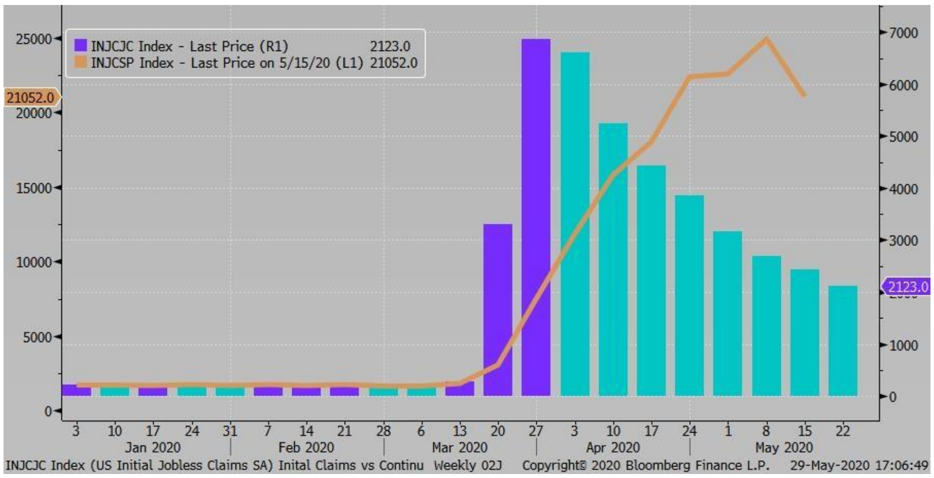
Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

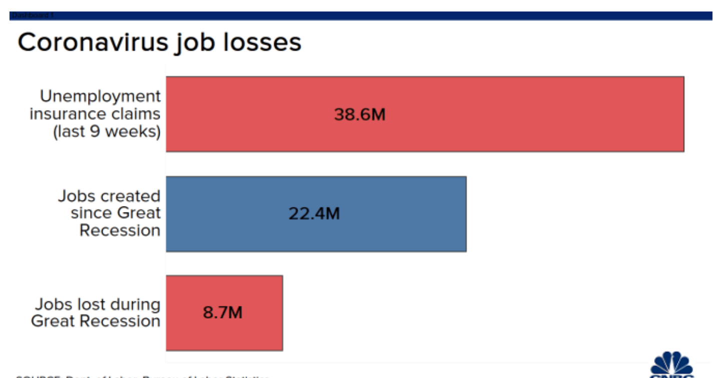
Client Update – Green shoots and China Back on the Table (05/31/2020)

Latest Developments and Economics

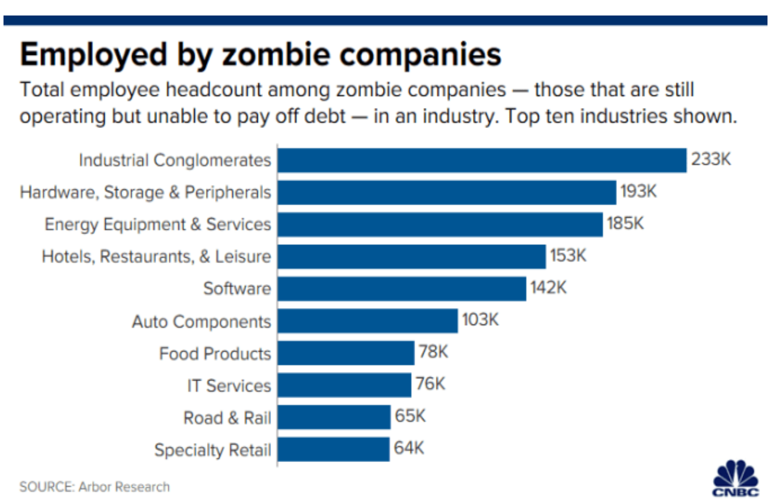
In a week where Covid-19 deaths surpassed 100,000 in the United States there was plenty of offsetting positive news. Moreover, a big news item from 2019 comes back into the picture. The first good news item was that all 50 states are in some form of reopening, but the variation is extreme. Some states are wholly open while others are regionally open, and Texas talked about allowing outdoor sports with spectators while New Jersey is technically still in a 'stay at home' order, even though some business have been allowed to open. This will make for a geographically diverse economic recovery to start.



