July 24, 2020

7/24/2020		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	26,469.89	-202.06	-0.76	2.46	-7.25	-3.22
S&P 500	3,215.63	-9.10	-0.28	1.88	-0.47	6.99
NASDAQ	10,363.18	-140.01	-1.33	0.83	15.50	25.59
S&P MidCap 400	1,849.94	13.39	0.73	1.93	-10.33	-5.43

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.14	Euro/Dollar	1.16	1.77
5-Year	0.27	Dollar/Yen	105.86	-1.20
10-Year	0.58	GBP/Dollar	1.28	2.02
30-Year	1.23	Dollar/Cad	1.34	-1.32

Source: Bloomberg/FactSet

What Caught Our Eye This Week

Representatives from five pharmaceutical companies told a Congressional subcommittee earlier this week that they are confident one or more of their vaccines will work. Each also warned of challenges ahead. As expected, the subcommittee members are focused on safety, manufacturing capabilities, and pricing. With less than 4 months until the election, many are also focused on drug pricing. According to a recent study published in the Journal of the American Medical Association (JAMA), the drug industry earned an average annual profit margin of 13.8% from 2000-2018, almost twice that of 237 large non-pharmaceutical industries. Some progress on lowering drug prices was being made before the coronavirus outbreak. The House of Representatives passed H.R. 3, the Elijah E. Cummings Lower Drug Costs Now Act in December 2019 but the Senate has yet to act on it. Today, President Trump will likely issue a series of executive orders aimed at lowering drug prices. Expectations are for the orders to utilize the international pricing index (amounts charged based on prices for the drug in markets outside the U.S.), to include a plan for Americans to buy lower-cost prescription medication imported from Canada, and to shift drug manufacturing back to the U.S. While the anticipated executive orders may generate negative headlines for the pharmaceutical industry, analysts expect the overall impact to be limited.

Economy

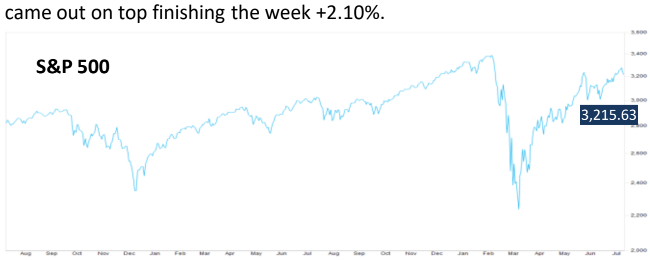
It was an uneventful week for economic data, and the main focus was on existing home sales, which were released on Wednesday. Following three consecutive months of declines, existing home sales surged 20.7% to 4.72 million units at an annual rate in June. This was the biggest increase on record going back to 1968. Over the past twelve months these sales have declined by 11.3%. The median price of an existing home is now at $295,300, which is a year-over-year increase of 3.5%. The most impressive statistic of the existing home sales data was 62% of homes sold were on the market for less than a month. On Thursday, weekly jobless claims ticked up for the first time since March increasing by 109,000 to 1.4 million during the week ending July 18th. The number of people receiving benefits decreased by 1.1 million to 16.2 million for the week ended July 11th. Finally on Friday new homes sales easily beat expectations surging 13.8% to 776,000 units at an annual rate in June. This figure was slightly above January's level (774,000) and new home sales are now up 6.9% year-over-year. The median price of a new home sold is now at $329,000 an increase of 5.6% over the past 12 months.

Fixed Income/Credit Market

Since the start of the third quarter, the 10-year U.S. Treasury has traded in a narrow range of approximately 10 basis points (bps) following 2Q's range of 32.5 bps. The tight range for the 10-year tenor is not surprising given that interest rate volatility has dropped precipitously since the MOVE Index hit a record high of 163.7 on March 9th. The MOVE Index (Merrill Lynch Option Volatility Estimate) which is a yield curve weighted index of volatility on 1-month Treasury options hit a one-year low of 42.5 on Friday, well below the one-year average of 70.3. Week-over-week, yields across the U.S. Treasury curve decreased as much as 10.2 bps at the 30-year tenor. The benchmark 10-year Note dropped 4.4 bps and closed Friday at roughly 0.58%. With the Fed's zero interest rate policy (ZIRP) expected to continue into the foreseeable future, the markets are indicating the U.S. Treasury curve will remain rangebound. Bloomberg's forward curve matrix forecasts the 10-year to increase just 16 bps over a one-year horizon.

Equities

All three major indices closed down for the week as losses on Thursday and Friday erased the gains set earlier in the week. Fear of a resurging coronavirus, U.S.-China trade relations deteriorating, weakness in the tech space as well as concerns over a stalling economic recovery and worry that the market is overvalued served as headwinds to investor sentiment and ultimately led to the two-day selloff. Thursday's news that the release of the GOP's new stimulus bill had been pushed back to Monday also weighed on market performance. Republicans have come to a consensus on a package totaling ~$1T, a significant divergence, however, from the $3T sought by Democrats. As of Friday, of the 26% of the S&P 500 companies that have reported earnings, 81% have beaten consensus earnings expectations. In aggregate, the reported earnings are 11.4% above expectations, while sales are 3.0% above expectations. Despite the relatively solid numbers, the lack of fiscal year guidance due to uncertainties over the coronavirus has left investors uneasy. For the week, the S&P finished -0.28%, value outperformed growth +0.16% to -0.71%, and information technology was the week's laggard, down 1.54%. Energy came out on top finishing the week +2.10%.



Our View

The U.S. fiscal response to the Covid-19 pandemic was expansive and impactful during a time of enormous human suffering and uncertainty. The main component of the domestic fiscal response is the CARES Act, which was passed on March 27th with overwhelming support by Congress and amounted to approximately $2.2 trillion. Unfortunately, some provisions of the CARES Act are set to expire soon and without an additional fiscal package, the nascent economic recovery will be in jeopardy. One of the more effective but controversial provisions of the CARES Act is the additional $600 per week unemployment benefit, which layers onto existing state unemployment benefits and will expire at the end of the month. Moreover, the additional $600 per week equates to approximately $65 billion in monthly income and studies have shown that a vast majority of this additional income is spent. Furthermore, overall retail sales in June showed that spending was down just 60 basis points compared to the pre-pandemic level. On the other hand, it has been noted that the additional unemployment benefit is so generous that some individuals are making more money unemployed than they did while working. The obvious solution is to continue the additional unemployment benefit but at a somewhat reduced level to create an incentive for all individuals to reenter the workforce. Another area where additional federal funding is needed is at the state and local government levels. The CARES Act did make $150 billion available to state and local governments but only for the specific purpose of fighting Covid-19 and not for general budgetary purposes. Due to the massive sales and income tax short falls caused by the lockdowns, state and local governments have eliminated roughly 1.5 million workers in three months, which far exceeds the state and municipal job losses experienced after the financial crisis. The near-term economic outlook will dim without additional fiscal stimulus. Right now, Congress is not in agreement on what the next fiscal stimulus package will look like, but it is our belief that given what is at stake, a resolution to partially alleviate a portion of the suffering due to Covid-19 will be found.

COMING UP NEXT WEEK		Consensus	Prior
07/27 Durable Orders SA M/M (Preliminary)	(Jun)	6.5%	15.7%
07/28 Consumer Confidence	(Jul)	95.0	98.1
07/30 GDP SAAR Q/Q (First Preliminary)	(Q2)	-34.5%	-5.0%
07/31 Personal Consumption Expenditure SA	(Jun)	-1.0%	-4.2%
07/31 Michigan Sentiment NSA (Final)	(Jul)	73.3	73.2

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