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The Economic Implications of Covid in the White House

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Summary

- *Recent events are a further warning that the immediate impact of the pandemic remains substantial and its path dependent, in part, on the manner in which countries manage the crisis and adapt to it. Adapting to Covid has been both highly creative and highly destructive. The “net” of this destruction and adaptation tells us where how overall economy and employment picture is doing. In typical prior expansions, monthly gains in net employment just one third of September’s would be considered quite strong. New US business start-ups have risen to 3.2 million this year vs 2.7 million through the same period during 2019.*
- *A much lighter than typical flu season will probably save tens of thousands of lives. It also suggests a pick-up in the US economy this year of nearly \$170B.*

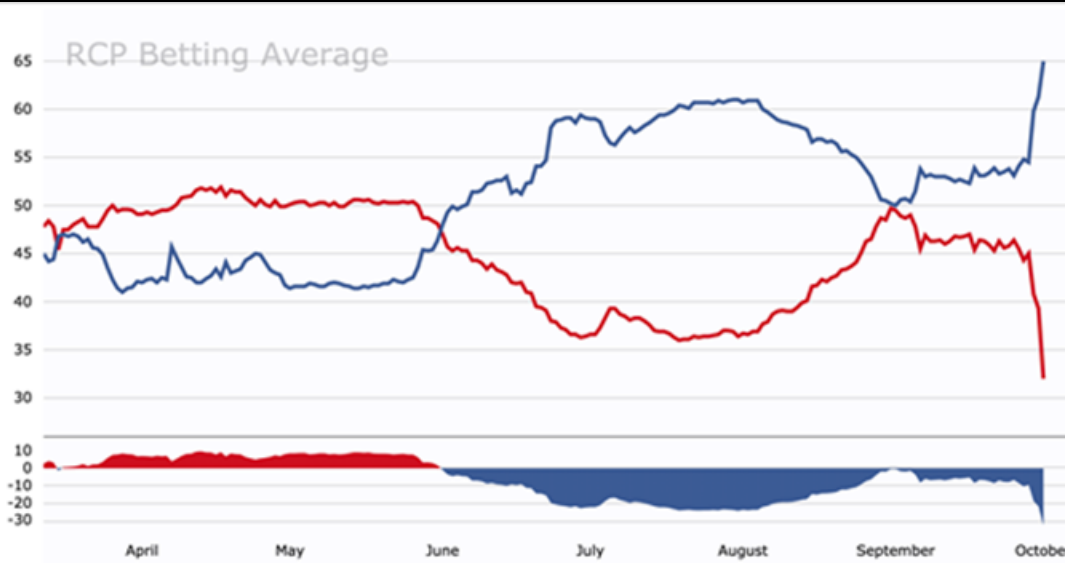
The Economic Implications of Covid in the White House

The fact that the US President, First Lady, three Senators and a significant number of private and public individuals who have attended White House events have tested positive for COVID is not as surprising as it is dramatic. We wish all of them a speedy return to good health. Coming just 31 days before the election, with the President at Walter Reed Hospital for treatment and the campaign suspending normal operations, the events are a further warning that the immediate impact of the pandemic remains substantial and its path dependent, in part, on the manner in which countries manage the crisis and adapt to it.

The market response to the rapidly changing political and health dynamics on Friday was rather mild, with tech stocks leading US shares lower and bond yields rising. This was not the market performance one might expect amidst the dual risks of a President in peril and a worsening view of the pandemic. But it may be indicative of the view that “good” may yet come of these events. Perhaps we will see action on passage of stronger US fiscal stimulus.

Prediction markets, meanwhile, priced in a slightly increased probability of a Biden victory after Trump’s health announcement (Figure 1). Undoubtedly, news of the President’s infection highlights the increased health risks for the US and strengthens the hands of those arguing for a measured approach to economic re-openings. It is highly unlikely to mean a delayed US election, which would require consent of the Democrat controlled House. We would similarly presume no delay in Senate confirmation of Supreme Court Nominee Coney Barrett. At the margin, we think that the news may move Republicans toward a compromise on greater stimulus efforts.

