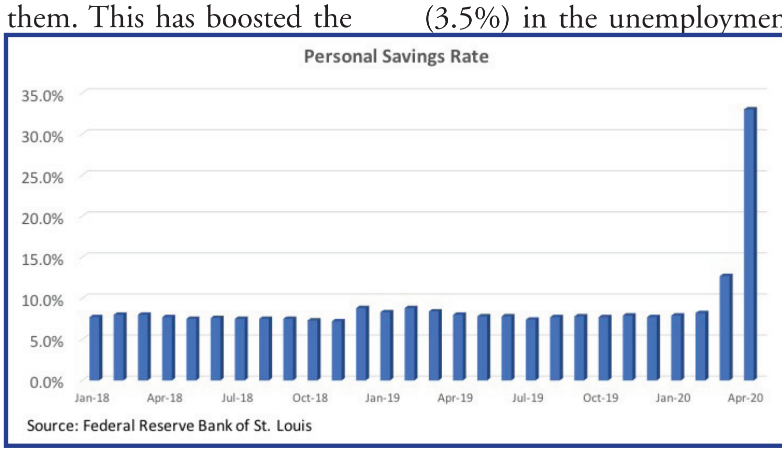
JAMESSON ASSOCIATES

SUMMER 2020

QUARTERLY NEWSLETTER

Recent Economic Events

Economic statistics by their very nature are backward-looking. They report on events which have already occurred. Typically, the NBER, the official arbiter of these things, declares the start of a recession about the time it is over. Because the change in economic activity in the wake of the pandemic has been so abrupt and significant, we don't have to wait for the official designation. The coronavirus recession began in mid-March. Real GDP was impacted even though the economy was doing fine for most of the first quarter. The recession has been marked by an unprecedented increase in job losses and an unemployment rate rivaling that of the 1930s. In response, the Federal government has enacted a wide-ranging package of aid, sending dollars into the hands of taxpayers, businesses, and medical facilities. Instead of spending the dollars, recipients have largely held onto them. This has boosted the savings rate, cratered retail sales, and transformed inflation into deflation.



Source: Federal Reserve Bank of St. Louis

First quarter real GDP dropped by a sharp 5% as consumer spending plunged. This was the weakest quarterly performance since the depths of the Financial Meltdown in late 2008. Were this the end of the retrenchment, it would be bad enough, but second quarter estimates suggest a far larger contraction. While they differ in magnitude, both the New York and the Atlanta Federal Reserve Banks project second quarter declines five to ten times greater. Private estimates tend to center around 35% to 40% drops. Needless to say, nothing of the sort has occurred in the postwar time frame. However, a note on GDP math is pertinent. Real GDP is reported quarterly in the US. To make the numbers more comparable to year-over-year changes, they are annualized to indicate what would happen were the quarterly change to persist for a full year. This makes a lot of sense when the raw quarterly changes are .5% to .8% as they annualize to a rate of 2% to 3%. When the declines are as massive as they were and likely will be, annualizing may not be as illuminating. Nevertheless, while the run rate of GDP in the current quarter will not be half to two-thirds of what it was in late 2019, it will be down 10% or more. On a starting value of $22 trillion, that's a big hit.

Overall activity tends to obscure the more personal tragedy of job loss. Since social distancing began in earnest in mid-March, over 40 million Americans have filed for unemployment insurance. Not all qualified for benefits, but we can reasonably conclude that all lost their jobs. This turned a 50-year low (3.5%) in the unemployment rate into an 80-year plus high (14.7%). In May, some of the job decline was reversed. There were 2.5 million jobs added, shaving the unemployment rate to a still high 13.3%. The sad fact is that 21 million Americans were officially unemployed in May, an additional 10.6 million were working part time even though they wanted full-time jobs, and a further 9 million were not in the labor force but would have taken a job if one were available. Once again, over 40 million.

Congress acted quickly to put together a record bailout package which included direct checks to most American taxpayers, forgivable loans to businesses, extended unemployment benefits, and supplemental aid to those fighting the pandemic. The price tag was about $2.2 trillion, which roughly matches the estimated hit to GDP. The idea was that

Recent Economic Events (cont.)

these dollars would keep the economy going. However, while personal income jumped over 10% in April, retail sales fell by over 16%. The spendable funds became savings, which vaulted to a super-high 33% of income.

Prices have not been exempt from the collapse in consumer demand. Oil prices are half of what they were when the year began, even going negative for a day in the futures market. Both producer prices (down 1.3% in April and 1.2% from a year ago) and consumer prices (down 0.8% in April up only 0.3% y-o-y) are showing weakness.

