Weekly Market Flash

Halfway There

June 26, 2020

It's hard to believe that this surreal stretch of time known as year 2020 of the Common Era is nearly halfway over. However the next six months play out, we imagine that very few people will be sad to kick this year into the history books come December 31. So let us now look ahead and consider what the second half of the year might look like, and what factors at play might change the landscape from base case expectations.

Still About the Virus

Remember those pictures in the news after Memorial Day weekend? You know – the packed swimming pools and crowds of lusty young holiday-makers hoisting their red plastic beer cups on bar patios overlooking Lake of the Ozarks or the Florida Gulf Coast? Well, it is quite likely that at least some portion of those merry souls (not to mention those with whom they subsequently came in contact) figure into the increasing number of new cases, new hospitalizations and – tragically – new fatalities related to Covid-19. Just yesterday the number of new cases hit a record – over 40,000. Unfortunately the death rate also, unexpectedly, spiked far above its trend line at nearly 2,500.

For many weeks now we have considered alternative outcomes to how the summer progresses based on the likelihood (or not) of spikes in new cases. Will weather play a factor? Will phased reopenings in states be conducted in such as fashion as to keep certain social distancing protocols in place, including a willingness to sacrifice some personal comfort by, for example, wearing masks when out in public? Well, we have had some record-breaking heat events in places including Arizona, Texas and Florida which are now in the epicenter of new hotspots, so the weather correlation can apparently be dispensed with. And virus-containing social protocols like distancing and mask-wearing have been haphazard to say the least (reckless might be a better term, at least among a not insignificant cohort).

The virus and the economy are not the artificial dichotomy as is so often presented in media accounts; they are very much intertwined. So what does the ongoing presence of Covid-19 center stage suggest for how economic events play out in the coming months?

A New Fiscal Cliff

Remember the "fiscal cliff"? That was the brief scare back in late 2012 when a combination of expiring Bush-era tax cuts along with government spending cuts hastily agreed to in 2011 were due to converge in January 2013. In the end that fiscal cliff was averted through some budgetary Band-Aids. This year we have an approaching cliff of a decidedly different nature and, at the moment, no plan for averting it.

The broad swath of fiscal relief programs passed back in March included two remedies aimed specifically at struggling households: the $1,200 checks to families (with additional funds for children and students), and increases of $600 to weekly unemployment benefits to ease the strain on those laid off by businesses as they shut down for quarantine. The checks have been cashed and the unemployment benefits will expire next month. So will the credit facilities available to small and mid-sized businesses under the Paycheck Protection Program component of the umbrella CARES Act.

These programs were certainly not without their flaws and their critics (egregiously, it turns out that the Treasury Department mailed some $1.4 billion worth of checks to dead Americans, which just boggles the mind). But they played a big part in keeping household income levels at least somewhat afloat, and that in turn helped consumer spending not be as terrible as it would likely otherwise have been. Remember that consumer spending accounts for over 70 percent of our total national output. Consumer spending also…well, keeps businesses in business.

Unfortunately, whatever brief moments of bipartisan support existed for long enough in March to get the CARES Act passed are becoming more distant by the day. With the election now just a bit over four months away, everything that happens in Washington is going to filter through the harsh prism of electoral advantage. It will be increasingly difficult as the weeks progress, and as the intense fall campaign season approaches, to pass what almost all economic experts outside the political process agree is a necessary next phase of fiscal relief. That cliff may be steep and painful.

Municipal Reckonings

The coronavirus pandemic has wreaked havoc on state and local budgets. Now many of them are facing renewed pressure on public health and first responder institutions as the number of new cases goes up and hospital beds become scarce. The budget gap – the difference between revenues and expenditures – is expected by some estimates to top $1 trillion this year. Since almost all states (Vermont being the odd exception) are required to have balanced budgets, the prospects for massive cuts in public payrolls and services loom large. As with relief to households and businesses, federal aid to municipalities will become increasingly problematic as Washington goes into full-on campaign mode.

After the Storm…the Vaccine?

All things considered, the current outlook suggests a bumpy start to the second half of the year that could persist for some time. The V-shaped recovery so luridly fantasized about among certain political circles and day trader bros seems ever more distant. But that does not mean that there are not potential upside X-factors as well – probably first and foremost of which is the potential for a vaccine against Covid-19.

News about the developmental progress for a vaccine is often misleading. Here is what is important to know. First of all, there is an unprecedented number of groups feverishly working on advancing potential candidates through the three phases of clinical testing to establish viability. A small number of them have moved into Phase 3 trials which exposes a wider number of population groups to testing in order to determine the likely outcome, with attendant side effects, if made available to the population at large.

The second important point is that the companies and institutions associated with some of the leading vaccine candidates, with some public sector support, are already investing in the physical infrastructure necessary to mass-produce and distribute the drug once viability is established and regulatory approval given. This is unusual, because the investment is entirely at risk; there is no guarantee of success for any of the leading candidates as of today, and history tells us that the chance of failure is not insubstantial. Note that we do not have vaccines for SARS or MERS, two coronavirus-based diseases that predated SARS-Cov2-19. Nor, after many years of trying, do we have one for HIV.

So it is certainly too early to celebrate the end of Covid-19 through a game-changing medical breakthrough. The good news is that, if a successful candidate does come out of Phase 3 testing sometime in the fall, it would be physically feasible as a matter of process to make the vaccine widely available by the first half of next year. This is what much of the commentary about Dr. Anthony Fauci's comments on the subject has missed: Fauci has not said that a successful vaccine is a given, only that the timetable for production and distribution will be massively faster than usual if one is found. That's an important distinction.

In summary, we are comfortable now with our portfolios remaining on the defensive side of positioning as we steer into the various headwinds potentially buffeting the transition to the second half of the year. However, we also believe there will be opportunities for repositioning with a view towards longer term resumption of growth (albeit growth at rates closer to the pre-pandemic trend rather than a resumption of the higher growth levels characteristic of earlier economic up-cycles). As always, we will continue to share our thoughts with you as they evolve from week to week. For now, though our most important message is: stay safe, stay healthy and stay optimistic for better days ahead.

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