10/09/20 Is the Economic Recovery Immune to Rising Medical Risks?
A Coronavirus Update from Chris Phelps, Advisor

Schools and universities across the country are back to in-person session. Locally, San Diego State lived up to its reputation and has generated upwards of 1,100 virus cases with only one short-lived hospitalization. Poway Unified School District has opened its elementary schools for in-person learning. Sheri, my wife just finished her first week with her preschoolers, who were ecstatic to see and each other. As Brad McMillan notes in the attached article, these openings may be contributing to still small rises in virus case levels both locally and nationally. Nevertheless, the virus remains under control and the likelihood of renewed lock downs is minimal. This is good news for the economy and the markets. Hopefully, our path to resuming normal life is beginning to get shorter.

In San Diego County the daily new case level seven-day average increased from 251 per day to 276 per day. San Diego County hospitalizations currently increased to 262 of which 215 are confirmed virus cases. This compares with over 284 hospitalized three weeks ago. California reported new daily cases continue to trend down with the current seven-day average at 3,047 compared to 3,405 three weeks ago. A decline of 12%. Also, hospitalizations continue to trend down significantly with total positive and suspected cases hospitalized standing at 3,186 as of October 8, 2020. This compares to 3,570 three weeks ago or a decline of 17%. Based on 819 "associated" Covid-19 deaths in San Diego County as of yesterday, infection fatality rates continue to hold steady at 0.03% for those under age 60, 0.40% for ages 60-69 and 1.7% for those age 70 or older. The state of California has essentially identical infection fatality rates. As you can see, both California virus case and hospitalization levels have leveled off in recent weeks but are still at ***one-third*** of where we were two-three months ago. The virus is likely mutating into less virulent forms and our medical systems are employing better therapeutic regimens. This trend continues to be an incredibly positive development, both medically and economically as California continues to re-open.

This past week stocks bounced off recent lows having its best week since July, reflecting some good economic news as well as some renewed optimism that Republicans and Democrats may get together on a stimulus package. Overall unemployment dropped to 7.9% although new weekly unemployment claims continue to remain above 800,000 (e.g. since March 2020). Consumer confidence continues to rise as reflected by increasing spending levels which are now two-thirds of the way back to pre-pandemic levels. Business confidence is also continuing to rise with capital spending increasing significantly in the last quarter. Federal Reserve support is ongoing however, fiscal support in the form of another stimulus bill would be a shot in the arm for the economy. In the short term I expect stocks to remain volatile but will likely trade in a range pending the results of the election and depending on virus activity. Overall, however, the above developments continue to indicate that the economic recovery is still on track and expanding. Volatility will always be with us, but I believe the U.S. economy and consumer will also continue to grow over the longer term.

I have attached this week's letter by Brad McMillan, Commonwealth's Chief Investment Officer. He remains concerned that new cases of the virus up ticked to some extent and how that may put pressure on hospitals and affect re-openings in various states. He further states that risks remain, but they appear to be under control at the State and National levels. 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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Is the Economic Recovery Immune to Rising Medical Risks?

Presented by Christopher Phelps

In this past week, the medical news has gotten worse. Although the pandemic remains under control and the case growth rate is below recent peaks, case growth has continued to rise on a seven-day average basis. This rise may be due in part to increased testing; however, much of it likely owes to a mix of schools and universities reopening and widening outbreaks in many states. Indeed, this is a growing problem, as case growth in many states is starting to approach levels that could threaten the health care systems.

Nationally (as of October 7), the daily spread rate is 0.7 percent per day, up from 0.6 percent per day in the previous week. During the week, we did see higher levels on several days. Because of this, the seven-day average of the daily number of new cases has increased to 45,600, up from 42,800 last week, and back to the levels of August. While case growth remains below July levels, the numbers continue to rise, and the rate of increase is getting faster. Using another metric, the daily case growth against active cases (rather than total cases), we have also seen a rise from 1.6 percent to 2.1 percent. Overall, this data shows that medical risks continue to rise.

