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Economic and Market Outlook

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The COVID-19 Recession

Part A. The Shape of a Recession—V or U?

Writing for *Forbes* (June 8, 2020 issue), in an article entitled, "Alphabet Soup: Understanding the Shape of a COVID-19 Recession," David Rudeck began by describing, or defining, the National Bureau of Economic Research's (NBER's) view of what a Recession constitutes:

> The Recession, they declared to have begun in February 2020, is defined as:
> "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales."

Rudeck went on to say:

> Thankfully, recessions do not last forever, and neither will a coronavirus recession. At some point, the economy will reopen and start growing again, although what the recovery might look like is unclear. The best-case scenario for the COVID crisis is a V-shaped recession. If this happens, the economy will rebound as quickly as it has declined, with minimal long-lasting financial damage. A sharp downturn followed by a quick rebound in growth defines the V-shaped recession.
>
> Some executives are hopeful about the prospects for a V-shaped recession. Around 38% of companies believe that the recovery will be V-shaped, with the economy rebounding in the third quarter of 2020, according to a survey from EY [EY stands for Ernst & Young Global, a data analytics firm]. [See Chart 1-A (V-Shaped Recovery).]

> In a U-shaped recession, it takes many months, if not years, for the economy to recover. The long, flat stretch of sideways growth comprises the bottom of the U shape. The Great Recession is a good example of a U-shaped recession. The formal recession itself lasted 19 months, from December 2007 to June 2009, and even after growth resumed it took years before employment recovered to pre-crisis levels. [See Chart 1-B (U-Shaped Recovery).]

Around 54% of companies expect a U-shaped recovery.

What signs have there been that might indicate a V-shaped recovery? Well, the stock market to this point is predicting one. There have been some early economic signs also. The May Jobs report showed a gain of 2.5 million jobs. The last Retail Sales number showed an increase of 17%. Pending Home sales showed an increase of 44.3%. These are all glimmers of hope.

In addition we have mentioned before that, if history is to be any guide, since 1917 it has taken the stock market on average about 6 months to recover from the initial shock of a pandemic. If we mark the initial travel restrictions as the start, then the end of July is our target.

We share the expectation of a U-shaped recovery—first, because of the demographic make-up of Consumer-Spending in the time of COVID-19; then, because of the nearly all-time high of Unemployment; and, finally, because we expect considerable problems with interdependent supply chains.

Each of these problems will be discussed in what follows, but make no mistake, the economic effects of the pandemic have been brutal.

Part B. Who Are the Consumers of the COVID-19 Recovery?

We begin with observations concerning the incredible change in the level of Unemployment between December 2019 and May 2020 (i.e., latest data).

Table I
Comparisons

Age Group	Unemployment Rate		Career Status
	Dec 2019	May 2020	
16-19	11.0	29.9	Very Early Career
20-24	6.3	23.2	Very Early Career
25-34	3.6	13.4	Early Career
35-44	2.8	10.2	Established Career
45-54	2.6	10.7	Established Career
55-over	2.4	11.8	Established Career and Retirement

May's total Unemployment was reported at 13.3%, down from April's 14.7%. Even a brief glance at Table-I shows just how bad current conditions have become, particularly among the younger workers.

Note carefully the two Very Early Career groups—16-19 and 20-24—plus the Early Career group—25-34. These three groups account for 35.4% of the labor force, most of whom are likely to have trouble becoming re-employed.

In Chart-3 (Annual Growth Rate in Labor Force by Age, Projected 2014-24), note the weakness in all groups except 65-74 and 75 and older.

It is this pattern that has led to slower Productivity growth. In the years since 2014 and those projected to 2024, we are simply becoming an aging country.

Such low growth continuing in the more skilled groups—35-44, 45-54, and 55-64—suggest a continuation of lower Productivity from shortages of skilled labor. This problem is also compounded by accelerating retirements of 65 and older.

An additional problem is that the more rapid growth of retirements in those 65-and-over comes from those very likely to be retired from small-businesses and corporations with capital problems.

