

In this Q2 recap: the economy measures the impact of the coronavirus threat; the stock market rises with help from a dovish Federal Reserve and a rebound in some economic indicators; oil prices and mortgage rates touch historic lows.

Quarterly Economic Update

A review of Q2 2020, Presented by Chris Buckley

THE QUARTER IN BRIEF

As a new quarter begins, we look back on an eventful second quarter for households and investors – a quarter in which the economy took a mighty hit, while the stock market soared. Complying with stay-at-home orders, Americans abruptly cut back on discretionary spending, traveling, and commuting, resulting in a dire scenario for some industries. Unemployment rose as business revenue declined. Fundamental economic indicators saw big swings, and on one trading day, oil prices actually collapsed into negative territory. Homes became easier to finance; though, transactions declined. The Federal Reserve made proactive moves to try and foster a bit more economic stability. While Main Street quieted, Wall Street rallied, sensing that an economic rebound might be starting. The Standard & Poor's 500 gained 19.95% for the quarter.¹

DOMESTIC ECONOMIC HEALTH

The economy was certainly thrown for a loop this spring. Statistically speaking, some of the numbers were startling. Others were not as bad as some analysts thought they would be.

As workers were laid off, the jobless rate went north. The April employment report from the Bureau of Labor Statistics showed unemployment at 14.7% in March, with 78.3% of this population being furloughed with the potential to return to their jobs. May's report showed a record monthly job gain, as nonfarm payrolls swelled with more than 2.5 million net new hires in April; the jobless rate fell to 13.3%. As the May numbers went public, however, the BLS

admitted it probably undercounted the furloughed in April and that unemployment likely topped 16% in the fourth month of the year. The U-6 unemployment rate, which also counts part-time workers and discouraged job seekers, reached 21.2% in May.²

Many Americans received an economic stimulus from the federal government this spring, an Economic Impact Payment of up to \$1,200, resulting from the passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Will there be another? With the current \$600 monthly boost to unemployment insurance slated to fade away at the end of July, a decision on a second stimulus payment could happen in the third quarter.³

The stay-at-home orders hurt consumer spending and retail sales, but there was also a comeback. Personal spending weakened 12.6% in April, while retail sales slumped 14.7%. May's numbers were different: with help from states relaxing stay-at-home orders, personal spending rose 8.2%, and retail sales advanced 17.7%.⁴

Americans definitely put more of their money in the bank during Q2, or at least, under the mattress. The personal savings rate, already up to 12.7% in March, increased to a record 33.0% in April. It was still at 23.2% in May.⁵

The Conference Board's monthly Consumer Confidence Index stayed under 90 in the first two months of Q2 before staging a June rebound. The gauge came in at 85.7 in April, 85.9 in May, and 98.1 in June. The University of Michigan's Consumer Sentiment Index never cracked 80. It displayed an April reading of 71.8, a May reading of 72.3, and a June mark of 78.1.^{6,7}

Monthly reports from the Institute for Supply Management found that the service sector had contracted sharply at the start of spring along with manufacturing. ISM's Purchasing Managers Index for service businesses came in at 41.8 for April and 45.4 for May; any number under 50 indicates reduction rather than growth. The Institute's factory PMI showed similar numbers: 41.5 in April, 43.1 for May.⁸

Amid all these developments, the Federal Reserve remained proactive. With short-term interest rates back near zero, the central bank used other tools to try to help the economy and send dovish signals to financial markets.

In their June 10 policy statement, Fed officials pledged to increase their purchases of Treasury notes and mortgage-linked securities in the "coming months." During each month of Q2, the Fed bought \$80 billion of the former and \$40 billion of the latter. On June 15, following up on a provision of the CARES Act, the Fed announced that it was ready to build a portfolio of investment-grade corporate bonds, as a nod to big businesses dealing with financial anxieties. The median 2020 forecast of Fed policymakers now projects 9.3% joblessness by the end of the year and gross domestic product (GDP) retreating 6.5% for 2020. Most Fed officials now think short-term interest rates will remain at historic lows into 2022.^{9,10}

Last month, the private-sector National Bureau of Economic Research, a respected arbiter of U.S. economic cycles, stated that America's ten-and-a-half-year economic expansion had ended. By its analysis, a recession had begun in February.³

GLOBAL ECONOMIC HEALTH

During April, the International Monetary Fund forecast the global economy to shrink by 3.0% in 2020. In June, it estimated the economic damage would be worse. The IMF's chief economist, Gita Gopinath, termed the coronavirus pandemic a crisis "unlike anything the world has seen before," one that could send both developed and emerging economies simultaneously into recession for the first time since the 1930s. Gopinath did state that "pent-up consumer demand" for goods and services might hasten a global rebound.¹¹

China's closely watched manufacturing industry contracted slightly in April, but expanded again in May, at least by the measure of the Caixin/Markit Manufacturing Purchasing Managers Index. The private survey showed a factory PMI reading of 49.4 in April, then improvement to 50.7 a month later. China's official factory PMI displayed a 50.8 mark for April, a 50.6 reading for May, and a 50.9 mark for June.^{4,12}

The European Central Bank made a major policy decision on June 4, nearly doubling the amount of its current monthly bond purchases to €1.35 trillion for at least the next 12 months. Seventy-six percent of European economists in a June Reuters poll believed the ECB would make further policy moves this year, and 56% felt that the bank would expand the scope of its bond-buying to an even greater degree. In addition, the European Commission proposed creating a €750 billion recovery fund to help eurozone nations ride through economic challenges.¹³

WORLD MARKETS

The MSCI EAFE Index (a benchmark for developed equity markets in Europe and the Asia-Pacific region) and the MSCI Emerging Markets Index posted double-digit gains in the quarter; although, they were still down year-to-date as June ended. The EAFE rose 14.17% in three months; the Emerging Markets, 17.27%.¹⁴

