Perspectives

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UnionBank The Private Bank

JUNE 12, 2020

Market Update

Key Highlights and News

- **European politicians and central bankers seem to be getting on the same page for a rapid and aggressive policy response to the coronavirus crisis.** The European Central Bank's decision to boost its Pandemic Emergency Purchase Program by a larger-than-expected €600 billion brings total bond purchases promised by the central bank since the pandemic began to €1.35 trillion. The larger-than-expected €130 billion stimulus package unveiled by Germany and last week's unveiling by the European Commission of a plan to raise €750B for pandemic recovery by selling bonds backed by all 27 EU members were also seen as indications of increasing cooperation. *(New York Times, Bloomberg)*
- **The U.S. economy officially entered into a recession in February, ending the longest economic expansion on record.** The National Bureau of Economic Research said economic activity "reached a clear peak" in February before entering a recession sparked by the coronavirus and pandemic-related shutdowns. The recession marks the end of a 128-month expansion that began in June 2009—the longest since records began in 1854. *(U.S. News & World Report)*
- **Research firm EPFR Global reported that approximately $22.5 billion moved into U.S. bond funds in the week ending June 3 as investors shifted out of risk haven money market funds to riskier but higher yielding investments.** The infusion into U.S. bond mutual funds and ETFs was the most since at least 2007 and was split between investment grade corporate bond funds ($5.5 billion), broadly diversified bond funds ($7.5 billion), and high yield funds ($8.5 billion). *(Financial Times)*
- **OPEC, Russia and allied countries agreed to extend record oil production cuts until the end of July**. The group also demanded countries such as Nigeria and Iraq, which exceeded production quotas in May and June, compensate with extra cuts in July to September. *(Reuters)*
- **The Federal Reserve (Fed) left interest rates unchanged and near zero at Wednesday's meeting.** The Fed projected a slow economic recovery from the recession and, in their first economic projections of 2020, forecasted the unemployment rate to end 2020 at 9.3% and remain elevated for years, coming in at 5.5% in 2022. Gross Domestic Product (GDP) is expected to be 6.5% lower at the end of this year than it was in the final quarter of 2019. *(New York Times)*
- **The Organization for Economic Co-operation and Development (OECD) warned many economies will face a disappointing economic recovery from the historic downturn caused by the pandemic which will leave deeper scars than any peacetime recession in the past 100 years.** While economies are likely to experience a rapid initial bounce back, they will likely fall far short of bringing living standards back to pre-pandemic levels in early 2020 and global GDP may contract by –6.0% in 2020 and –7.6% if a second coronavirus outbreak occurs. *(Financial Times, Bloomberg)*

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What to Keep an Eye On

- **Chinese companies are putting off plans for U.S. exchange listings as tensions rise**. The drop in interest follows proposed U.S. legislation that would make it harder for some Chinese firms to debut in the U.S. and mounting scrutiny over Chinese corporate accounting practices. A senior auditor at one of the big four accounting firms in China said inquiries about U.S. listings have halved this year. Many companies that reported plans for U.S. listings to China's securities regulator are now said to be targeting exchanges closer to home. *(Reuters)*
- **The U.S. economy could take the better part of a decade to fully recover from the coronavirus pandemic and related shutdowns.** The nonpartisan Congressional Budget Office is forecasting a 5.6% real GDP plunge for this year with hardly any rebound in 2021. *(Congressional Budget Office)*
- **The U.S. economy appears to be bottoming out as layoffs are easing, businesses are closing fewer locations and high-frequency tracking data show an increase improvement in areas such as travel and dining out.** But it is likely to take a long time for the economy to recover: when economists declared the Great Recession officially over in June 2009, the unemployment rate did not return to prerecession levels until 2017. *(Washington Post)*
- **U.S. banks expect a significant number of borrowers to get back on normal payment schedules once their forbearance deals expire later this month.** Based on income patterns of those who secured payment holidays and bank conversations with clients who were granted forbearance measures, the disruptions to payment schedules have not been as bad as feared. But temporary government stimulus measures may have played a role in the fact that around 40% of those who were granted forbearance continue to make full payments on their loans. *(Financial Times)*
- **Japan's $2 billion program to help companies shift production home is having limited success.** Iris Ohyama, which makes face masks in China, is so far the only large firm known to be taking advantage of the subsidies. Many other Japanese firms say shifting output back home is simply impractical and uneconomical as they need to be physically present in China because much of what they are making is ultimately for the Chinese consumer and to meet the demands of "just-in-time" production. Major industries such as autos and electronics specifically said repatriation of production is problematic. *(Reuters)*