Figure 1: Real Clear Politics Prediction Market Odds US Presidential Election

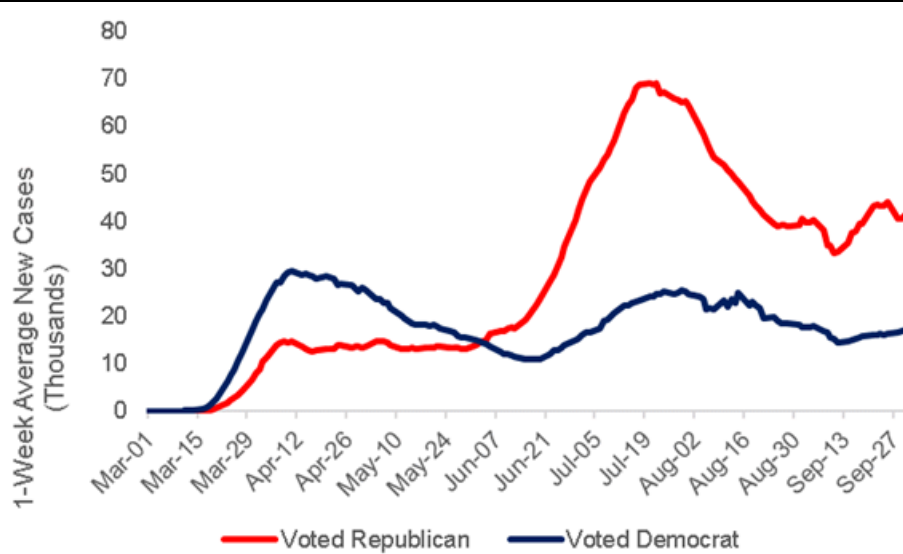


Source: Real Clear Politics, Bloomberg as of October 2, 2020.

That said, the impact of “Covid in the news” on the Senate elections and on turnout may be substantial. It will strengthen arguments for Biden’s more cautious approach to Covid. As the “handling of Covid” is a major issue in the 2020 election, we will be watching how undecided voters behave given the events. It is possible that the President’s positive test will have no impact on them, given that the speed of news flow may displace this story weeks from now.

Given that the US has not managed to knock out new Covid cases to the same degree as much of the rest of the developed world, a potential second wave could be rising from a higher base. The situation is made “political” by the fact that the greater number of new cases in the United States are now occurring in states that voted for President Trump in 2016 (see figure 2), where public figures have typically been more skeptical about the need to shut down the economy to stop the virus.

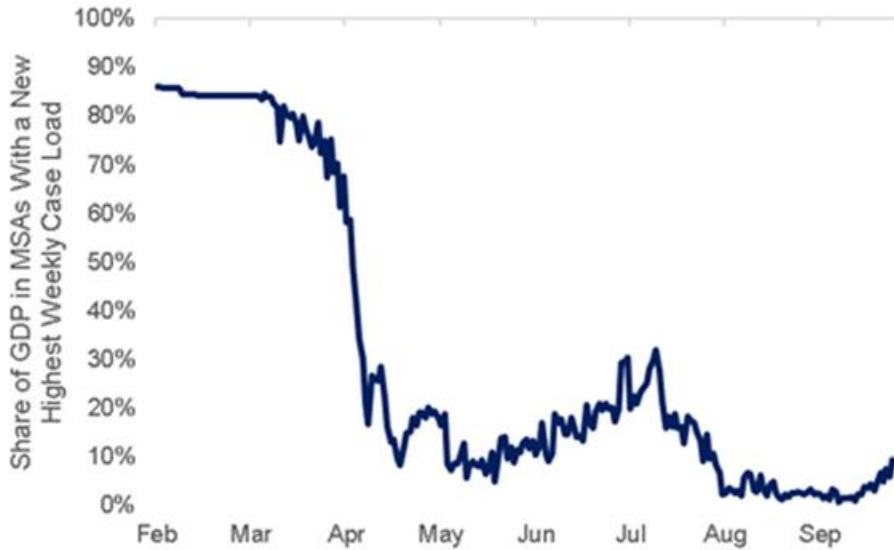
Figure 2: Covid Infections in US States that Voted Republican and Democrat in 2016



Source: Haver Analytics as of October 2, 2020.

