WEEKLY
Economic Commentary

August 21, 2020

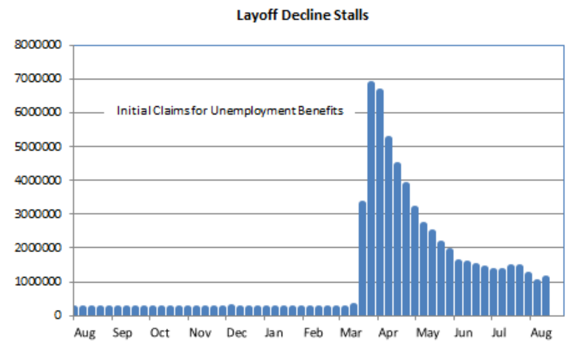
Millennium
CORPORATE CREDIT UNION

Following two months of mostly upside surprises, recent economic data are coming down to earth. For sure, none suggest that the recovery has hit a wall. The economy remains on a positive trajectory and broad measures for the current quarter will show that it staged an impressive growth rate for the period. Indeed, taking stock of events over the past month, there were still more hits than misses. Retail sales and home construction, for example, are back to pre-pandemic levels, the job market is still growing payrolls and factories are turning out more product. Likewise, the stock market recovered all of its precipitous February/March losses and then some, with the S&P 500 hitting new highs this week.

But for a broad swath of the population, the recovery from the pandemic-induced recession is hardly complete. And with Congress at loggerheads over whether or how much of the now-expired fiscal stimulus provided under the CARES act should be replaced, households and businesses are getting more concerned. The enhanced unemployment benefits and the PPP program were vital catalysts that launched the recovery, but the prospect of a watered down or, worse, no replacement coming forth poses a major threat to its survival. President Trump's attempt to bypass Congress by providing $300 in enhanced unemployment benefits by using FEMA funds is a drop in the bucket, as only a handful of states are taking advantage of the program and the funds will run out in about a month.

Assuming, as we do, that Congress will cobble together a stimulus package sometime in September, the downside risks to the economy should be mitigated, although by how much will depend on the size and scope of the package. It's doubtful that it will match the $3 trillion provided under the CARES act, but both parties seem to agree that the PPP program needs to be extended and some form of supplement to unemployment benefits is necessary. Still, the delay is coming at a time when signs of faltering activity are proliferating. Regional surveys of manufacturing activity indicate that the three-month rebound in industrial production from April's collapse is running out of steam, as the New York and Philadelphia indexes of manufacturing activity slipped in August.

Importantly, even as Congress deliberates over how much unemployment assistance is necessary, the ranks of the unemployed are starting to grow more rapidly. In the week ending August 15, new claims for state jobless benefits rose above 1 million again after slipping to 971 thousand the previous week. The increase to 1.1 million reverses two weeks of declines and suggests that businesses are pulling back on rehiring in the face of slowing activity, heightened uncertainty over future prospects, the intractable spread of virus cases and the expiration of the PPP program. For sure, the weekly uptick may be nothing more than noise, and the downtrend from the near 7 million level of initial claims seen in late March will resume in coming weeks. But in the latest Census Bureau Pulse Survey, fully 87 percent of small businesses said that their rehiring plans are being negatively impacted by the ongoing health crisis.



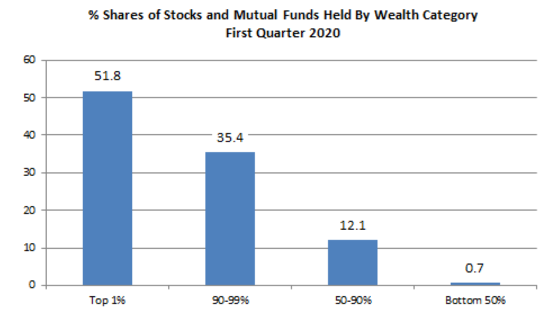
As we noted last week, it looks increasingly likely that the economy is hitting an air pocket in August, as the stimulus funds from the CARES act has mostly been spent, the spread of virus cases is prompting states to slow, or even reverse, the lifting of lock-down restrictions and a sizeable fraction of rehired workers are being laid off a second time. We suspect that when Congress reconvenes in September, the urgency to come up with a relief package will be more obvious than it was when legislators left town two weeks ago. At that time, the bulk of incoming data was far more robust than is the case now, with jobs growth coming in stronger than expected in

July, production rebounding and consumer spending being propelled higher by the stimulus checks and enhanced unemployment benefits.

Interestingly, the signs of sputtering activity on Main Street are clearly not being echoed on Wall Street. Stock prices, as noted earlier, have raced to new record highs, recouping all the market's confidence-shattering losses caused by the initial phase of the pandemic in February and March. Investors are drawing renewed confidence from the Federal Reserve's strong commitment to do whatever it takes to get the economy moving again and a conviction that more fiscal relief will be forthcoming to sustain the recovery. But it is important to remember that the stock market is not the economy, and the rally over the past five months is being driven by a handful of technology companies that have been gifted a huge competitive advantage by the pandemic. Indeed, 56 percent of the companies in the S&P 500 have seen their stock prices fall so far this year, with a sizeable fraction of those suffering a drop of 20 percent from their highs.

What's more, those hoping the breakneck rally in the stock market will stoke a meaningful wealth effect that spurs consumer spending will likely be disappointed. For one, fully 87 percent of all stocks and mutual funds are held by the top 10 percent of wealthiest investors. The bottom 50 percent hold less than 1 percent. Hence, the wealth boost will benefit only a sliver of the population, not the vast majority of shoppers whose purchasing power is derived mainly from their paychecks or government payments, both of which have a tenuous future. For another, the market rally is not likely to boost the spending propensity of the wealthiest shareholders, who already have the wherewithal to buy whatever they want. If anything, these consumers have seen their favorite discretionary purchases come under severe restraints, as access to the theater, museums and other services that attract wealthier households are still subject to state lockdown restrictions.