Chart-4a (Change in Wealth since 1989, by Age), Chart-4b (Job Openings: Total Nonfarm), and Chart-4c (Unemployment by Race) all point to aspects of the spending and employment problems.

Chart-4a makes it clear that the change in wealth by age group since 1989 has been stunning. The three age groups (ages 25-54, with groups combined) in their Peak-Earning Years are not only barely growing, or even not growing (see again Chart-3), but their wealth has importantly been declining; thus, the wealth effect on consumption growth is negative.

Chart-4b shows a drop in job openings of more than 30% through May, which is deep into Recession territory. The lack of openings is a clear problem.

Chart-4c simply drives home the re-employment problem. The Unemployment rate for Black and Hispanic minorities is far greater than for Whites and Others.

Chart-5 (Unemployment Rate) shows just how serious the problem has become. Note that the rate is the highest in more than 70 years. Keep in mind this is government induced unemployment.

Part C. What Does Inequality Mean for Economic Recovery?

In the June 19 issue of *Barron's*, the Feature article entitled, "Wealth Inequality Doesn't Show Up in Broad Economics Metrics, Masking the Fragility of Our Current System," the writers say [with our emphasis throughout]:

> Low-income workers have seen very little wage growth since the last recession: The top 1% of earners now account for a fifth [i.e., 20%] of total income in the U.S., while the bottom half of earners account for just 13% of total income.

They add:

> Savings rates for the top 10% have risen over the past three decades, while the other 90% has seen negative savings rates, leaving those earners with little to invest and often saddled with debt. And while a little more than half of U.S. households own some stock, usually through 401(k) plans, just 10% of households own 84% of the stockmarket, which means a swath of Americans didn't reap the benefits of the last bull market.
>
> The COVID-19 pandemic exacerbated and highlighted these problems.
>
> Some 40% of the people who have lost their jobs were earning less than $40,000, compared with 13% of those earning $100,000 or more.

The writers continue:

> Hard-hit sectors like leisure, transport, and retail are filled with parttime and lower-wage jobs that generally don't come with safety nets like paid leave, health care, or work-based 401(k) savings plans—and many of those jobs might not come back.

They conclude:

> In a consumer-driven economy, lower-income households are a critical source of growth because they are more likely to spend any additional money they get. According to a working paper by the Chicago Fed in May, those who lived paycheck-to-paycheck spent more than two-thirds of the recent $1,200

relief checks within two weeks, while those who save much more of their monthly pay spent less than a quarter.

Clearly, inequality matters in thinking about the shape of the Recession and the recovery.

Part D. Gray Is the Color of Recovery

Those with little-to-no savings and who carry increased credit-card debt during the pandemic (perhaps nearing card limits) will spend every dollar of government aid, but most programs are set to end in July, unless extended.

Those in the 25-34 and 35-44 age groups may fare importantly better than those under age 25. However, economic slumps can inflict semi-permanent, or even permanent, scars on consumers' views about spending and saving.

The shape of the economic recovery is very likely to be determined by age groups that are gray: the Silent Generation (over 75), the Baby Boomers, or simply Boomers (age 55-74), and Generation X (age 45-54). These three groups represent 62.6% of annual aggregate expenditures. The Boomers by themselves account for 41% of expenditures (data taken from Table 1300 of the U.S. Bureau of Labor Statistics, September 2019).

Statistics on the Boomers alone are dramatic (data based on an internet article, "Baby Boomer Spending Habits in 2020," published January 13, 2020, by the firm Lexington Law):

1. Boomers control 80% of personal financial assets (Cash + Savings + Stock and Bonds + Cash Value in Life Insurance, Real Estate, Business Valuation, Vehicles, Furniture, Computers, Jewelry, Pensions/Retirement Accounts, etc.).
2. Boomers own 2.34 million small businesses.
3. Boomers buy 43% of domestic cars and 48% of luxury cars.
4. Boomers buy 80% of luxury travel.
5. 59% of Boomers have children between 18 and 29 that they support.
6. Boomers hold $2.6 trillion in buying power.
7. 67% of Boomers own a smartphone.
8. More than 50% of Boomers prefer shopping online over physical stores.
9. Boomers make up 46.8% of pet spending.
10. 59% of Boomers are willing to pay extra for socially compliant, sustainable products.
11. 69% of Boomers expect to work past age 65 or don't plan to retire.
12. Boomers are expected to spend nearly $1 trillion per year (next 10 years) for healthcare services and products compared to $200 billion last year.

