. Further, the number of active cases started to grow again, a negative sign. Overall, conditions still remain much better than they have been in recent weeks, but we did not see much (if any) additional progress in controlling the virus.

When considering these results, it’s important to keep in mind that last week coincided with the start of the reopening of the economy and the loosening of social distancing measures in several states. In fact, the data shows that social distancing had been subsiding in many areas even before the formal loosening. So, last week represented the start of a new environment for the spread of the virus. One of the biggest concerns in that new environment was for a second wave of infections. This week’s pause in the reduction in new cases suggests there may be some effect. But so far, at least, the virus remains substantially under control. Let’s take a look at the details—including whether the reopening may actually be going better than expected.

The Pandemic: Where We Are Now

Growth rate. 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. Over the past two weeks, however, the growth rate has stayed steady at around 1.5 percent per day. If that growth rate holds, the number of cases will double about every seven weeks. We have succeeded in flattening the curve, but the virus continues to spread.

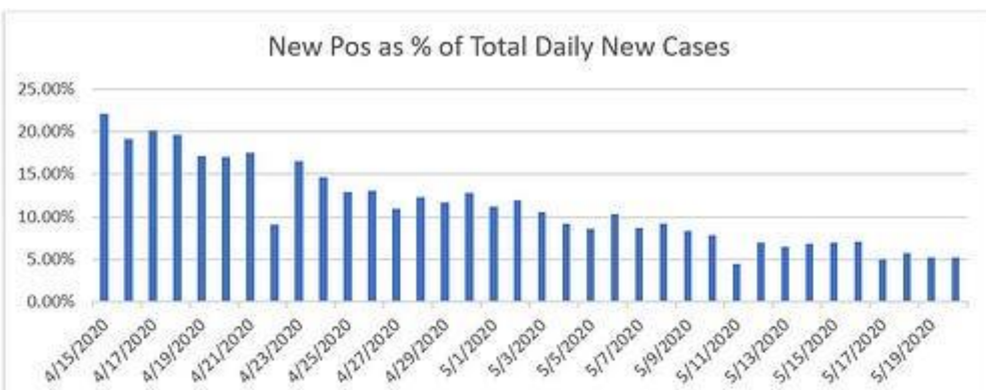


Source: Data from worldometer.com

Daily testing rate. We have made more progress on testing, with the daily test rate up from just about 300,000 per day last week to about 400,000 per day in the past several days. While this is still not where we need it to be, it represents real progress.

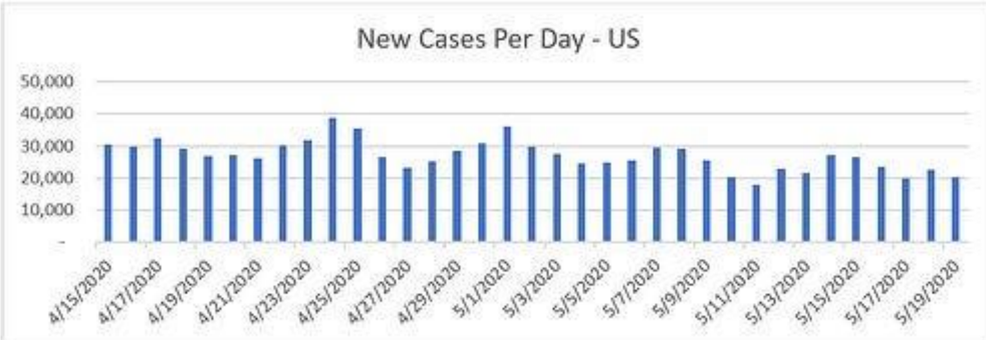
Source: Data from the COVID Tracking Project

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.



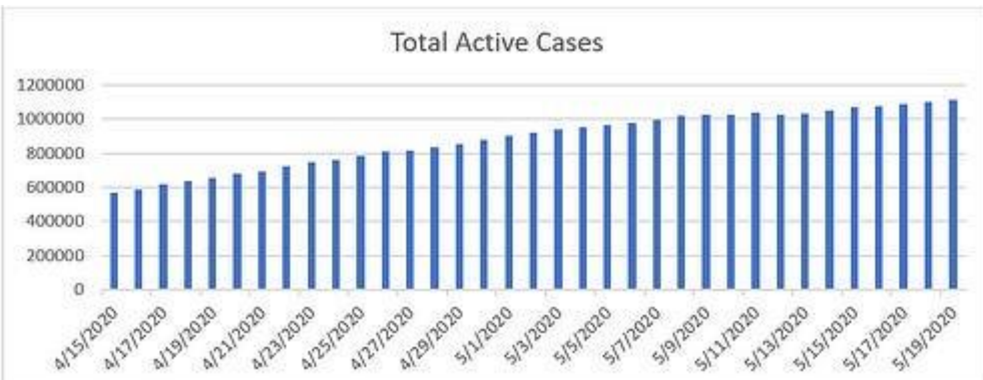
Source: Data from the COVID Tracking Project

New cases per day. Despite the growth in testing, however, the improvement in new cases per day has paused, with cases stabilizing between 20,000 and 25,000 per day. But this number is somewhat better than it looks. With the wider range of testing and the number of tests growing, other things being equal, we would expect reported cases to increase in proportion to the number of tests, which has not happened. With the reopening, we would also expect to see more new cases—which has not happened. Stabilization, in this context, continues to be positive overall.



Source: Data from worldometer.com

Total active cases. The continued growth in new cases has led to an increase in active cases, likely due in part to the reopening. After a brief pause, active cases have been rising at 10,000 to 12,000 per day over the past couple of weeks. Although this is a significant improvement over a month ago, this area remains one to watch.