Indeed, the disconnect between Main Street and Wall Street is adding new intrigue to the debate over what type of recovery the economy is likely to follow. Until recently, the debate focused on three

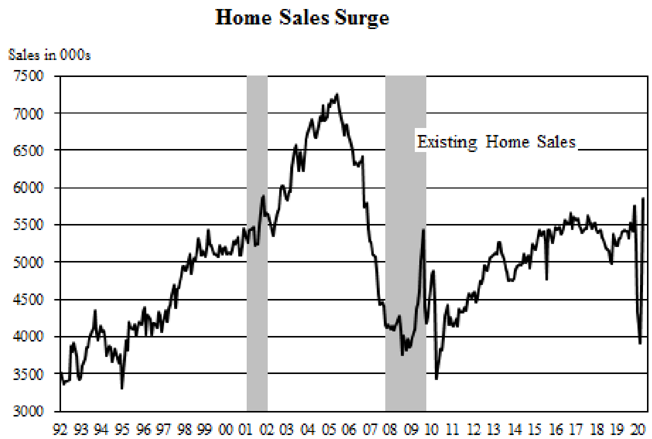


responses - a V, signaling a vigorous snapback; a U, describing a slow delayed upturn; and the so-called Nike Swoosh, depicting a painfully lackluster recovery. The new entrance to this recovery lexicon is the letter K, which portrays a bifurcated recovery between the haves and the have-nots. The upward sloping leg of the letter represents the haves, which includes the wealthy investors as well as higher-paid workers that are able to retain a job and work remotely. The downward sloping leg consists of 30 million laid off workers and the mostly lower-paid segment of the workforce whose services are performed onsite and are more at risk of infection.

It remains to be seen which recovery tracker will most accurately reflect the economy's path in coming months. One sector that is clearly withstanding the headwinds from Covid-19 is the housing market. Both construction and sales are blowing past expectations and mirroring the stock market's rise to pre-pandemic levels. The volume of building activity is not quite there yet, but the 22.6 percent surge in housing starts in July was among the strongest monthly increases on record and lifted total starts to just under February's level of 1.567 million units, settling at 1.496 million. Building permits, however, blew past the February pace, jumping nearly 19 percent to 1.495 million units, the highest since January.

Importantly, builder confidence has never been higher, as the National Association of Homebuilders reported that its index of homebuilder confidence shot up to its record high set in December 1998. This euphoria among homebuilders is understandable.

The demand for homes is skyrocketing and homes put up for sale are flying off the market. Sales of pre-existing homes surged by nearly 25 percent in July, reaching 5.86 million, a pace not seen since December 2006 when the nation's greatest housing bubble was nearing its final phase. Unlike then, when there were 345 thousand homes on the market to choose from, the inventory now is considerably slimmer, with only 150 thousand up for sale, the lowest for that month on record. That scarcity of supply relative to demand is driving up home prices, as the median price of an existing home sold reached a record $304 thousand last month, up 8.4 percent from a year ago.



The good news is that the rapid climb in prices is boosting housing equity for millions of homeowners, delivering a wealth-inflating asset for many that are missing out on the stock market rally. The bad news is that the increase in prices is far exceeding wage growth and, hence could be pushing many prospective buyers out of the market. The offset to higher prices, of course, is the still-historically low mortgage interest rates despite a modest uptick in recent weeks. Still, this may be one sector that is benefiting from the coronavirus, as there is a groundswell of second-home demand from buyers striving to flee virus hotspots. What's more, with remote working becoming a more deeply entrenched trend, people are looking to trade up into larger homes.

But even a thriving housing market, which has a relatively small influence on overall economic activity, would not be enough to sustain the recovery, much less impart renewed momentum to a flagging growth rate. The economy is entering the second stage of recovery, as the initial burst of activity has run its course. Meanwhile, the health crisis is still very much a potent headwind, and it's doubtful the economy can navigate the rough waters without additional help from the government. The next month or so may determine which of the alphabet soup of recovery trackers noted earlier will describe the path ahead.

KEY FINANCIAL & ECONOMIC INDICATORS

FINANCIAL INDICATORS

INTEREST RATES	August 21	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.09%	0.10%	0.11%	1.96%
6-month Treasury bill	0.12	0.12	0.13	1.86
3-month LIBOR	0.26	0.28	0.25	2.13
2-year Treasury note	0.17	0.15	0.15	1.54
5-year Treasury note	0.26	0.30	0.27	1.42
10-year Treasury note	0.64	0.71	0.59	1.54
30-year Treasury bond	1.34	1.44	1.23	2.02
30-year fixed mortgage rate	2.99	2.96	3.01	3.55
15-year fixed mortgage rate	2.54	2.46	2.54	3.03
5/1-year adjustable rate	2.91	2.90	3.09	3.32
STOCK MARKET				
Dow Jones Industrial Average	27930.39	27931.02	26469.89	25628.90
S&P 500	3397.16	3372.85	3215.63	2847.11
NASDAQ	11311.80	11019.30	10363.18	7751.77
Commodities				
Gold ($ per troy ounce)	1945.20	1954.00	1899.80	1535.60
Oil ($ per barrel) - Crude Futures (WTI)	42.27	42.18	41.27	53.88

ECONOMIC INDICATORS

	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Quarters Ago	Average-Past 6 Months or Quarters
Housing Starts (July) - 000s	1496	1220	1038	1254
Building Permits (July) - 000s	1495	1258	1216	1304
Existing Home Sales (July) - 000s	5860	4700	3910	4971

Millennium Corporate Credit Union
8615 West Frazier Street
Wichita, Kansas 67212