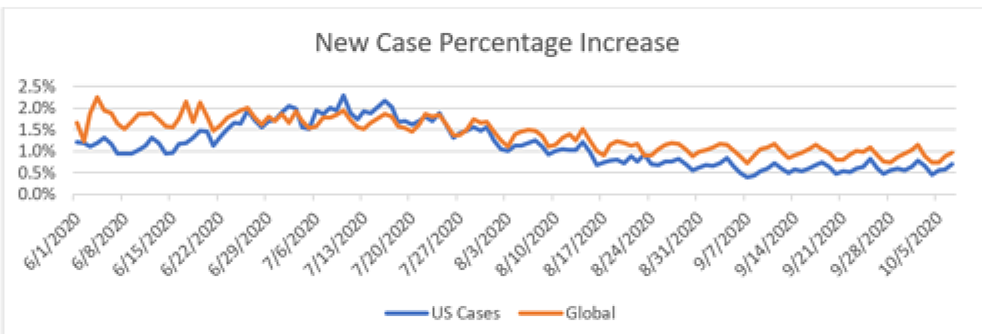
The testing news was better. The number of tests has continued to trend up, although it remains quite variable. As testing levels continue to increase, we look to be getting closer to adequate levels. The fact that the positive testing rate has remained low and is now around and even below the recommended maximum of 5 percent suggests that we are getting close to the testing level sufficient at the moment to keep the virus under control. It also suggests that some of the increase in cases may be coming from better visibility.

Beyond the headline numbers, state-level data is worsening, as multiple states are showing rising infection rates. In some cases, they are high enough to start to threaten the local health care systems. With the breadth of faster infection growth and rising case rates, the national risks remain under control. But risks in some areas are now material, and the national risks are rising.

While the medical risks are rising, the economic recovery has been better. Consumer confidence and spending, an area of concern, have shown better data, which is encouraging. Financial markets have also ticked up. Let’s take a look at the details.

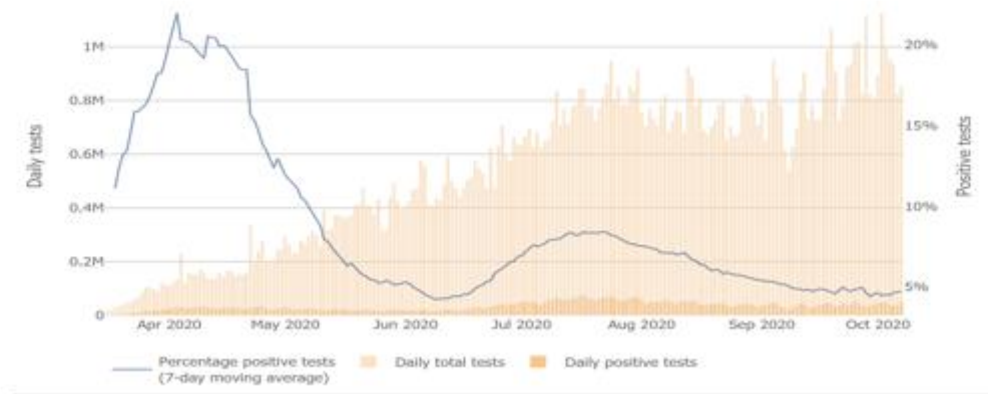
The Virus: Growth Rate Still Contained

Growth rate. The daily case growth rate ticked up last week, ending the reporting period at 0.7 percent per day, up from 0.6 percent per day the previous week. We also saw several days of faster growth during the week. The upward variability in the spread rate suggests that the medical effects of the school and university reopenings are now showing up. We are also seeing faster outbreaks in a number of states, however, which do not appear to be connected to school reopenings. In addition, looking at the growth based on active cases rather than total cases, which is becoming a better indicator, we see a faster national growth rate.



