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BLBB Advisors, LLC – Bi-Weekly Market Update Friday, May 29, 2020

It has been an eventful two weeks since our last economic update. US equity markets mostly continued the impressive rally they began in late March, and many of the major equity indices are up about 4.5% - 4.8% so far this month. On May 27th, the Dow Jones Industrial Average closed over 25,000 and the S&P 500 closed over 3,000 for the first time since early March. As you would expect, equity market volatility remains elevated, although well below the all-time high point reached in mid-March.

US fixed-income markets have stabilized since the initial shock of the pandemic roiled bond markets throughout much of March. Bond yields remain well below where they began the year, primarily because the Federal Reserve reduced the federal funds rate to a range of 0% - 0.25% as part of their efforts to support the US economy in the wake of the pandemic. It is likely interest rates will remain low for the foreseeable future – probably until there is mounting evidence that the US economy is well on its way to recovering from the sudden shock of the widespread domestic and global lockdowns.

While US equity markets rally, US economic data continues to illustrate the toll this pandemic will end up taking on our economy. We just learned that another 2.1 million people filed new unemployment claims this week. This is yet another staggering number and now over 40 million have filed new unemployment claims since mid-March (link here). While these numbers are a bit depressing, there are several bright spots on the horizon. First, the US reached its high point in new unemployment claims back in March – every week since then there have been fewer and fewer new claims. This week's number is the lowest since the pandemic began (link here). Second, there is evidence that previously laid-off employees are starting to return to work as factories reopen and the restrictions on retail businesses begin to ease (link here). Indeed, 4 million people came off of unemployment this month (link here).

In addition to the weekly unemployment claims data, we also just learned that first quarter GDP has been revised downward from -4.8% to -5.0%. Unfortunately, but not surprisingly, most economists expect second quarter GDP will be significantly worse than first quarter GDP – primarily because the pandemic did not really begin to impact the US economy until later in the first quarter (link here). Although the National Bureau of Economic Research (NBER) has yet to declare the US is officially in a recession, it is a foregone conclusion at this point. A recession is defined as a period of at least two consecutive quarters of negative economic growth. We already had our first quarter of negative economic growth earlier this year, and are now in the midst of what surely will be our second consecutive quarter of negative economic growth.

GDP is an attempt to broadly capture all the economic activity happening inside the US during a given period. It is comprised of consumer spending, business investment, government spending, and net exports (exports minus imports). Consumer spending is the dominant number in this formula and usually accounts for 68 – 70% of GDP. However, consumer spending, of late, has fallen dramatically. It was down 7.5% in March (April data will be out shortly). Retail sales, another good measure of consumer activity, was down 16.4% in April (link here). It is quite possible April will end up being the worst month – at least as far as economic data goes – during this pandemic event because it appears it will be the only full month when a vast majority of the country was in quarantine.

Many clients have been asking us why equity markets are rallying when the economic data seems so dire. While we also find the intensity of the current rally to be somewhat surprising, we think there are several reasons why the rally is occurring:

1. Investors have had almost three months to come to grips with the pandemic. Back in March, fear levels were extremely high. Some scientists were predicting that a million or more would die of the coronavirus in the US in 2020 (link here). Now, while this health crisis is far from over and it is still scary, much more is known about the disease, what it does to the body, how it spreads, and how it can be treated. While a cure has yet to be discovered, numerous pharmaceutical and biotech companies along with a number of major universities are focused on developing effective treatments and have human vaccine trials underway. As a result, many investors are feeling more positive about the future and the likelihood that an effective treatment and/or vaccine will be available in the coming 6 – 12 months.
2. Our current situation is a major and sudden global economic downturn precipitated by the world's response to a pandemic. The US economy started off 2020 in good shape – inflation was under control, unemployment was low, consumer confidence was strong, and the 2019 US/China trade war had subsided. Absent the pandemic, it is highly likely US financial markets would have continued to make new highs this year – just as they did pre-pandemic in February – and the US and global economies would have turned in reasonable levels of growth. Because the economy was strong when the pandemic hit, and because the underlying issue is a health crisis rather than an economic issue, some investors believe the economy will recover more quickly than it would have if the real issue had been an economic one.
3. The fiscal (Congress) and monetary (Federal Reserve) response to the pandemic was swift, decisive, and massive. These extraordinary relief efforts should not only help support and sustain businesses, individuals, and families during the quarantine period, but also help ignite economic growth as we begin to transition out of lockdown.
4. Some well-known business leaders have begun to speak out suggesting the US economic recovery could be relatively quick. Jamie Dimon, the CEO of JP Morgan, recently opined that US economic growth could pick up dramatically in the 3rd quarter as our economy continues to normalize (link here). A recent survey conducted by TMF Group of over 300 US corporate leaders revealed that two-thirds of these leaders believe the US economy will recover within a year and 74% are confident about the US economy (link here).