Assuming that Republican states remain more likely to stay open and resist more severe precautionary economic restrictions (see figure 3 for the GDP of most impacted States), it is unlikely that the second wave will harm markets and the economy anywhere near as deeply as it did in the Spring. In general, the public and healthcare system readiness for the second round of Covid suggests less “shock impact.” The US economy (and we believe most others) is adjusting and altering the composition of activity to live with Covid for the time being.

Figure 3: Share of US GDP by Metropolitan Statistical Area Experiencing Their Highest Case Loads



Source: Haver Analytics as of October 2, 2020.

Employment Gains Surprisingly Durable, But Face Future Risks

The adaptability of the US economy remains remarkable. There are many countervailing forces at work. A high level of gross job destruction is ongoing, yet net employment has gained. These gains are not just re-openings, but new job creation in sectors helping the public adapt to Covid.

US employment rose 661,000 in September. The headline results were weaker than consensus estimates and the past month's result continues a pattern of *decelerating* gains since the reopening surge in May. But given that the **peak of government support for the economy was April, 2020**, the news is far more positive than the news headlines suggest. April's 22 million job losses on forced shutdowns was catastrophic. But in typical prior expansions, monthly gains in net employment just one third of September's would be considered quite strong,

The US unemployment rate fell to 7.9% from 8.4%. Looking below the surface, we still see that some of the improvement is at risk. Most notably, leisure and hospitality employment in September jumped by 318,000, or 36% of private-sector job gains (877,000). This is the category of employment most impacted by Covid shutdowns and re-openings. As such, we cannot expect substantial further improvements in the sector during the winter months and a partial reversal cannot be ruled out.

Another area of risk for the US economy is state and local education employment, where 280K jobs were lost in September (see Figure 4). While some of these losses may be due to delays in school openings, we think it is also indicative of the degree to which state and local governments have not received bailout funds despite having drastically reduced revenue.

Figure 4: US State and Local Government Employment

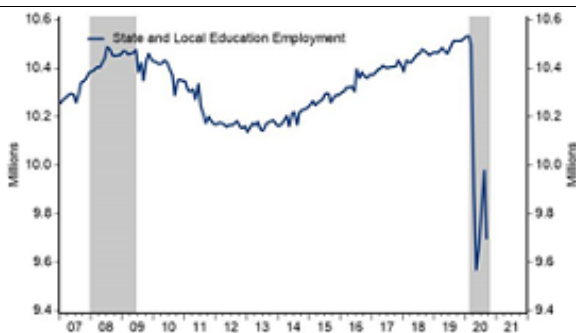
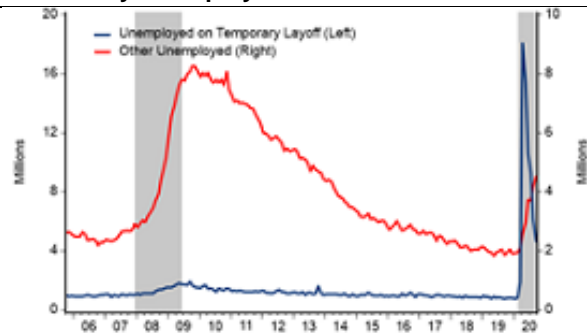


Figure 5: US Workers Temporarily Unemployed vs Permanently Unemployed



Source: Haver Analytics as of October 2, 2020

Adapting to Covid has been both highly creative and highly destructive. The "net" of this destruction and adaptation tells us where the overall economy and employment picture is doing. New US business startups have risen to 3.2 million this year vs 2.7 million through

the same period during 2019. The “net” also explains the overall level of the US equity market once factoring in negative real interest rates. The destruction has impacted certain sectors deeply, large parts of consumer services for example, while “digitization” of everything has surged.