The speed and severity of the COVID-19 recession has been unprecedented. While government attempts to shore up the economy have similarly been fast and substantial, they remain at the mercy of human nature. The psychological hit from closed businesses and job losses is real and will likely take more than a government bailout to cure. After the horrible second quarter wraps, we should see positive activity. The open question is how confident the economic actors will be, not whether they have the wherewithal to spend.

Commentary

It is becoming increasingly obvious that we elected a simpleton as President in 2016. Those who voted for him then and who still support him now full well knew what they were doing. In frustration with the political and economic elite, they wanted to reject the ideas of those who 'knew better' and upend the system. They have gotten their wish. In the era of short attention spans, our sound-bite Chief Executive excels in pithy phrases (Make America Great Again, Build the Wall, etc.) and tweets limited in character length so as not to tax our reading comprehension.

> The President: "I don't take responsibility at all" - a rare truthful admission of irrelevance.

It turns out that simple works surprisingly well as a marketing strategy and quite badly as a response to a crisis. During the first three years of the President's term, he was unable to add to his electoral base even as the economy grew, unemployment plunged, and foreign military adventures were reduced. Never once did his approval rating surpass the 50% mark. In the face of peace and prosperity, suburban voters deserted the Republicans in 2018, turning over the House to Democratic control. No doubt the President would say, "that's not my fault," but he says that about everything that goes wrong anyway.

Then comes 2020, a year shaping up to be one of multiple crises that require more than simple solutions. The coronavirus pandemic is not entirely unprecedented, but close to it given the decades that have passed since the Spanish Flu or the centuries since the Black Death. The resulting economic collapse is the worst of our lifetimes. Add the utter failure of America's criminal justice system to police the police, and we have the makings of a very hot summer. And where is the President?

His initial response to the pandemic in February can be forgiven, as information at that time was scant and in some conflict. However, by early March, the evidence was much more concerning and clearly called for a Federal response. The President: "I don't take responsibility at all" — a rare truthful admission of irrelevance. As the virus spread, his daily briefings became as much sources of misinformation as information, culminating in his surreal musings on internal UV lights and bleach. This led to the bizarre spectacle of Clorox's warning not to drink their product.

Consequently, the country was left to enact patchwork lockdowns as different regions fought over medical supplies. The President decided that a good way to combat job losses was to propose a cut in social security taxes, notwithstanding the fact that people who are laid off don't pay social security taxes, and neither do

Commentary (cont.)

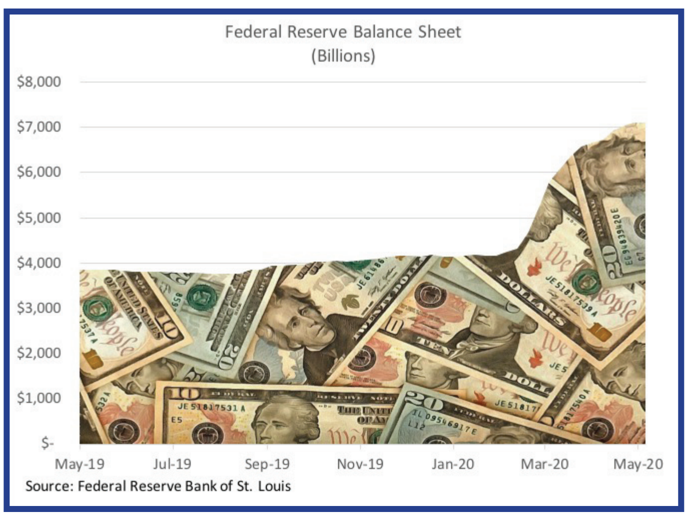
businesses that have no employees on the payroll. Surprisingly, Congress disregarded the White House and passed a bailout bill along bipartisan lines.

George Floyd's death in Minneapolis sparked widespread protests against police violence. We might have expected a responsible leader to publicly ask for calm. Instead, he tweets, "when the looting starts, the shooting starts". He even threatened to use military force to shut down protests, an action denounced by a former Secretary of Defense and contradicted by the current (for now) one. Then he decides to use shock and awe tactics to clear out peaceful protestors for a photo-op holding a Bible in front of a church in DC. The chances that he has read even one page of that Book since taking office are infinitesimally small.

