MARKET STRATEGY VIEWPOINT

Recalibrating

June 29, 2020

Some states have reconsidered, slowed, or rolled back economic re-opening plans as a result of a recent lift in Covid-19 case data.

In our view, the uptick in coronavirus cases can be traced to an elevation in the level of testing as well as poor social-distancing adherence by some.

U.S. daily case rates have clearly been elevated in recent weeks, and daily death rates have now begun to turn up as well.

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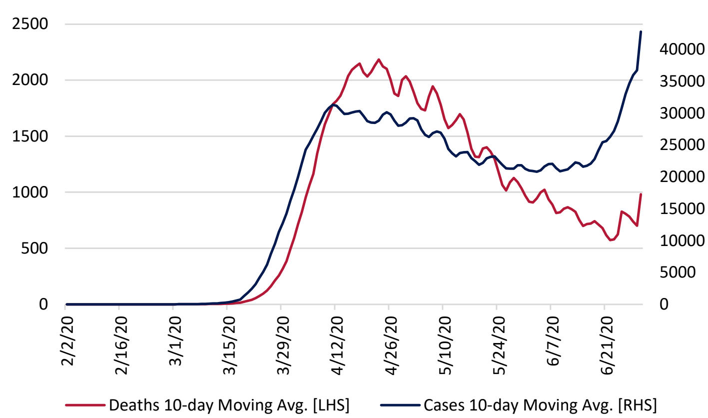
Second Wave?

There has been considerable media attention and speculation that the U.S. and certain other countries could be experiencing a second wave of Covid-19 cases. Much has been said and questions have been raised about the efficacy of economic re-opening plans, in particular, as it regards states such as Florida, Arizona, and Texas. These states were some of the earliest to re-open their economies. Covid-19 cases in these states have accelerated based, we believe, on some lackluster application of personal distancing protocols and an increase in the amount of virus testing. Increased testing has led, not surprisingly, to more cases. Testing patterns in some states appear to be less robust compared to what has occurred in the three states mentioned.

For the U.S. in aggregate, daily cases rates have indeed turned materially higher, and the recent trajectory has upset what had been a decelerating trend. We believe this may be worrisome from a health and economic standpoint should the trend persist and governors further recalibrate their re-opening plans. Some states, including Pennsylvania, Texas and Florida have reinstituted restrictions on some segments of the economy.

The good news is the rates of deaths due to Covid-19 have not yet matched the case spike, although this trend may also be changing. We believe better knowledge of effective medical therapies may help hold down virus death rates, relative to cases.

Figure 1: Covid-19 U.S. Daily Cases and Deaths - 10-day Moving Average
Source: Johns Hopkins, Bloomberg



Select State-by-State Data

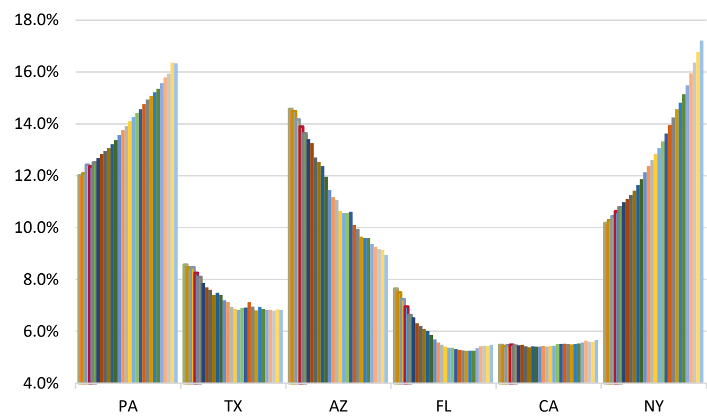
The U.S. recently recorded its worst day of infections since early May, though testing, case, and death trajectories have varied materially by state. Previous hot spots such as New York, New Jersey and to some degree Pennsylvania are now doing quite well, but testing in these states has not been as robust as others. Conversely, places like Texas and Florida are now encountering the virus to a far greater extent than they ever did in March, April, or May, but more widespread testing has helped contribute to higher case numbers. In Texas and Florida, rates of infection for those tested remains low. In contrast, confirmed cases as a percentage of tests are much higher in states such as Pennsylvania and New York.

Importantly, the rate of daily deaths in all states just mentioned remains low; perhaps a sign that the U.S. medical community is fine-tuning its treatment of the disease. This is the best rebuttal against claims that U.S. Covid-19 management is spiraling out of control.

Increased testing in Florida and Texas has seemingly contributed to the case spike, but infection rates of those tested remain low.