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Our Perspective: Unemployment Yo-Yo

According to the Department of Labor, more than 44 million Americans have filed for unemployment insurance in the last three months. Weekly jobless claims peaked the week ending March 28 at 6.9 million and have been trending down since then with the most recent report, for the week ending June 6, showing 1.5 million new claims.

June's weekly report follows May's monthly release from the Bureau of Labor Statistics (BLS) which surprised investors and economists by showing a decline in unemployment and total nonfarm employment actually growing by 2.5 million jobs, with 1.8 million of those in service-providing sectors such as leisure/hospitality and construction, far above consensus forecasts which estimated a loss of 7.5 million jobs. It should be kept in mind, however, that the same BLS report shows 18 million service sector jobs have been lost, accounting for the bulk of the 20 million jobs lost over the last three months.[1]

Fed Chair Jerome Powell referred to the May employment report at his press conference following this week's meeting as "the biggest data surprise that anybody can remember. It's a pretty good illustration of just how uncertain these times are."

[1] U.S. Bureau of Labor Statistics

He also referred to the report as "a welcome surprise, we are very pleased, we hope to get many more like it but I think we have to be honest. It's a long road and depending on how you count it, more than 20 million people are displaced in the labor market and it's going to take some time." He went on to say the Fed would continue to deploy the monetary tools at its disposal "for as long as it takes."

The May report also showed a decline in the overall unemployment rate which was welcome news to investors. But here again, an easy answer was difficult to discern. The coronavirus has made the job of calculating employment figures difficult as census takers are hampered by mobility restrictions. These survey takers misclassified about 5 million people as "employed but absent from work," rather than "unemployed on temporary layoff." Including these workers, the unemployment rate jumps from the 13.3% level according to the BLS May report to around 16.4%. While this is an improvement on earlier estimates in the 20% range, it is still the highest unemployment rate since the Great Depression.

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It is welcome news that nearly 2 million service sector workers have gone back to work. Several indicators also suggest a bottoming of the labor market and overall economy. These include purchasing manager indices for the manufacturing and services sectors along with data showing increasing mobility trends.

But while the worst of the recession may be behind us, a key question and debate that remains is the speed and shape of the recovery after what Powell characterized as "the biggest economic shock in the U.S. and the world, really, in living memory" that saw the lowest level of unemployment in 50 years swing to the highest level of unemployment in nearly 90 years over the space of two months. The equity market appears to be pricing in a V-shaped economic recovery which we think is overly optimistic. Any recovery will be a process, uneven and sporadic, with setbacks along the way as the economy heals over time.

Upcoming Market Updates

To hear our latest market insights, be sure to register for our new client Webex that will be held this Wednesday, June 17 at 9:00 a.m. PT. This Webex replaces our prior client calls so please note that the dial-in number you may have saved will no longer work.

We hope that you have enjoyed these weekly Market Updates, which were generated due to COVID-related market volatility. After this week, we will be moving to a monthly Market Update on the third Wednesday of each month to coincide with our client Webex calls.

To hear our latest insights on market developments, please join us on the third Wednesday of the month at 9:00 a.m. PT. Dial in: 866-504-7651.

MUB2125 (6/12/20)