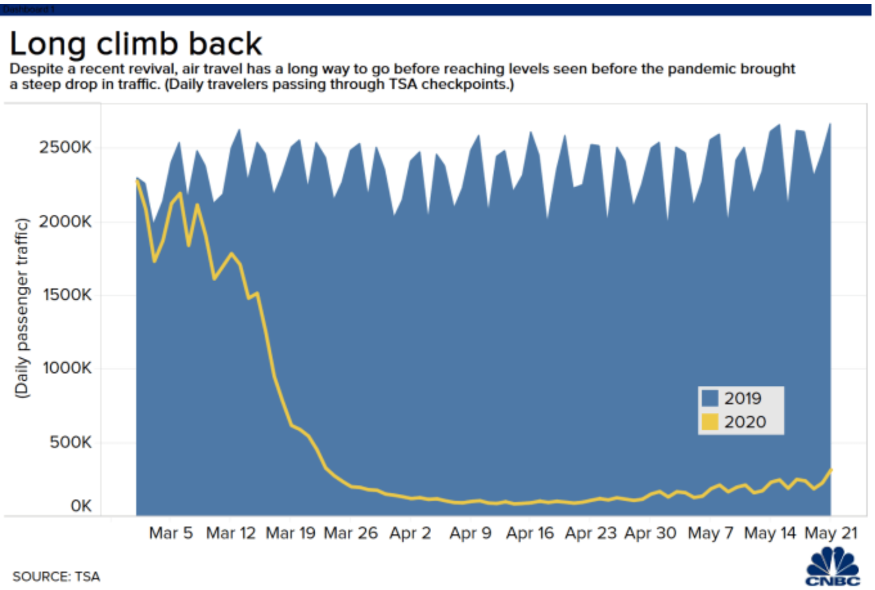
We have two positive interpretations from the latest unemployment data. First, the pace of initial unemployment claims, while still historically unprecedented, continues to fall. The chart to the left shows that weekly initial unemployment claims (bars) fell this week to 2.123 million following 2.446 million last week. This brings the 2020 total initial claims (since March 20) to almost 41 million American workers out of work for at least some time. The second positive note was that the continuing claims data (line) are also falling. The current 21 million people (down from 25 million) will still result in historic unemployment but may suggest that employees are starting to be called back to work.



The reopening brings another thought to mind, borrowing a phrase from Field of Dreams – if you open will they come? Just because the businesses may open does not necessarily mean that the customers will follow in a meaningful way. This can result in another dimension of the pace of recovery - industry diversity. There may be a few reasons that people may not immediately participate in consumption. First, the consumer, which is responsible for almost 70% of U.S. GDP, needs to have money to spend. High unemployment does not enable consumer spending. Even when the economy starts back up there are many workers in industries where the company still operates but is highly leveraged and may have issues as a going concern. This is one reason why, even as initial unemployment claims continue to drop, it may take a while for the American economy to absorb all the currently unemployed once shutdowns end. There is a possibility that unemployment remains elevated for some time after the crisis has passed.



In fact, data released this week shows that consumer spending dropped 13.2% month to month in April – which puts it nearly 20% lower than February. This lower spending comes in the face of an increase in personal income of 10.5%, primarily due to the CARES recovery checks distributed in the month. So, if consumers did not spend the money what did they do with it? The personal savings rate jumped to 33% of income, almost double the previous record. The income and savings rates are expected to fall back to normal levels shortly unless another direct payment is passed into law. Recently Treasury Secretary Steven Mnuchin and Fed Chairman Jerome Powell testified (virtually) to Congress. Both struck a positive tone for the future (you can see Chairman Powell on 60 Minutes on 5/17) but differed on current needs. Chairman Powell felt strongly that the economy needs additional help from Congress while Mnuchin wants to wait to give the strong response a chance to work its way through the economy.

