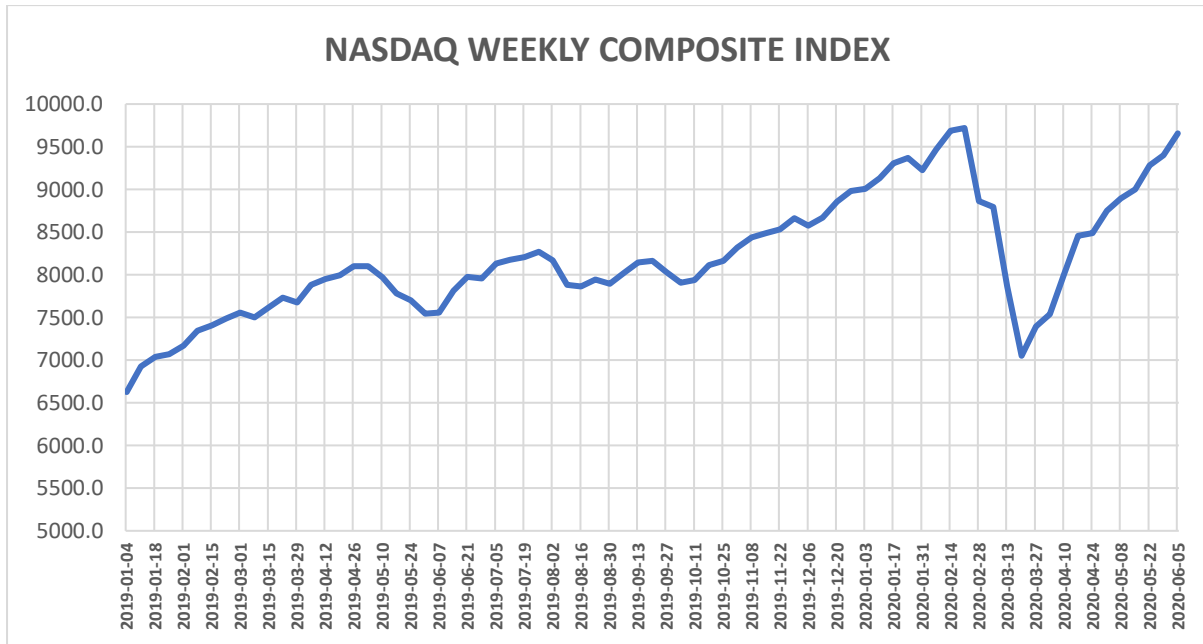


## AS FOR THE MARKETS, COVID-19 NEVER HAPPENED

As far as the Stock Markets go, the pandemic never happened. As Graph 1 below shows, the Nasdaq has reversed its fall and is now trading at the FED induced peak around the middle of February.

Graph 1.



(Source: FRED Table NASDAQCOM)

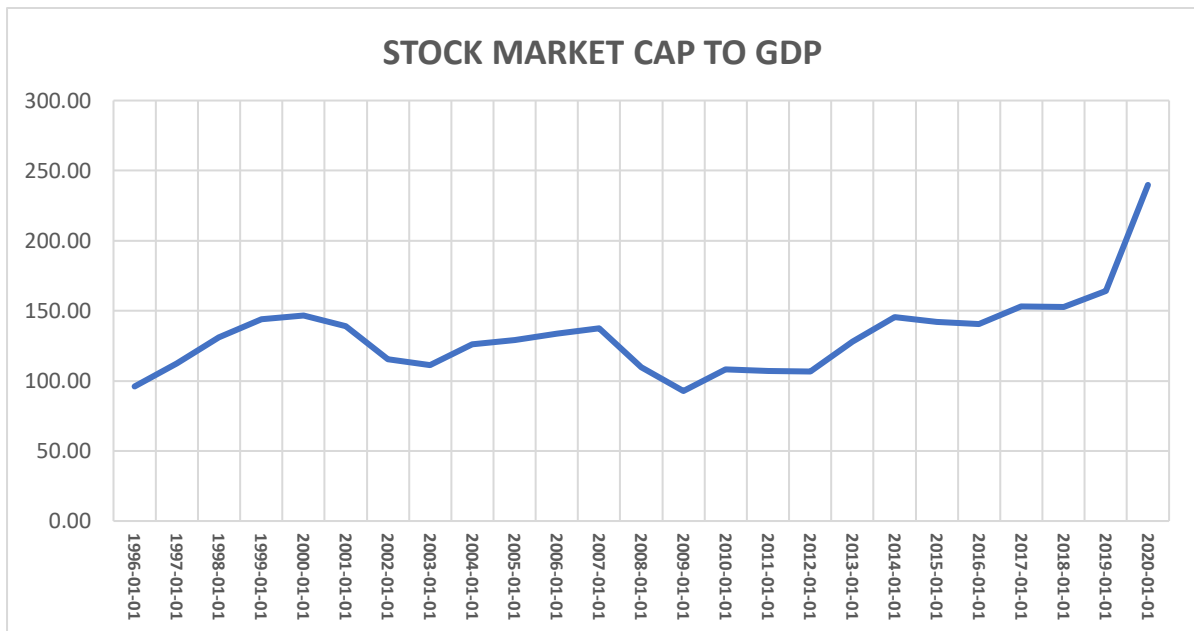
The markets remind me of the old-style audiences found on live TV shows. In front of them was a man (generally) holding up placards which read either, CLAP, SHOUT, or BOO. Whenever they were told, the audience erupted with either clapping, shouting or booing. So too with the markets. This Friday after the payroll data was announced, the placard read BUY, which they did, causing the markets to rise by between 2 and 3%. Even Thump was converted back into a smiling Trump, declaring happy days were back, even when viewed from heaven.