Thus, we think of Covid as two “events”, the shutdown period and its knock-on impacts, and a typical recession happening at the same time. We can “see” the lockdown and roll-off clearly, but we cannot easily see an underlying recession for several sectors because it is dwarfed by the Covid tidal wave and adaptive recovery.

The recession thus far includes a permanent loss of more than two million jobs that will likely take a Covid vaccine and easy monetary policy to repair. The recession is also happening at the state and local levels, with large decreases in tax revenues and employment. This would normally be followed by a slow recovery, but perhaps in 2021 not a full one. In fact, during the coming Covid recovery, we may even see some States and industries have a brief period of contraction (albeit of a much more normal scale) after the reversals of the lockdown are largely over.

Typical recessionary activities have been masked by seven million temporary job losers and re-gainers, those that have already been re-employed (see figure 4). Looking to the future, the net increase in labor demand in other areas of the economy has generated 1.5 million new UNFILLED job openings over the past three months (see figure 6). Though we see decelerating net job gains, job opening are still indicative of a moderately growing economy at the start of 4Q 2020. It follows swings in real GDP related to the shutdowns and reopening at a -30% and likely +25% rate, respectively, in the 2Q and the 3Q.

Figure 6: US Employment and Job Openings (Unfilled)



Source: Haver Analytics as of October 2, 2020. Note: Red arrow indicates increase in both US job openings and US non-farm employees over the past three months.

To understand the destructive Covid wave, one need only look at New York City where there have reportedly been 6,000 retail store closures in August and a jump of about 40% in bankruptcy filings. Only 15% of office workers have returned to work thus far, with a surge in Covid cases predicted in late Fall and Winter. The pandemic could permanently close as many as a third of New York’s 230,000 businesses, according to the Partnership for New York City. It takes quite a bit of time for new business formations to make up for this magnitude of loss. In the meantime, dwindling tax revenues are already causing a reduction in City services.

Understanding the Coming COVID Season

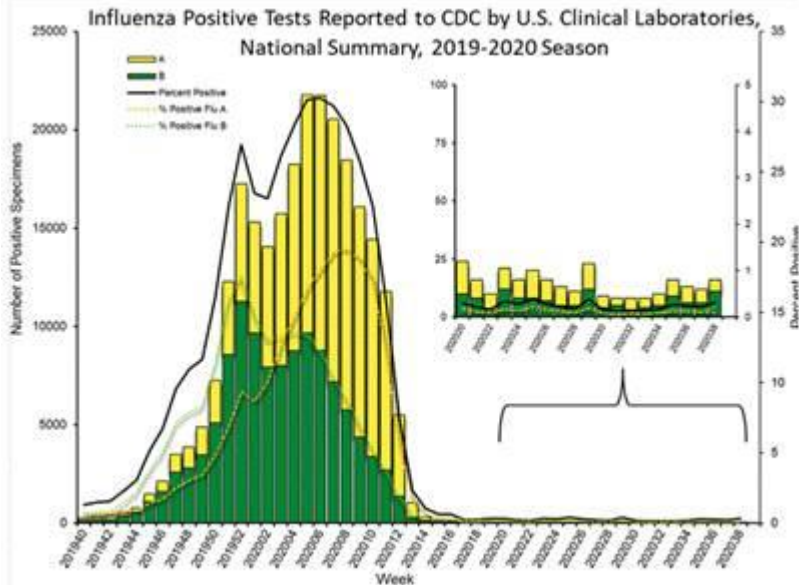
Adherence to mask wearing, social distancing and better personal hygiene have been the keys to fighting Covid-19. Additionally, smaller tactical lockdowns of hot spots appear effective at reducing spread. Therefore, we see a second wave as more of a health care challenge than an economic one. Our view is that further fiscal stimulus is both necessary and likely, but that the undifferentiated lock downs of whole economies is not likely to be repeated.

