Market **Insights**

Economy | **Capital Markets**

Q2
2020

Economy

"These are the times that try men's souls" was a famous quote by Thomas Paine amidst our nation's fight for independence centuries ago. Its meaning is appropriate today as we continue to battle an unprecedented global pandemic and the resulting economic, social and financial market upheaval. As we attempt to resolve these issues for the good of all people, our collective societal ideals and norms are being tested and will likely be altered forever. Hopefully, for the better. While the immediate impact of COVID-19 has subsided and most states have reopened their economies, we remain far from anything resembling a "normal" environment. The ripple effects appear severe. While the path may be difficult, history is littered with crisis periods that have tested our nation's resolve, but ultimately sharpened our character and improved prosperity for all. This time is no different.

After 10 years and the longest economic expansion on record, the devastating effects of the virus pushed our economy into an official recession since February. Within three months, the employment picture quickly went from one of the best on record to one rivaling the Great Depression. Weekly jobless claims jumped into the millions with about 20 million people currently collecting an unemployment check. The unemployment rate is expected to top out around 15 to 20 percent. There are, however, some positive signs. Already, the latest jobs report for May showed a stunning 2.5 million new jobs created for the month, the highest on record. While full employment is perhaps years away, the expanded unemployment benefits should help displaced workers in the short term.

Other parts of the economy are showing nascent signs of recovery. During the height of the economic lockdown in April, industrial production slumped 12.5 percent, an historic low dating back to 1919. A modest rebound in new orders, employment and deliveries during May and June helped restore some confidence to the sector. Yet, we still have a long way to go. The quarantine proved detrimental to the housing market as builders faced multiple pressures, such as a lack of foot traffic, historically high unemployment and tighter credit conditions. New home sales plunged in April by the most since 2010, before showing a modest rebound in May. Still, while the market begins to thaw, the housing sector is likely to recover slowly amidst many economic pressures. Finally, consumers are beginning to show signs of life. Retail sales surged 17 percent in May as shoppers returned with a vengeance, propelled by pent-up demand amid easing lockdown measures. Despite the sharp rebound, retail sales remain more than 8 percent below pre-virus levels. Annualized growth for the second quarter is expected to fall more than 30 percent. A level last reached during the Great Depression. The last two quarters of the year should see a rebound in growth, but its sustainability over the next few years is unclear.

Early in the crisis, the Federal Reserve (Fed) and federal government came to the aid of both consumers and businesses with unprecedented stimulus programs. Congress passed four separate spending bills that totaled $2.9 trillion, more than two times the stimulus passed after the 2008 financial crisis. The stimulus included approximately $720 billion of funding for small businesses, $500 billion for individuals, nearly $300 billion in unemployment insurance, more than $250 billion for healthcare, and $150 billion for states and municipalities. All totaled, the response equaled nearly 14 percent of U.S. Gross Domestic Product. At the same time, the Federal Reserve has unleashed unlimited support for the capital markets in an attempt to restore confidence and halt the slide in risk assets. After dropping short-term interest rates to zero, the Fed provided trillions in new liquidity and lending facilities since March. They also announced a program to buy assets in the open market, which includes U.S. Treasury bonds, mortgage-backed bonds and corporate bonds. This action should keep credit markets functioning reasonably well and force market-based interest rates lower.

As these chaotic events unfolded, the capital market's response was equally volatile. From the recent all-time high in the S&P 500 in mid-February, the index quickly fell about 34 percent through late March. From that point, the market has rebounded about 39 percent. At the end of this quarter, it is down about 7 percent from its high and only down around 3 percent for the year. Most international and emerging market economies and corresponding capital markets have generally lagged our domestic markets. Fixed-income securities have gone through a wild ride over this time. Investment-grade and higher yielding bonds were hit very hard early on. Once the Fed came in to support the credit markets, both came soaring back to almost pre-virus levels.

Where do we go from here? The global economy has started to recover from the sharpest but also likely one of the shortest recessions of modern times. While a near-term technical bounce in economic activity is encouraging, we expect the subsequent climb to be long and arduous for several reasons. First, the social and economic effects from the virus still linger, with concerns of a second wave this fall. Until a viable vaccine is produced, social distancing and curtailed activities will weigh on growth. Second, global supply chains will remain impaired for some time as businesses cope with new reopening requirements and weak end-user demand. Next, a reallocation of capital and labor will occur from depressed to thriving sectors of the economy. Leisure, travel and hospitality may be severely impacted for years, while technology and other consumer friendly sectors may thrive. Finally, addressing the needs of workers and businesses amidst the crisis has left an immense debt overhang at the corporate, public and household levels. Dealing with all this debt will likely drag on economic growth for years. We are cautiously optimistic that unlimited support by the Federal Reserve will buoy financial markets as the economy attempts to heal from the ripple effects of the pandemic. Yet, we are keenly aware that any missteps or unforeseen obstacles could quickly result in heightened market volatility.

Capital Markets

Stocks came roaring back during the quarter as investors became more comfortable with post-virus conditions and liquidity support by the Federal Reserve. U.S. treasury yields continued to decline and riskier bonds posted stellar results for the quarter. Most international stocks and bonds posted solid results as well.

Disclosure: It is not possible to invest directly into an index. The indices listed above are unmanaged and are not affiliated with the Advance Capital Companies.

Market Index Performance (%)
As of June 30, 2020

	2nd QTR	YTD	1 Year	Annualized 3 Year
S&P 500	20.54	-3.09	7.49	10.71
Dow Jones Industrial	18.51	-8.43	-0.54	9.07
Nasdaq Composite	30.95	12.74	27.05	19.18
Barclays Aggregate Bond	2.90	6.14	8.74	5.32
FTSE USBIG Corporate	9.01	5.36	9.79	6.37
MSCI World	19.57	-5.47	3.43	7.32

Economy from a Historical Perspective

	Latest	Average*	Definition	Comments
U.S. Unemployment Rate	13.30%	6.10%	Represents the number of unemployed persons as a percent of the labor force	Historically high
Consumer Price Index	0.10%	4.00%	Represents changes in prices of all goods and services purchased for consumption	Sharply lower
U.S. Capacity Utilization	64.80%	80.10%	The greatest level of output that a plant can maintain within the framework of a realistic work schedule, accounting for normal downtime	Historically low
Gross Domestic Product+	-5.00%	2.80%	Total value of all goods and services produced indicates strength or weakness of the economy	Substantially lower
10 Year Treasury Yield	0.70%	6.22%	Yield on the current 10 year treasury bond	Historically low
Annual Housing Starts	974,000	1,430,000	New privately owned housing unit starts annualized rate	Dramatically lower

*Average from 1966 to Present   + Annualized   *Source: Bloomberg*