Let us be clear. We are in the biggest bubble in history. Investors underestimated the fall in March, now they are overestimating the recovery. Therefore, they are vulnerable to bad news. And there is a lot of bad news to come. When that happens, the placard raised will read FIRE, and investors will trample each other heading for the exits. The bursting of the bubble will leave a financial crater so deep capitalism cannot avoid toppling into it, necessitating a socialist revolution if society is to recover and escape all that has become scorched. The FED, in securing the fortunes of present-day capitalism, has cost it its future.

In case you think I am exaggerating consider Graph 2. "Shock and awe." This graph has been prepared by taking the stock market cap index at close of business on Friday, and comparing it to current GDP expectations of a 30% fall for this quarter. The ratio soars to nearly 250% of GDP from an already elevated 150%. (Sources: Fred Table DDDM01USA156NWDB for ratios up to 2017. BEA table 1.1.3 for GDP to Q1. Fred Table SPASTT01USM661N for current market cap index.) If we add in the market cap of bonds and non-residential property the ratio zooms to over 400% of GDP. A mere 20% correction would wipe out the equivalent of GDP from January to October.

Given the 12% projected fall for Q3 GDP (N.Y. FED), this is not a one quarter phenomenon. It is likely that unless the bubble bursts, the ratio's new normal will be above 200% for the foreseeable future.

Graph 2.