Historically, the second year of a pandemic has been the most severe as the base population from which the epidemic grows is larger. However, we have no other recent example beyond the 1918 Spanish flu, with its four discrete waves that ran from 1918 through 1920. Much has changed in terms of public awareness, medical practice and treatment, and by the successful protocols implemented by some governments in contrast to 100 years ago.

We know this is true because the global flu season has been so drastically altered by the steps taken to control Covid. In the US, the measures that were put in place to stop Covid in April and May appear to have brought an abrupt end of the 2019-2020 flu season (see Figure 7). This is also true for the southern hemisphere, where people are not getting sick nor dying from the Flu (see Figure 8). Covid has killed substantially more individuals in the southern hemisphere than the Flu normally does, but the measures taken to address the pandemic have virtually stopped the normal seasonal flu there as well.

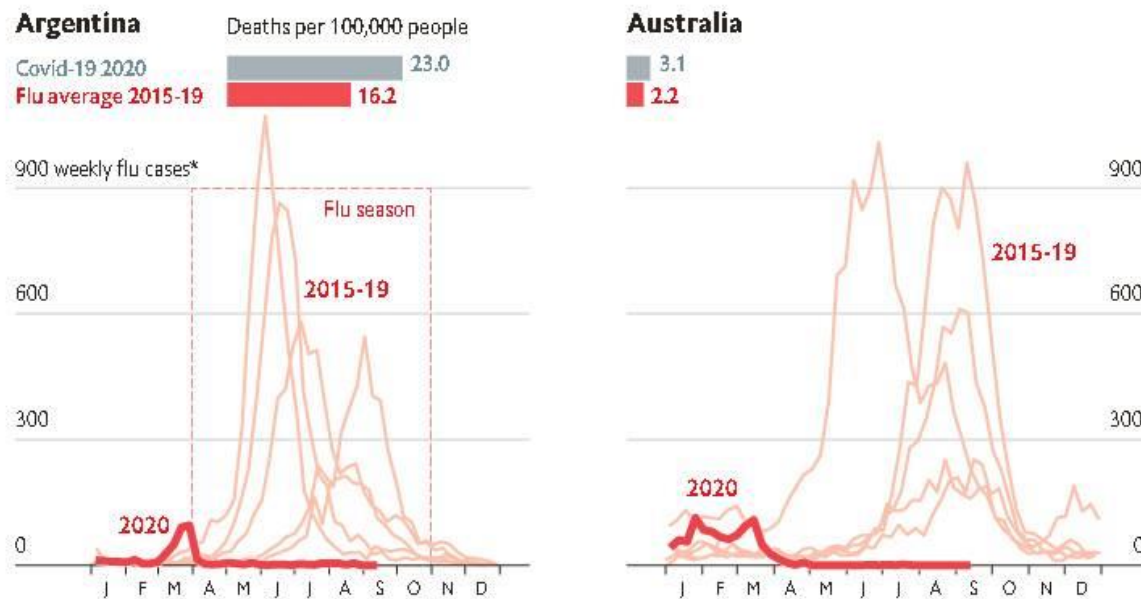
A much lighter than typical flu season will probably save tens of thousands of lives, and while that is a small number relative to the more than 210 thousand US deaths from Covid-19 in the past 6 months, it means a lot to the economy as a whole.

Figure 7: Positive Influenza Tests in the US in 2019 and 2020



Source: Centers for Disease Control as of September 30, 2020.

Figure 8: From Australia to Argentina Flu Season Has Failed to materialize in the Southern Hemisphere



Source: World Health Organization as of September 30, 2020.

An Unexpected Economic Dividend... and a Medical One, Too

A British Medical Journal article, "Flu Costs the US \$90bn a Year" (2007) reported that the seasonal Flu cost the US \$90 billion in lost revenue in 2003. Scaled to the larger size of the economy today, that suggests a pick-up in the US this year of nearly \$170B. Project comparable and proportionate economic benefits globally and one can see that "less flu" creates a sizable economic dividend. While this secondary stimulus is not going to flow directly onto any firm's balance sheet, it is nonetheless going to support the economy meaningfully.