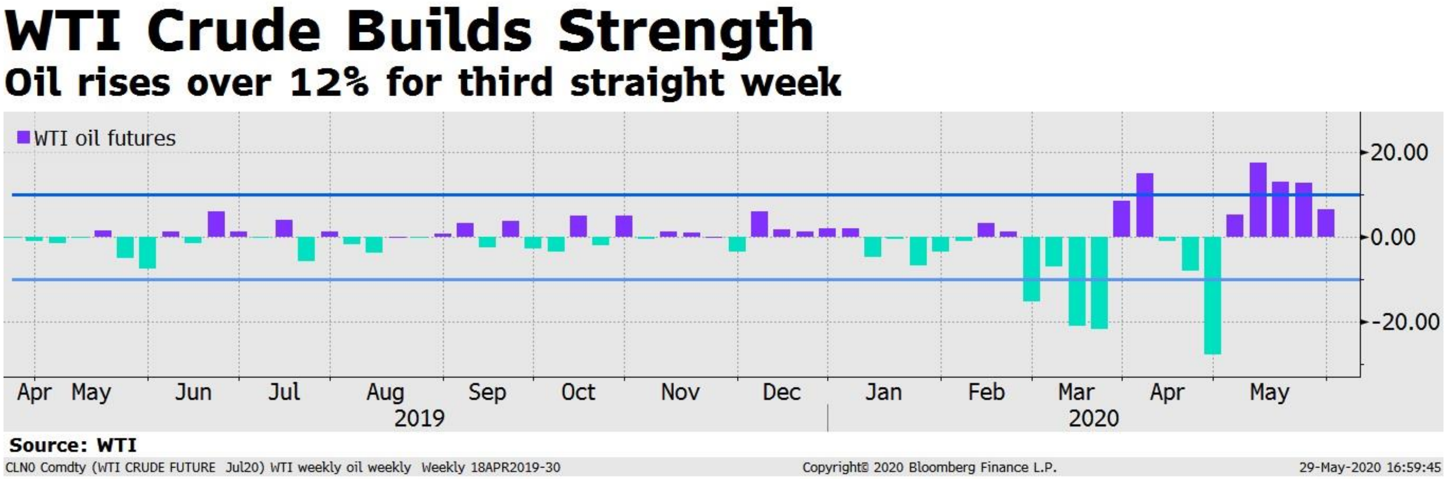


The second reason for lower spending is no opportunity to spend. With very little retail open, except for online, it was harder to make purchases even if you wanted to do so.

Finally, even when the economy opens fully will people feel comfortable? Consumer behavior and attitude may result in industry diversity in recovery. How quickly will people be willing to patronize restaurants, theaters, sporting events, hotels or airlines? The chart on the left shows the passenger traffic through TSA checkpoints in 2020 vs. 2019. It is about a 90% drop in April but, you can see that May starts to show an uptick in volume. Another industry that bears watching is retail. We have seen venerable names such as J. C. Penney, Pier 1 and J. Crew all file for bankruptcy recently with several others reporting significant financial difficulties.

As you can see on the chart at the right most of the retail firms and activities mentioned above make up a significant portion of mall space in the United States. J.C. Penney, for example takes up about 6.0% of the square footage of an average mall and is present in about 48% of the malls across the country. Retail was already struggling long before the appearance of the virus and closing for months made the situation even worse. The pervasive thought on the consumer is that they will not be ready to fully engage in the economy as they did before until a proven vaccine is ready, available and distributed.

The other positive note recently comes from the energy markets. You may recall earlier this year that West Texas Intermediate (WTI) was priced negative in near term futures contracts. Even after that temporary condition oil was priced at historic lows. On April 21 WTI was priced at $10.01 per barrel. The recovery in the oil markets has been significant and WTI closed at $35.29 to end the month of May. As you can see in the chart below oil has risen more than 12% for the last three weeks – some of this due to a slight increase in demand.