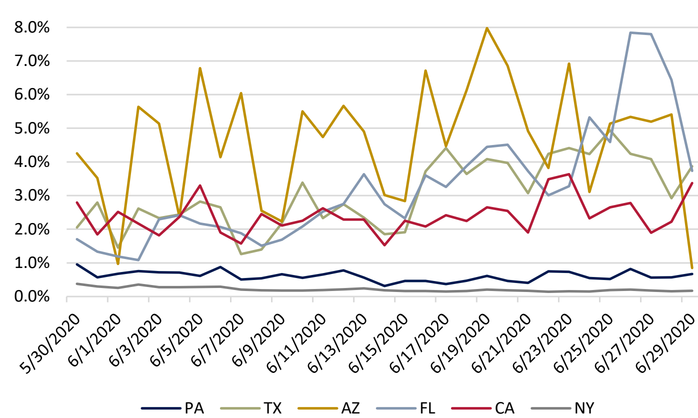
Meanwhile, of the states we highlight here, Pennsylvania, New York, and Arizona have relatively high infection rates.

Figure 2: Select State - Covid-19 Cases as % of People Tested (5/30 through 6/29)
Source: Johns Hopkins, Bloomberg



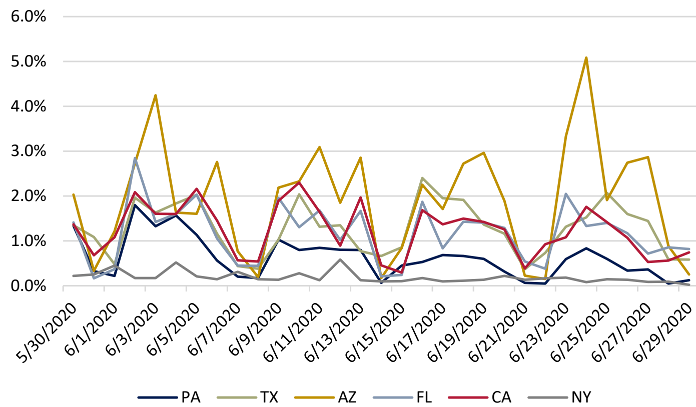
Case growth rates in some select states look to be on a modest rise.

Figure 3: Select State - Daily Covid-19 Case Growth Rates
Source: Johns Hopkins, Bloomberg



Covid-19 death rates remain at low levels but have been somewhat volatile of late.

Figure 4: Select State - Daily Covid-19 Death Growth Rates
Source: Johns Hopkins, Bloomberg



On-the-Ground Impacts

Long-term damage to small and medium size businesses in this country will likely depress economic growth rates for the foreseeable future.

While equity prices remain relatively buoyant and some economic data has surprised to the upside, the real negative effect of Covid-19 seemingly gets lost in much of the headlines. The segment of the economy likely hardest hit by it all are medium and small businesses with perhaps limited flexibility and finite resources. The business shutdowns have been devastating. Another round of forced closures or renewed limitations on commerce would only add to the long-lasting negative effects on many livelihoods.

Yelp, the popular site for crowd-sourced reviews of small and medium-sized establishments, recently released a report detailing the number of businesses permanently closed due to the economic effects of the pandemic. The company has indicated that across the country, 41% of businesses on Yelp that were open on March 1, but closed during the pandemic, won't reopen. The company went further in detailing permanent business closures by type of business (Table 1).

Companies have the option to contact Yelp to report substantial business changes. The data at right represents some of the information collected and reported by Yelp in their recent Local Economic Impact report.

Table 1: Yelp - Business Closures
Source: Yelp

	Shopping & Retail	Restaurants	Beauty & Spas	Fitness
Total Closures as of June 15	27,663	23,981	15,348	5,589
Temporary closures	65%	47%	76%	74%
Permanent closures	35%	53%	24%	26%

Economic and Capital Market Ramifications

We anticipate the new trajectory in U.S. Covid-19 cases will cause forecasters to reconsider their economic outlooks for the coming quarters. While we anticipate third quarter economic activity should indeed bounce back following a decidedly weak Q2, the degree of anticipated economic bounce in Q3 and Q4 could change if current conditions persist. Thus, “on-the-ground” economic conditions will remain in a debilitative state and the elongation of those conditions risks doing long-term damage to the U.S. economy.

A recalibration in how economic forecasters see these new Covid-19 developments should have a negative impact on capital markets as the rate of economic recovery investors had priced-in should change. However, what should happen and what could or will happen may, in this case, be two different things.

The offset to what may be necessarily altered economic expectations ahead could be more stimulus to come from policymakers. That is, if another wave of coronavirus hits the economy, then we expect policymakers to roll out additional stimulus to potentially combat the effects. While we believe-at some point the monetary and fiscal safety net will run into the law of diminishing returns, we anticipate that any near-term policy moves would be supportive for risky asset prices. Moreover, the mere anticipation of future stimulus may in fact keep prices supported.

Long-term we believe that policy’s perverse effects on the market could create lasting imbalances that result in poor future returns. At this time, however, the Pavlovian response from investors as it relates to current and anticipated stimulus action cannot be ignored. As such investors may want to maintain guarded exposure to equities and stay nimble in their overall asset allocation. While equity prices seem undaunted now, downside risks grow as the economic foundation under capital markets remains in a deteriorated state.

Risks

Investors should be aware of the risks associated with all portfolio strategies, and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, and other geopolitical events can have a substantial effect on portfolio performance, our macroeconomic theories, and the effectiveness of strategic and tactical portfolio approaches.

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