Of course, it remains to be seen whether investors are correct about how and when the US economy will recover. Also, we do not have much prior experience to call upon and help us navigate what might be coming on the economic or pandemic front. If the US and the world are able to reopen and normalize without causing a major second wave of coronavirus infections, and if an effective treatment or vaccine is quickly developed and mass produced, then, this positive outlook and bullish equity market behavior is most likely warranted. But, these are some major "ifs" and they may not occur as quickly or as smoothly as we all would like. Also, while it is quite possible that additional economic relief and stimulus will be needed to bolster suffering economies, it is not clear whether enough will be forthcoming and when.

As if the pandemic and ensuing economic fallout were not enough to handle, the US/China trade war, that dominated headlines for much of last year, may be starting to heat up again. Three important things happened this month that give us some pause. First, China's legislature voted to impose its national security law on Hong Kong. Among other things, this law criminalizes anti-government activities and also appears to conflict with Hong Kong's constitution known as its "Basic Law" and the 1997 agreements that were put in place when Hong Kong was returned to China by Britain.

Second, and in response to this action by China, the US just declared it no longer considers Hong Kong to be autonomous from China. This is a serious declaration with far-reaching consequences because the US treats Hong Kong differently than China when it comes to international trade. Hong Kong receives special trade privileges and access to certain technologies that are not made available to China. For example, Hong Kong was not hit with the tariffs that the US imposed upon China last year. Hong Kong received these benefits because it was autonomous from China. Now, that designation is in serious jeopardy. Furthermore, Hong Kong is a major world financial center with a much freer economy than that of China. China's unilateral imposition of its national security law also jeopardizes Hong Kong's status as a world financial center.

Third, the trade deal reached earlier this year contains terms that now seem unattainable because of the pandemic-induced economic downturn. For example, China has not been able to purchase the amount of American goods it previously agreed to buy (link here). Tensions are again running high and the likelihood of returning to a punitive tit-for-tat trade war seems to have returned, although, China's imposition of its national security law has certainly raised the stakes.

At this juncture, we are cautiously optimistic at best. On the one hand, it seems hard to believe that all will go smoothly with our economic recovery, that a safe and effective vaccine and/or coronavirus treatment will be developed and widely available in the next 6 – 9 months, and that the China/Hong Kong/US situation will not escalate. On the other hand, people are resilient, healthcare/pharmaceutical researchers are dedicated and have unfettered access to more technological resources than ever, and the governments and central banks of the major world economies appear committed to wholeheartedly supporting their citizens and stimulating their economies as best they can. We will check in with you again in two weeks and report any further developments on these topics.

BLBB Charitable announces important leadership changes

On May 18, BLBB Charitable, the Giving Arm of BLBB Advisors, welcomed Nicole G. Tell into the newly created position of Executive Director. Nicole brings a wealth of nonprofit experience and an impressive background to BLBB Charitable. She has over ten years of leadership experience in nonprofit fundraising and administration and most recently served as Senior Vice President of Development and Chief Operating Officer of the Children's Scholarship Fund Philadelphia. Previously, Nicole was the Director of Donor Relations and Communications at Project HOME. You can read more about Nicole here.

We are also happy to announce that Diana Doherty, after voluntarily stepping down from her position as Manager of BLBB Charitable, accepted our offer to become the newest member of the Foundation's Board of Directors. She joins current Directors Clifford Haugen, John Lawton, Laura Brewer, and Dean Karrash.

We look forward to working with both Nicole and Diana in their new roles!