While writing this report, we came across a telling graph, appropriate to look at here, that shows the recent pattern of Consumer Spending from mid-February to early June 2020--see Chart-15 (Change in Consumer Spending during the Pandemic). Note the pattern of recovery after all four groups showed a massive decline.

What was not expected is that the top 25% and top middle 25% in income (roughly equal to the Silent Generation [age over 75] plus the Boomers [age 55-74] and the oldest part of Generation X [age 45-54]) not only fell further than the younger, less affluent (bottom middle 25% + bottom 25%), but in recovery, their consumptions remain way below their normal levels, while the younger quartiles, with Federal aid, are approaching normal levels.

Besides seeing the very large percentage drops in spending in Chart-15, if we turn to the rest of the charts, beginning with Chart-6 (Personal Saving Rate), which shows the Rate of Saving jumped from 7.5% in March to 33% in May.

Consider Chart-7 (Average Weekly Hours of Production and Nonsupervisory Employees, Manufacturing), Chart-8 (Advanced Real Retail & Food Service Sales), Chart-9 (Industrial Production: Manufacturing), Chart-10 (NFIB Small Business Optimism Index), and Chart-11 (University of Michigan Consumer Sentiment Index).

Chart-12 (US Real GDP Change: Actual vs. Expectation for Q2: 2020) shows that Q2 is expected to be the worst quarter in history (note: Q2 Actual to be released in late July). The median May "Nowcast" for US Real GDP Change is shown on the Chart as -31.6, but updated on June 25, the "Nowcast" projects a decline of 46.6% for Q2.

The Philadelphia Fed's "Nowcast," called the Aruoba-Diebold-Scotti Business Conditions Index, can be seen in Chart-13. This Index declares that a Recession exists when it falls to a -0.80%. Note that on June 13, 2020, it was at a -9.0%. This extreme reading may indicate a bottom because, once again, the reading is due to government mandated shutdowns.

Part E. Supply Chains Broken

While the COVID-19 pandemic has hit Service industries the hardest, Manufacturing has not escaped. See again Chart-7 and Chart-9, both of which show that the Other 30% of GDP has its own problems.

These problems are primarily of a Supply-Chain nature that has become truly global.

Chart-14 (COVID-19 Impact on Manufacturers) shows a survey, conducted in late-May through early June by the National Association of Manufacturers, comprising 14,000 members across the U.S. in every industrial sector. As the Chart shows, 35.5% of Manufacturers are already facing supply-chain disruptions, and a full 78.3% of the members expect negative financial impacts resulting from COVID-19.

China has made itself vital to the supply chains of the U.S., as well as globally, through their supply of raw materials, intermediate parts and assemblies, to finished goods. Supply chains involving China and many other countries have been a major driver of productivity growth and cost savings.

Supply chains take time to repair. Disruption can lower productivity and increase costs for some years ahead.

Part F. Summary

Perhaps, in the final analysis, we should simply say that the uncertainty level is so high because of the sudden shutdown of the economy from the pandemic, and that forecasting faces conditions in both the economy and financial markets that will not be fully appreciated until after the recovery.

The economy and investors have no pre-existing models of what to expect; thus, there are no clear defenses against the shocking disruptions. There are no playbook or best practices to help.

How and when Consumption and Industrial Production reach prior levels remain in debate.

It is clear the stock market rally from the late-March lows is based on a sharp, or V-shaped, recovery conclusion.

However, the Federal Reserve Chair, Jerome Powell, increasingly warns investors that the economic recovery is likely to take a considerable period of time.

Like all, we hope for the earliest control of the COVID-19 pandemic.

Stay safe—be smart.

When you arise in the morning,
think of what a precious privilege
it is to be alive—
to breathe, to think, to enjoy, to love.
--Marcus Aurelius

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