Some Other Perspectives March 16, 2020

After another news-heavy week, we thought it appropriate to provide a brief update. We have sent two other similar communications over the past few weeks. If you have not received please let us know and we'll make sure to resend.

First, our hearts go out to the individuals, businesses, and communities affected by the COVID-19 viral outbreak. Needless to say, we are committed to serving our clients during this unprecedented time and will do everything in our power to continue to operate with the same level of service that you have come to expect. We have contingency plans in place to limit disruptions, and regularly test those plans to ensure the ongoing continuity of our business. At this time, we have restricted non-critical travel for our advisors and associates, and significantly limiting face-to-face office appointments, but do not anticipate making any other changes unless necessary.

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As a part of our decision-making process, we are constantly reading and reviewing what experts in our field are saying and thinking. Below we've included a few recent articles that you may find edifying:

Reasons to Be Positive About the US Coronavirus Fight

Bryce Gill, Economist with First Trust

Less than a month ago markets were at a record high, as healthy data on the US economy signaled continued growth on the horizon. Then, as Coronavirus made its way to continental Europe and the United States, markets went into a tailspin, suffering one of the fastest declines on record. The last several weeks have been characterized by extreme volatility as investors try to make heads or tails of the situation. Coverage around the virus has been almost exclusively negative, as experts extrapolate worst case scenarios to spur action. It should come as little surprise then, that fear of a recession has moved to the forefront of many minds. At times like these, we think it's crucial to look at the data and note some positive developments that aren't getting as much media coverage.

Testing Capacity is About to Rise Substantially: The initial government response to Coronavirus has been extremely disappointing. The first round of test kits sent out by the CDC were faulty, requiring a recall and costing precious time in the fight to find/quarantine those infected. Further slowing action, only the CDC was allowed to do tests at its own facilities, limiting testing capacity. Now, things are beginning to change. Many private labs have now been approved to conduct tests, and the FDA has announced that not only will high-volume testing be allowed, but that emergency approval has been given for an automated Coronavirus test that is estimated to speed up the testing process 10-fold. So not only are tests becoming more available, results will come quicker as well. Identify and contain, the proven method to-date, can be rolled out at the national level.

A Wave of Recoveries on the Horizon: The number of official infections in the United States has continued to rise at an accelerated pace over recent weeks. Meanwhile, our preferred measure of active cases (total cases minus deaths and recoveries, which gives a better picture of the number of people who are able to spread the virus further) has continued to rise consistently as well. As so often occurs during virus

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outbreaks, fears arise that the early pace of spread will continue, unabated, at a exponential rate. History – including the experiences of both China and South Korea with Coronavirus –

shows identification and treatment leads to a slowdown in the pace of new cases, and a pickup in recoveries. Typically, it takes roughly two weeks for otherwise healthy individuals who test positive to get better and be officially moved from the "active" to the "recovered" counts. Now that we are about two weeks out from the initial surge in US cases, recoveries should begin to rise consistently. The world recovery rate currently sits at 93% right now, while in the US it is only 43%. We expect the US to move toward and then exceed the world recovery rate in the weeks ahead.

The Private US Healthcare Industry is the Best in the World: One of the biggest things overlooked (and underappreciated) in the fallout from the Coronavirus is just how fast the private US healthcare industry has responded. Moderna has already begun testing a vaccine, and many other companies have followed suit with their own treatments. Meanwhile, doctors have begun using the experimental anti-viral drug Remdesivir to treat US Coronavirus patients, with positive results. The speed with which these discoveries have been made is absolutely breathtaking, imagine how long it would take to develop effective treatments for a never-before-seen illness 50 years ago! Meanwhile, a 2013 study by the Department of Health and Human Services determined that the US has the most Intensive Care Unit beds per capita of any country at 20-32 per 100,000 people. This is far higher than China where there are only 2.8-4.6, demonstrating why they needed to build hospitals overnight. Likewise, the US far outdoes countries with socialized medical systems like Canada (13.5), Sweden (5.8-8.7), or the UK (3.5-7.4). This means the US is better suited to deal with the healthcare capacity issues that could arise with a Pandemic than virtually any other country in the world.