The benefit of a low flu season goes even further than saved lives and more dollars. It also frees up hospital resources to fight Covid. In the US alone flu has been responsible for as many as 800,000 hospitalizations in a bad year (2017-2018). Even if the mild flu season only matches the best recent year in the US (2011-2012), that would prevent 650,000 hospitalizations, freeing medical capacity when it may be needed most.

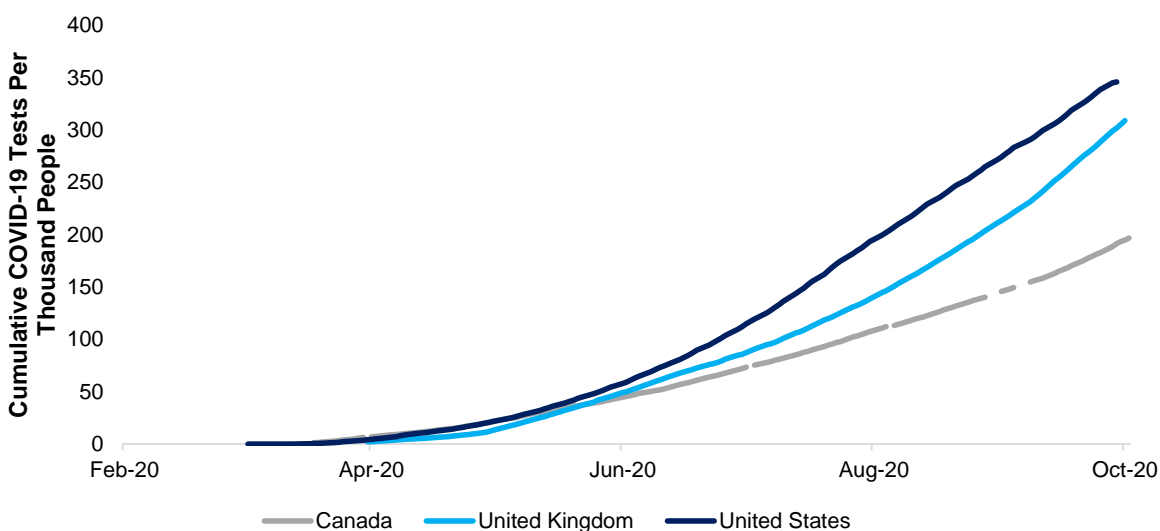
From the Covid White House, Another COVID Fighting Weapon

Anyone in the US watching the news over the last few days may have been surprised with how many government officials were able to receive a COVID-19 diagnosis seemingly within hours of the news that President Trump had tested positive. The White House and parts of the executive branch have implemented a systematic rapid-testing regime, designed to track and trace positive tests, ultimately enabling public servants to continue their work – much of which must be done in person within various Washington office buildings.

Beyond prudent individual steps like mask-wearing and social distancing, we expect companies, schools, and governments to make increased use of this growing capacity for rapid testing in the coming months, especially among richer economies (see figure 9). While rapid tests are not 100% accurate, when coupled with temperature checks and contact tracing, they should enable a subset of individuals to return to work and school, boosting productivity and sales for small businesses that surround those gathering places. While testing will not enable a full return to "normal", it could convince younger, less immuno-compromised individuals to feel more comfortable leaving their homes than they have been without that peace of mind of a negative test. Of course testing measures would be an imperfect substitute to an effective vaccine, which is likely the only way to achieve durable herd immunity in the coming years. We view the opportunities around testing as crucial for keeping economies in recovery mode, and this may also benefit a select few

companies providing necessary medical equipment and lab diagnostics in sufficient scale to meet increasing demand for those services.

Figure 9: Covid Tests Per Thousand in US, UK, Canada



Source: Haver Analytics as of September 30, 2020.

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