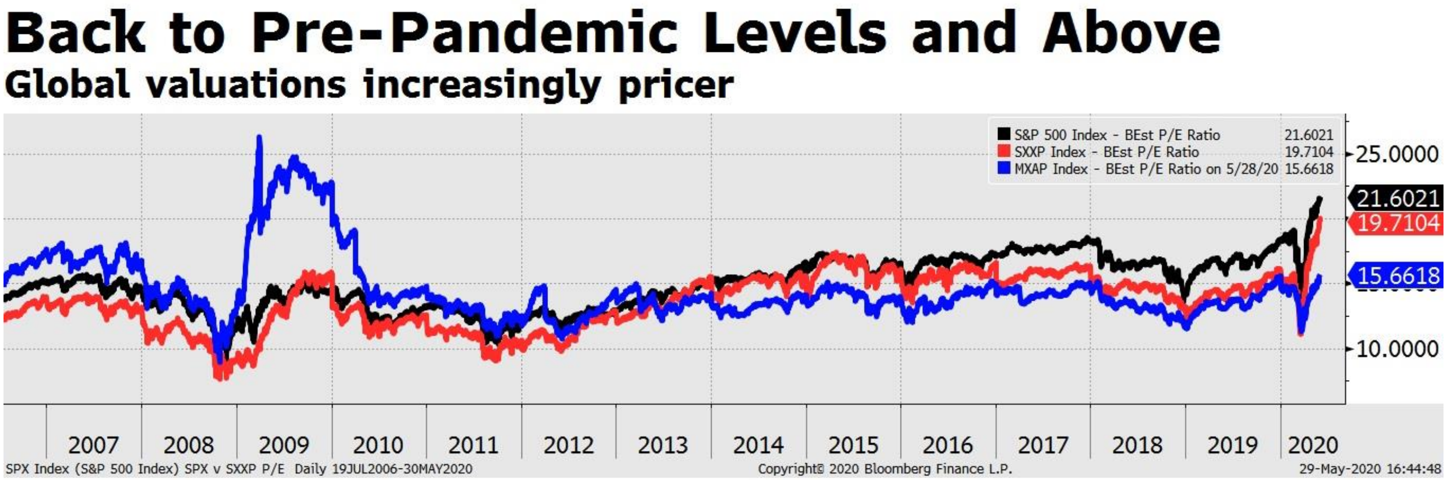


The last issue to keep an eye on is the developments in the relationship between the United States and China. In 2019 the trade war between the two countries was a key issue driving economies and financial markets. When the two countries passed a Phase 1 trade deal it signaled an easing of tensions and progress on the economic front. Several developments lately have turned that relationship sour. First, the current administration in the U.S. is upset about how the Covid-19, which originated in China, was handled by the Chinese government. The feeling was that the Chinese were not forthcoming and could have done more to prevent it from turning into a worldwide pandemic. In addition, the social unrest in Hong Kong prompted the Chinese government to pass laws which will rein in Hong Kong and subject its citizens to extradition to mainland China for prosecution. This law, which was condemned by several nations including U.S., Canada and Australia claims that it violates the international commitments and the “One Country/Two Systems” policy that were to be in place for 50 years after the U.K. turned Hong Kong over to China in 1997. In the financial markets Chinese companies listing on U.S. exchanges have come under fire for Accounting improprieties. The Chinese company, Luckin Coffee (LK), is similar to Starbucks and was accused of falsifying sales and not following proper accounting standards. Congress was debating a law requiring transparency for companies listing on U.S. exchanges or face delisting – removing access to American capital for Chinese companies. The issues with Huawei continue as well, with a Canadian judge finding that the U.S. had legal grounds for the extradition of Huawei’s CEO to the U.S. Finally, Congress passed legislation sanctioning China for oppression of Uighur Muslims in the western part of the country. China allegedly tortured and detained over one million people and are accused of gross human rights violations. All of this resulted in the President holding a press conference on 5/29 to discuss the situation with China. The present revoked Hong Kong’s preferential trade status (which could subject them to the same tariffs as mainland China), reiterated the financial regulatory examination of Chinese firms listed on U.S. exchanges and will deny U.S. entry to Chinese nationals believed to be a security threat. The markets were relieved that the response did not include additional tariffs nor a withdrawal from the Phase 1 trade agreement recently passed.

Financial Markets

The financial markets continue their remarkable recovery since March. After the fastest bear market in history the S&P 500 followed up with the fastest recovery in history. In May the S&P 500 turned in a 4.76% price gain, which was on top of the 12.7% gain in April. As of May 31, the 2020 YTD total return has improved to about -5.00%. In May the Information Technology sector (1.81%) far outpaced the runner up Communication Services (0.65%) but all sectors were positive for the month. Energy was still the laggard but even it earned a positive return for the month (0.06%). This has caused many financial leaders in the U.S. to caution that the market may be overly optimistic. Larry Fink, CEO of Blackrock (one of the world’s largest ETF providers) said this week that “The market is assuming that we’re not going to see a severe second wave or third wave” of Covid-19 and “I do believe jobs are going to be slower coming back than other people believe.” This was followed by Jamie Dimon, CEO of J.P. Morgan to be concerned that the Fed can’t prop up the market indefinitely and Citigroup Inc. CEO Michael Corbat also cautioned that there is still uncertainty regarding the virus.

The U.S. isn't the only equity market that have rapidly recovered. The quick rebound has also led some to believe that the equity markets are getting a bit expensive. The chart below shows the P/E ratio of the S&P 500 at 21.6, the Stoxx 600 (Europe) at 19.7 and the MSCI Asia Pacific All Country at 15.66. The chart clearly shows each at or above their recent highs. This support may be due in part to the massive stimulus in the U.S. but the European Union also announced the first EU-wide stimulus of $825 billion that would include agreement of sharing among the 27 sovereign nations in the coalition and Japan added another $300 billion to support its economy.



Should you have any questions please contact us.

Buffalo Office

1114 Delaware Ave.

Buffalo, New York 14209

PHONE: 716-883-9595

Jamestown Office

214 West Fifth Street

Jamestown, New York 14701

PHONE: 716-484-2402