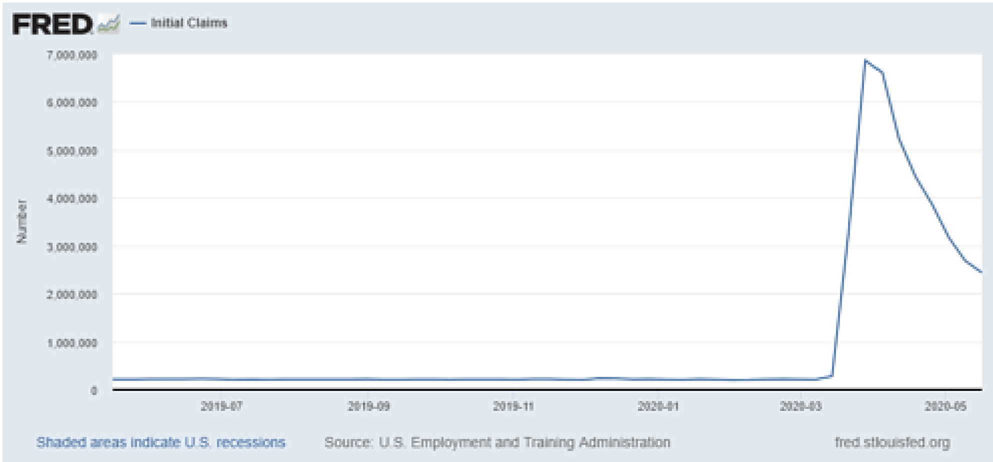


Source: Data from worldometer.com

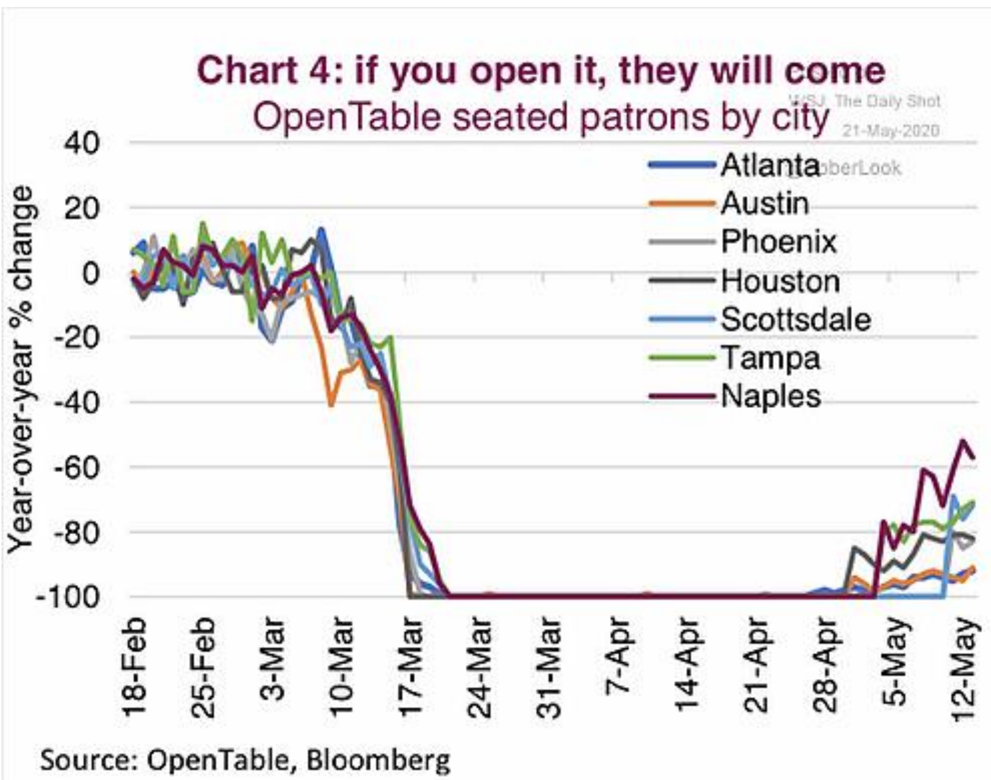
Overall, the pandemic continues to be largely under control, even though we saw minimal further improvement last week. The reopening is providing increased opportunities for the virus to spread, which may be a big part of the pause in improvement. But the good news is that we do not yet see any signs of a major second wave of infections, something we need to watch for.

The Economy: Reopening Underway

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.



With the reopening, we should also start to see people moving back into work. One of the hardest hit areas of the economy, restaurants have started to come back in many areas. There is still a long way to go, but the process has started.



The risks. Although the reopening is going better than expected and is clearly having some positive economic effects, as we reopen we certainly face risks. The biggest of these is a second large wave of the pandemic. We have not seen that yet, though, which is a positive sign, as it suggests that most people are continuing to act in a safe manner. The real test will come in the next couple of weeks, however, when the full number of any new cases arising from the reopening will start to show up.

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 are positive, with restaurants coming back faster than expected (as shown above). Another positive sign is that mortgage applications are almost back to 2019 levels, which would drive additional spending, and Google searches for vehicle sales have also rebounded significantly. While risk of a slow spending recovery still exists, early data shows that spending might come back faster than anyone expected.

The Markets: Reassessing the Risks
For the financial markets, now that the reopening is underway, 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 week's data has been positive on the whole and markets have responded—a trend that will likely continue if the news remains positive.

Another Good Week a Positive Sign for Future
The real takeaway from this past week is that progress continues, to the point that a successful reopening over the next several weeks 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. Another good week.

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