A quick look across the world reveals many other climbs for stock indices. Three-month gains of 10% or more were common this spring. For example, Russia's RTS soared 26.51%, while Germany's DAX jumped 25.42%. France's CAC 40 rose 12.73%; Spain's IBEX 35, 8.58%. Away from Europe, Australia's All Ordinaries gained 15.54%, and South Korea's Kospi, 22.78%. Japan's Nikkei 225 increased 16.78%; India's Nifty 50, 24.40%. China's Shanghai Composite and

Hong Kong's Hang Seng both saw smaller gains: the former benchmark rose 8.64%; the latter, 5.40%. Argentina's Merval improved 67.54%; Brazil's Bovespa, 30.38%.¹⁵

COMMODITIES MARKETS

April 20 was a historic day in commodities trading. With a May contract expiring and demand for oil suddenly drying up, the price of West Texas Intermediate (WTI) crude oil dropped more than 300% in a single trading session, sliding from \$17.85 down to an all-time low of -\$37.63 at close. Oil quickly rebounded from this aberration. By the end of the quarter, a barrel of WTI crude was worth \$39.70. The commodity gained 32.11% across the three months, ending in June. RBOB gasoline made an even greater advance, gaining 57.37% in the same period. Natural gas was a Q2 loser, with prices slipping 12.67%.^{16,17}

Key precious and semiprecious metals also posted quarterly gains. Silver jumped 23.57%, and gold improved 7.65%. Silver was worth \$18.06 an ounce when the quarter ended; gold, \$1,781.20 an ounce. Copper futures advanced 23.45%; platinum futures, 11.62%. Palladium futures pulled back 11.51%. The U.S. Dollar Index lost 1.04%.¹⁷

Agricultural futures were a mixed bag. Cotton notched a 3-month advance of 11.48%, while coffee retreated 14.63%. Orange juice improved 7.61%, and sugar, 4.81%. Wheat slumped 12.62%; corn, 7.65%. Soybeans fell 1.74%; cocoa, 1.63%. Lumber had one of the quarter's biggest gains, up 32.35%.¹⁷

REAL ESTATE

Mortgages grew cheaper as declining inflation pressure influenced long-term interest rates. The average interest on a 30-year, fixed-rate home loan fell to a historic low of 3.13%, as reported in Freddie Mac's June 18 Primary Mortgage Market Survey. That was where it remained in the last PMMS of the quarter, released on June 25. The average interest rate on the 15-year, fixed-rate mortgage also trended downward, landing at 2.59% in the June 25 PMMS.¹⁸

30-year, and 15-year, fixed-rate mortgages are conventional home loans generally featuring a limit of \$510,400 (\$765,600 in high-cost areas) that meet the lending requirements of Fannie Mae and Freddie Mac, but they are not mortgages guaranteed or insured by any government agency. Private mortgage insurance, or PMI, is required for any conventional loan with less than a 20% down payment.

Stay-at-home orders and COVID-19 fears disrupted existing home sales. The National Association of Realtors announced a 17.8% fall for residential resales in April (following an 8.5%

slip in March). In May, sales fell another 9.7%. The spike in joblessness thinned the number of potential buyers, and analysts wondered if sellers might soon reduce their asking prices. The inventory of existing homes for sale grew, at last, increasing 6.2% between April and May. New home sales were down 5.2% in April, but improved 16.6% in May, according to the Census Bureau.^{4,19}

Homebuilding activity slowed as the quarter began, then picked up. Housing starts dipped 26.4% in April and improved 4.3% in May. In another positive development, building permits for upcoming projects increased by 14.4% in May.²⁰

TIP OF THE QUARTER



There still may be time left to make a 2019 contribution to an Individual Retirement Account (IRA) or Health Savings Account (HSA). The Internal Revenue Service has extended the 2019 contribution deadline for both these accounts to July 15, 2020.

LOOKING BACK, LOOKING FORWARD

The rally that started in late March continued in the second quarter. Traders were encouraged by better-than-expected earnings in certain industries, positive news about potential COVID-19 treatments and vaccines, and the commitment of the Federal Reserve to address turbulence in the economy and the markets.

All three of the big Wall Street benchmarks recorded their best quarters of the century. As you look at the table below, note the difference in their year-to-date performance. The Nasdaq

Composite closed at 10,020.35 on June 10, reaching a new milestone. The Nasdaq ended Q2 at 10,058.77; the S&P, at 3,100.29; the Dow Jones Industrial Average, at 25,812.88.^{1,21}

MARKET INDEX	Y-T-D CHANGE	Q2 CHANGE	Q1 CHANGE
DJIA	-9.55	+17.77	-23.20
NASDAQ	+12.11	+30.63	-14.18
S&P 500	-4.04	+19.95	-20.00

YIELD	6/30 RATE	3 MO AGO	1 YR AGO
10-YR TIPS	0.66	0.70	2.03

Sources: cnbc.com, cnn.com, treasury.gov - 6/30/20

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.
10-year Treasury yield = projected return at maturity given expected inflation.

As this quarter starts, investors are wondering... is the worst of this recession now behind us? A quick answer may prove elusive. The third quarter may bring more signals that Main Street is bouncing back, but it could also bring a reversal of economic momentum if states continue to halt or reverse phases of opening. For the market to climb higher off of its Q2 melt-up, earnings and economic indicators have to keep showing improvement or least stability. The same goes for COVID-19 case counts. If they keep rising this summer, the bulls could easily be held back.

QUOTE OF THE QUARTER



“The best way to predict the future is to invent it.”

ALAN KAY

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