We have come to a point in the United States where 'united' is being sorely tested. There are no simple solutions to the complex problems posed by the pandemic, the unfolding recession, or the social upheaval represented by police violence protests. These challenges require deep understanding coupled with responsible recommendations of trade-offs. By refusing to take responsibility for things that might not turn out right, the President has become irrelevant. For someone who feels that everything must be about him, this may be the final comeuppance.

Market View

The financial markets have disconnected from the economy. As Main Street absorbs continual blows in employment, sales, production, and investment, Wall Street enjoys a record-fast recovery in stock prices from the March lows. This isn't how a well-functioning capitalist system is supposed to work. In such a system, the fundamentals of long-term profitability should be reflected in the shares of companies even if there are temporary deviations as investor emotions swing from greed to fear and back again. This swing to greed is supported by the largesse of the Federal Reserve and threatens to become permanent.



Source: Federal Reserve Bank of St. Louis

There is an old maxim, "Don't fight the Fed." Liquidity and low interest rates have been key in financial asset price appreciation. That's what $3 trillion and counting can do. However, data suggest that Fed liquidity infusions are slowing, and the dollar is exhibiting some weakness.

The initial response to the global slowdown was a rush to buy American assets. To do so, investors outside the US had to buy dollars first. While a lower dollar may ultimately help domestic exporters, its present weakness may signal less demand for US assets. Canary, coal mine, a harbinger?

So how do I see the future unfolding? Fiscal and monetary actions of the current magnitude would be producing record gains in the economy if that were the full story. They are not, because human nature is inhibiting the full use of the dollars. Money supply has jumped, but money velocity (how many times each dollar in the system is used to buy something) has plunged. The dollars that the Federal Government has provided have not led to new activity; they have simply offset the collapse in income which resulted from the abrupt economic stoppage. We are

Market View (cont.)

filling potholes, not building a new interstate highway system. Similarly, on the monetary side, the gain in the money supply has been mirrored by increases in bank reserves. Bank reserves are locked inside the banking system. Only when banks decide to lend those funds, and more importantly when borrowers decide to take them, will real economic activity resume.

Bank loans jumped dramatically starting in March as large companies drew down borrowing lines and then as Paycheck Protection Program loans started flowing. The gain was over $1 trillion. However, in the last few weeks, total loans have begun dropping, and when the PPP loans are forgiven over the next few months, the declines will accelerate. It is not unreasonable to expect total loans in the system to return to their levels of late February. At the same time, bank deposits have increased even more ($1.7 trillion) than loans have. This reflects the fact that Americans are experiencing the most significant economic trauma of their lives and are consequently boosting savings.

If these savings flood back into the purchases of goods and services as lockdowns are lifted, the economy will recover quickly, and the stock market will be justified in its optimism. If the dollars stay mostly in rainy-day funds, disappointing growth will drag down stock prices. How confident people are is far more important than the governmental dollars available. You can lead a horse to water ….

Keynes famously quipped, "the market can stay irrational longer than you can stay solvent." Smart investors need to keep that in mind if they are inclined bet against the current rally. However, I believe that the disconnect between financial markets and economic fundamentals will ultimately be resolved in favor of the fundamentals. In other words, this is still a bear market rally, not a continuation of the bull market.

If you buy my analysis, safety trumps risk. Raise cash on stocks that have outrun the averages while leaning towards stocks with secure dividends as core holdings. Fixed income options include Treasuries and TIPS. I continue to warn against lower quality bonds.

If you believe that the market is right and that the recovery will be rapid and complete, stay away from bonds, especially Treasuries. Buy momentum stocks. Look at emerging markets which have been beaten down but will benefit disproportionately on a global recovery.

Editor's Note

Sometimes it just pays to be lucky. Susan and I headed north in early March because of a couple of scheduled client meetings. We were planning on checking the house in Scottsville and then returning to New Orleans for the rest of our planned stay. Circumstances intervened, and we decided to, as the Greeks say, "καθίστε στα αυγά σας" *translated as "sit on your eggs". We have been doing our best to socially distance. We rarely venture out to areas with more than a few people and wear masks when we do. To say that everything is going swimmingly with no tension would be stretching the truth, but we still expect to celebrate our 38th anniversary later this month. Fortunately, warmer weather has arrived; our fruit trees were in full and fragrant bloom; Susan's flowers are offering a welcome reminder of life's renewal; and we both know how to cook. Those eggs we were sitting on — blowing through about a dozen a week. If COVID-19 was named for the estimate of lockdown weight gain, I'm about halfway there.*

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