Put it all together, and the US is well poised to not only win its own fight against the Coronavirus, but also to export treatments that should help the rest of the world. The coming weeks will be critical as tests go out en masse and we learn more about the fight we are up against, but we are up to the task. Panic is never permanent, and as the virus response ramps up, sentiment will turn higher as well. Every day we learn more. Every day we make progress. This too shall pass.

A Coronavirus Recession?

Brian Wesbury, Economist

No one knows with any real certainty how much, or for how long, the Coronavirus will impact the US economy. What we do know is that it will have an impact. And, after data releases of recent weeks, we also know that the US economy was in very good shape before it hit.

Nonfarm payrolls grew by a very strong 273,000 in January and another 273,000 in February. The unemployment rate was 3.5% in February and initial claims for jobless benefits were 216,000 in the last week of February. Retail sales in January were up 4.4% versus a year ago. In February, sales of cars and light trucks were up 1.9% from a year ago and were above the fourth-quarter average. This suggests that total retail sales for February rose as well.

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Industrial production fell 0.3% in January, but likely rebounded sharply in February. After all, hours worked in manufacturing durable goods rose 0.9% in February and colder weather likely lifted utility output.

Housing starts have been particularly strong lately, coming in at an average annual pace of 1.597 million in December and January, the fastest pace for any two-month period since 2006. Yes, part of the surge in home building was due to good weather, so February will likely fall off to around a 1.49 million pace, which excluding December and January, would be the fastest pace of building for any month since 2007.

The ISM Manufacturing index slipped to 50.1 in February from 50.9 the month before, but a level above 50 still suggests growth in factory activity nationwide. The ISM Non-manufacturing index, which measures a much larger share of the economy, rose to 57.3 in February, signaling strength.

Putting all of this data into their model, the Atlanta Fed projects real GDP is growing at a 3.1% annual rate in the first quarter. *That's not a typo*. However, March data, which isn't available yet will likely bring this number down.

The early economic headwinds from the Coronavirus are coming from slower production in China, which likely led to a big drop in inventories. We expect this to pull first quarter real GDP down to a 2.0% growth rate and we are now thinking growth will be zero in the second quarter. After that, given previous episodes of rapidly spreading viruses, inventory replenishment should boost growth to the 3.5 – 4.0% annual rate range in the second half of the year.

This may seem optimistic, but keep in mind what happened when the "Hong Kong flu" hit the US from September 1968 through March 1969, killing around 34,000 people in the US according to the Centers for Disease Control. During the last quarter of 1968 and first quarter of 1969, real GDP grew at an average annual rate of 4.0%. The "Swine Flu" in 2009 also did not lead to a recession.

However, a much more negative story unfolded in late 1957 and early 1958 when the US was hit by the "Asian flu," which killed almost 70,000 in the US and didn't spare younger people as much as the Coronavirus. Real GDP was growing around 3% annually in 1957, but as the flu started to peak in Q4, the economy shrank at a 4.1% annual rate, followed by an annualized 10.0% plunge in the first quarter of 1958, the deepest drop for any quarter in the post-World War II era (from 1947 through 2019).

But then, right after the plunge, the economy rebounded at a 7.8% annual rate for the next five quarters.

Before the Coronavirus hit we thought the odds of a recession in the next twelve months were about 10%. Now we think they're around 20%. Higher, but not high. There is no precedent for the first social media panic regarding the flu. Either way, here's a simple rule of thumb: if the unemployment rate goes up 0.4 percentage points or more compared to where it was three months prior then the US is probably in a recession, otherwise it's probably not. The jobless rate was 3.5% in December, so unless it goes above 3.9% soon the economy is still growing.

The bottom line is that we've had severe flus before without a recession and when we did have a downturn, the economy bounced back very quickly. The stock market is pricing in a steep drop in profits, which is certainly possible. A strong recovery, which we expect, will reverse this as it has in the past.

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