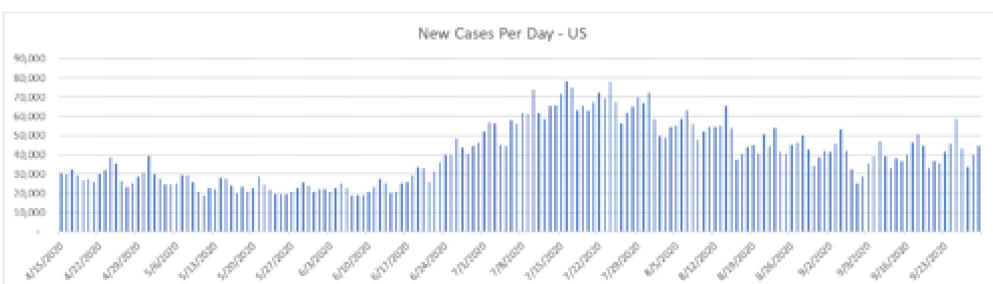
Source: Data from worldometer.com

Positive test results. As the case growth rate has risen, testing has also started to trend up, although it remains variable. 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 now achieving. One potential positive result of the increased testing is that some of the increased case growth may be due to better testing.



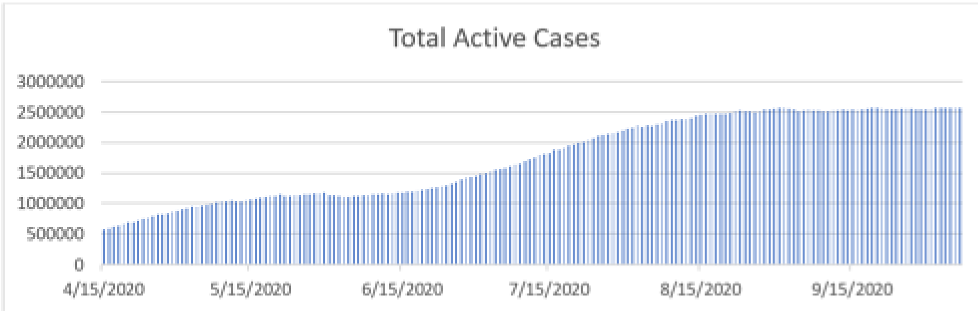
Source: Johns Hopkins University

New cases per day. The most obvious metric for tracking the virus is daily new cases. Here, we see more signs that school and university reopenings have started to increase viral spread. The seven-day average number of new cases per day rose from just over 42,800 per day last week to just under 45,600 per day, a faster increase than the previous week. This is the third week in a row we have seen an increase, and the rate of increase is growing. The new case rate is now back to levels seen in August—a reversal of the improvement seen in previous weeks. This is a sign of rising risks and, along with the faster state-level outbreaks, will need to be watched closely.



Source: Data from worldometer.com

Total active cases. Even as the number of new cases has started to rise again, the number of active cases remains fairly stable. If case growth remains under control, the number of active cases would continue to remain stable, which would be a positive sign. Using the active cases as a base to measure growth, however, indicates that the acceleration in the daily growth rate is faster—up from 1.6 percent last week to 2.1 percent this week—suggesting risks are rising faster than indicated by the growth rate based on total cases.



