John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday September 16, 2020

A vaccine is coming. Astrazeneca has resumed trials. Others are continuing trials. There are ten or more potential vaccines in the works. The timing is still uncertain. The consensus guess is that we will have a vaccine by early next year. Governments and pharmaceutical companies are ramping up production and distribution facilities. We don't know how long it will take to vaccinate enough people to get the economy back to pre-pandemic levels. But current data from the U.S. and global economies shows an underlying strength far greater than expected. The post-pandemic economic outlook is quite bright. We may well be heading for a long period of strong growth with low inflation and low interest rates.

The growth in new coronavirus cases and deaths has been falling steadily since midsummer. This has allowed a partial return to pre-pandemic activities. The economic result has been remarkable. An Oxford Economics Recovery index is back above 80 for the first time since the state of emergency began.

Goldman Sachs economist Jan Hatzius said on September 8 that he was "upbeat" about the direction of the global economic recovery, and saw annualized third-quarter growth in the United States hitting 35%.

In mid-August the Philadelphia Federal Reserve Bank did a survey of economists and found that the median forecast for the third quarter was roughly 20%. That is well below the Goldman Sachs early September forecast. Goldman Sachs is probably more up to date, following the fast-developing data on U.S. and global economic activity. For sure the data are coming in much better than feared.

I say this is remarkable because it comes in the wake of a terrifying health crisis. The virus has infected 6.3 million Americans and more than 190,000 have died. Given the chance, as infections declined, Americans have responded quickly and effectively. To be sure there is still an unacceptable number of Americans unemployed. But the evidence says there is hope for a return to low unemployment and millions of jobs once the vaccine is available.

The United States is not alone. Global trade in goods has defied the pessimists and declined far less than predicted. In April the outlook for trade looked dismal. Economists predicted a decline of 30% compared with 2019. In 2009 when the global economy contracted by 0.1%, global trade in goods fell 13%. This time the global contraction is heading for 4.9%, 50 times worse than 2009. The 2009 history points to a whopping decline in trade this time. But no that is not what has happened. Oxford Economics, a consultancy, predicts that in 2020 as a whole global trade in goods will be down by 10%.

According to Simon Evenett of the University of St. Gallen in Switzerland, the number of trade restrictions applied on medical goods and medicine since the start of the crisis peaked in April and has since fallen by 15%. Even more important, lockdowns were lifted more quickly than expected, allowing exporting powerhouses like China and Germany to reopen factories and boost output.

Pandemic-induced demand gave trade in some products a lift. America’s imports of protective equipment tripled between March and July. COVID-19 related products including computing equipment for working from home accounted for the majority of China’s year-on-year export growth.

Eytan Buchman of Freightos, an online marketing service, reports that ocean-freight prices are surging for routes between America and South-east Asia. He says that is partly due to “near frantic” e-commerce offerings by small businesses.

The Economist concludes: “Although the trade performance is a cause for relief, no one should declare victory yet.” That declaration will have to wait for an effective vaccine. But the current evidence clearly shows the potential for a quick recovery in global trade once the virus is under control.

Two weeks ago, investors were rattled by a sudden steep decline in stocks, with tech stocks getting hit the hardest. Apple, for example, lost $179.92 billion off its market value; the biggest one-day loss for a U.S. listed company ever. That one-day drop was bigger than the individual market capitalizations of 470 of the 500 companies in the S&P 500 index. The shock waves from that stock market plunge continue. *The Economist* in its September 12th issue has an entire article devoted to event. As I wrote last week a huge increase in call options by individual investors was at the root of the decline.

According to Goldman Sachs the total nominal value of call options traded on American individual stocks hit a record high in the last two-weeks of August, averaging $335 billion a day. That was the first time the average daily volume of stock options exceeded trading volumes of the underlying shares themselves. The volume of call options was more than triple the rolling average between 2017 and 2019.

On September 4th the *Financial Times* reported that Softbank, a Japanese conglomerate, had purchased $4 billion worth of long-term call options (meaning 3 or six months to expiration) on American technology companies. That is eye-opening but not the source of the big one-day stock plunge. Softbank hedged its call option position by selling an equivalent amount of the underlying stocks. This meant that the market-makers who sold Softbank the options did not have to immediately hedge their position by buying up shares in tech stocks. If it became profitable for Softbank to exercise the options that would simply put Softbank back where it was before the option trade. The bank would be covering the earlier sales of underlying stocks.

The problem came from an explosion in individual investor buying call options, naked, meaning without a hedge. Over four weeks small investors, who buy less than ten contracts at a time, spent more than $37 billion on call options. This forced market-makers to hedge their exposure buy purchasing the underlying stocks. That pushed the stock prices up suddenly creating a short-term bubble which subsequently burst sending the stocks prices down sharply.

What does this mean for stocks in the long run? The answer more short-term volatility, but not a change in underlying fundamentals. Leading up to the pre labor-day stock scare, the tech stocks had been rising in response to strong underlying fundamentals. A solid economic rebound following a vaccine would mean continued growth in sales and profits and higher stock prices no matter how the call option phenomenon works out.

I will have the next market review and update one week from today on Wednesday September 23, 2020.

All the best,

John Dessauer