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An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

The stalwart S&P 500 Stock Index (SPX) rallied for the week on less-bad news, rising just over 3% to close at 3044.31 on Friday. That rally leaves it down only 5.77% year-to-date and down 10.1% from its top in February. It is now up a whopping 36% from its nadir in late March and an impressive 10.62% from this time last year. Importantly to us who watch such things closely, the SPX is now comfortably above its 200-day moving average, an indicator that historically has often marked the end of a bear market and the beginning of a new bull. Notably though, nothing about this particular market panic has so far followed historical norms, so remaining cautious is likely a prudent course.

Oddly, the driver for the big market jump at the beginning of the week appears to have been the reopening of an institution that many have condemned as being archaic, the New York Stock Exchange live auction floor. The opening of the NYSE trading floor marks a visible resumption of "normal" albeit with modifications, such as the traders maintaining a six-foot separation and wearing masks, but nonetheless, a landmark step toward a better future. Symbols do matter.

The U.S. Treasury 10-year note's yield responded less enthusiastically, never having had a trading floor and unimpressed with the NYSE floor's reopening, by rising a subdued 1.66% for the shortened week to yield 0.657%, again confirming the positive slope of the Treasury yield curve. Its implied forecast continues to be that things will be better next year but "better" will be muted. West Texas Intermediate crude oil (WTI) joined with the stock market in a relatively exuberant nearly 5% price rise to $35.20, seeming to ignore the millions of barrels of oil tucked away in ships that must come back to shore before regular supply and demand will reassert its rules.

The Economy

The actuality and threat of contracting COVID-19 is the single most powerful driving force in the global and domestic economy. The actuality is that about 1.7 million Americans have been officially diagnosed with the disease and officially, 102,516 of us have died from it. The mortality rate for those officially recognized as having been infected has remained at about 6% for the entire month of May. Both of those numbers continue to grow at about 1.5% per day in the U.S. While people are driving about and resuming some economic activity, the fear of infection continues to restrict economic recovery. That dynamic could not be illustrated better than the Commerce Department report for income and spending in the month of April. Household income rose an astonishing 10.5% in one month while consumer spending fell a stunning 13.6%. The difference between the two, 24%, went to savings.

The dramatic reduction in consumer spending, or as economists put it, demand, resulted in the PCE Deflater, the Federal Reserve's preferred inflation indicator, coming in at a negative 0.5% for April as prices fell. That consumer behavior was reflected in the University of Michigan's Consumer Sentiment Index decline of 27.7% this year, the largest decline on record. Perhaps more importantly, their Index of Consumer Expectations fell even more, 29.5%. When people are concerned that not only are things bad now, but are likely to get worse in the future, they, quite rationally, reduce spending and increase savings. On a more objective level the same evidence can be seen as the money supply (M2) in America has increased by $2.5 trillion, 16.61% since February, another all-time record, even as prices of goods and services fell about 1%.

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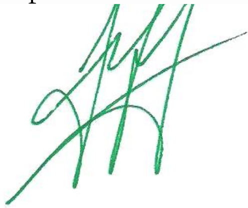
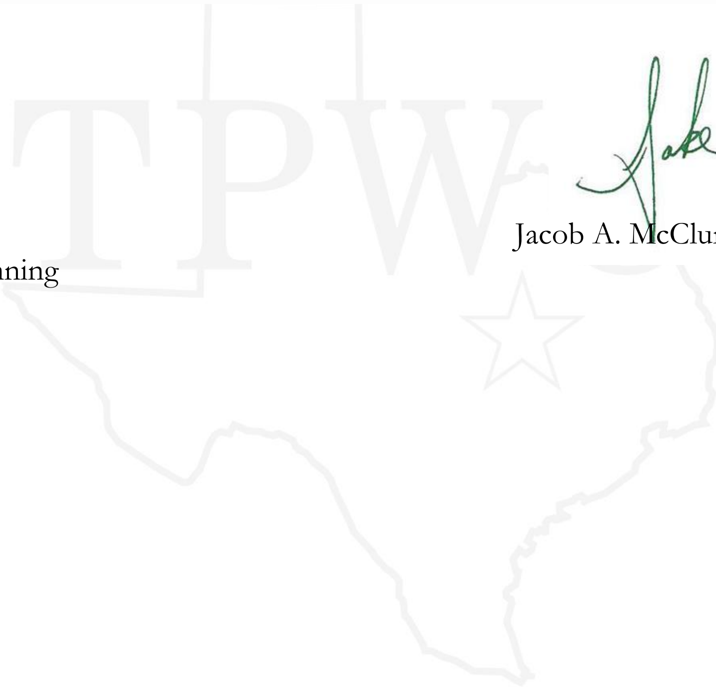
Economic growth requires both a healthy money supply and a reasonable velocity of that money supply. We certainly have plenty of money in the economy, but it is not moving at anything like a reasonable rate. Every indicator suggests that money movement will remain subdued until there is a return of consumer confidence. Consumer confidence is largely driven by the potential for jobs with good pay. Unfortunately, that condition is still down the road somewhere on the other side of the end of this pandemic. The Congressional Budget Office is estimating it will take three years from the end of the infection threat until something like a healthy employment rate returns.

The good news in all of this is that the money is there, waiting to be used. That situation is the exact opposite of the early years of the Great Depression when the Federal Reserve and Congress strove to reduce the money supply, fearing inflation, even as the economy contracted and prices fell. $2.5 trillion extra, sitting on the sidelines waiting to be spent and invested, goes a long way toward explaining the optimism in the stock market. All we need now is for the pandemic to be defeated, consumer confidence to be restored, and the boom may begin.

Until next week we remain your faithful observers, commenters, and investment managers. Stay safe. Stay well. This too shall pass.





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