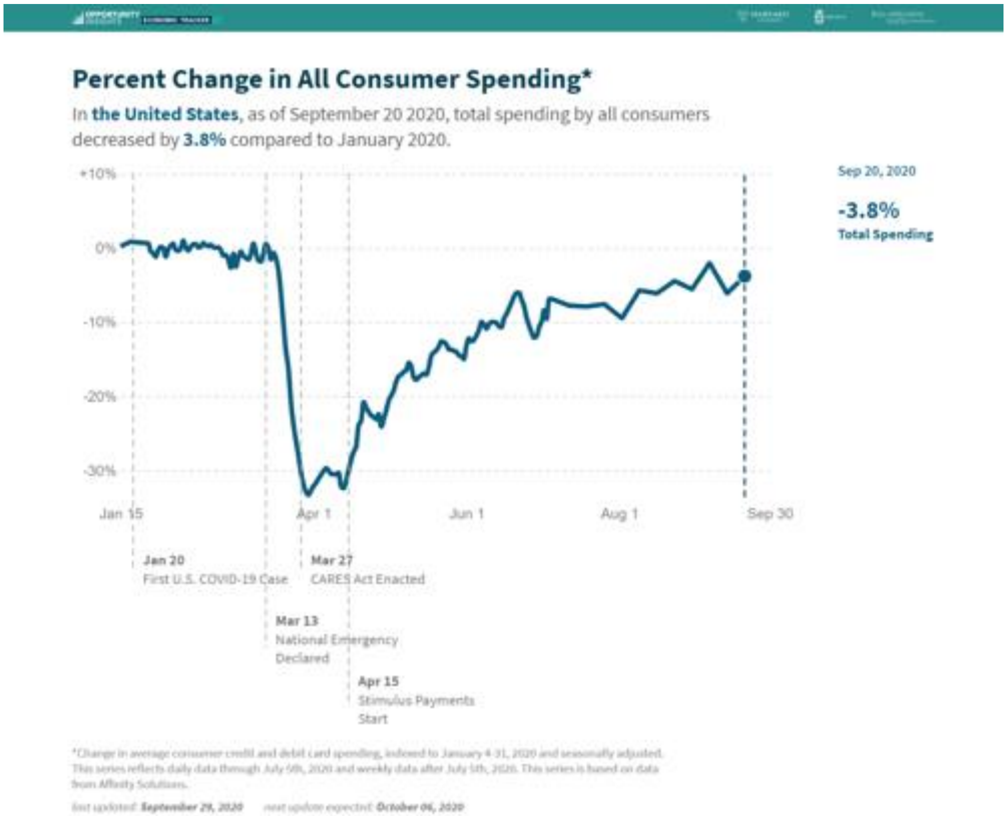
Source: Data from worldometer.com

Overall, the pandemic remains under control at the national level, although we are seeing signs of increased viral spread. At the state level, there are outbreak hot spots that are now starting to look like health emergencies like we saw at the height of the previous two waves, and concerns are growing in other states. While we still largely have the virus under control at the national level, the trends are moving in the wrong direction; in many states, risks are rising much faster.

Looking forward, the question is whether current conditions will continue into the fall. As noted above, the recent Labor Day holiday gatherings, combined with the ongoing reopening of school districts and universities, have increased the infection rate based on the most recent data. Given the lags between infection and detection, we still have a couple of weeks to go before the full effect will be seen. So, the risks remain material. If most of the recent infection growth has come from the reopenings, we might see it fade over the next couple of weeks, but that is uncertain and current trends are worrying. This will be something we need to watch.

The Economy: Showing Signs of Improvement

Consumer economy. While the medical risks are rising, the economic news has shown signs of improvement. The job market continues to show slower improvement, but the effects on consumer confidence and spending are becoming less apparent. Consumer confidence has bounced off of post-pandemic lows, and consumer spending has returned to a positive trend, after signs of a reversal. While these metrics remain something to watch, this improvement does suggest the effect of the expiration of expanded federal unemployment benefits may not slow the recovery as much as feared.



Source: https://tracktherecovery.org/

Business sector. On top of the signs of improvement in the consumer economy, the business sector continues to do well. Business confidence and investment are largely back to pre-pandemic levels, and specific higher-frequency indicators are showing improvement in many cases.

The real question, going forward, is how durable this recovery is. Much of the recovery so far has been based on the spending power generated by the federal supplemental income support. If we do not get support, that will likely be a headwind going forward.

While we need to pay attention to that risk, so far at least, confidence and spending are still holding up. The big picture is that, despite the rise in the medical risks, the recovery is still on track. But at more than two-thirds of the economy, consumer spending may be at risk despite recent improvements. While this risk is offset by strong business sentiment, it will bear watching.

The Markets: Show More Turbulence

Financial markets have rallied since the start of the month, despite rising medical risks. Given the data we reviewed above, we might see more volatility ahead, despite the improvement since the start of the month. That said, the fact that medical risks are still largely under control at a national level and that economic risks are moderating should continue to provide support.

The Recovery Carries On

The real news this week is that although medical risks are rising, especially at the state levels, the pandemic remains under control at a national level. The effects of the school reopenings are appearing in the data, and we have a couple of more weeks to go until the full effects will be apparent. With the data so far showing signs of rising risk and with growing outbreaks in multiple states, the risks are clearly trending up, and they will need to be watched.

The economic risks are also real. Despite recent positive news, we do see some slowing in the recovery. That will also need to be watched, especially if the medical risks rise. At the moment, however, 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 more volatility is quite possible. But the fact that, as of now, the medical risks remain contained and the economic recovery continues has brought markets back and should continue to 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. There are certainly risks coming into focus, and we need to be aware of them. But for the moment, the news remains positive.

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