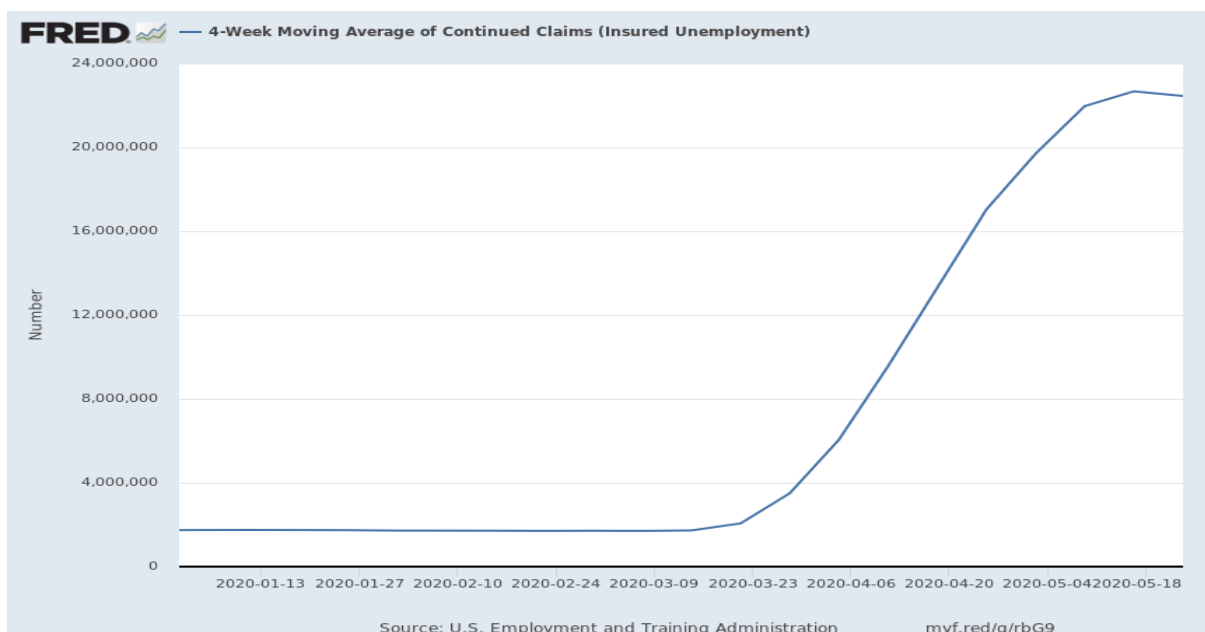


### Examining the payroll data.

As I have said previously, the current economic data is not trustworthy due to the unfamiliar business terrain created by the pandemic. This is certainly true for the payroll data. Despite the ADP survey of private business payrolls which was released on Wednesday showing a fall of 2.76 million (compared to an expected 8.66 million fall); by Friday the Bureau of Labour Statistics announced a rise of 2.5 million in payrolls, against estimates suggesting a fall anywhere between 3.5 million and 11 million.

The first problem we encounter with this positive figure is that unemployment claims are not falling. The best way to examine these is to use the four-week moving average found in Graph 3. In May they averaged 7 million more than in the second half of April.

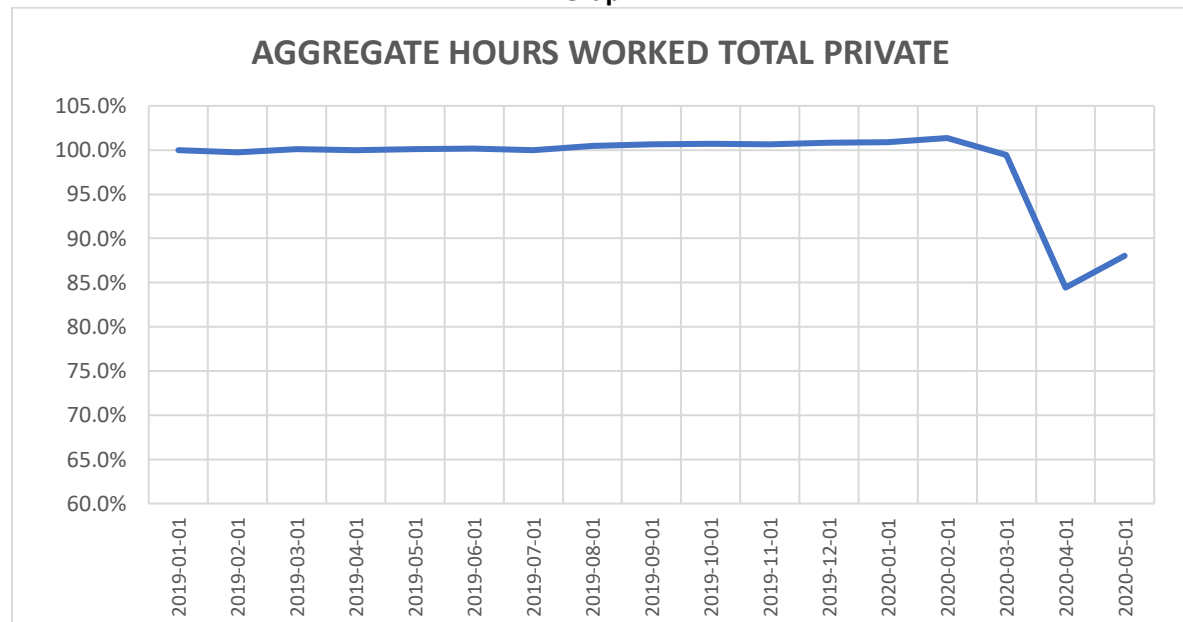
Graph 3.



The four-week moving average is the best indicator of ongoing claims in so far as it evens out the weekly variations. It seems paradoxical that unemployment claims rose in May while the number of workers being employed rose at an even faster pace. Seems more workers are being allowed through the front door compared to workers being shown the back door.

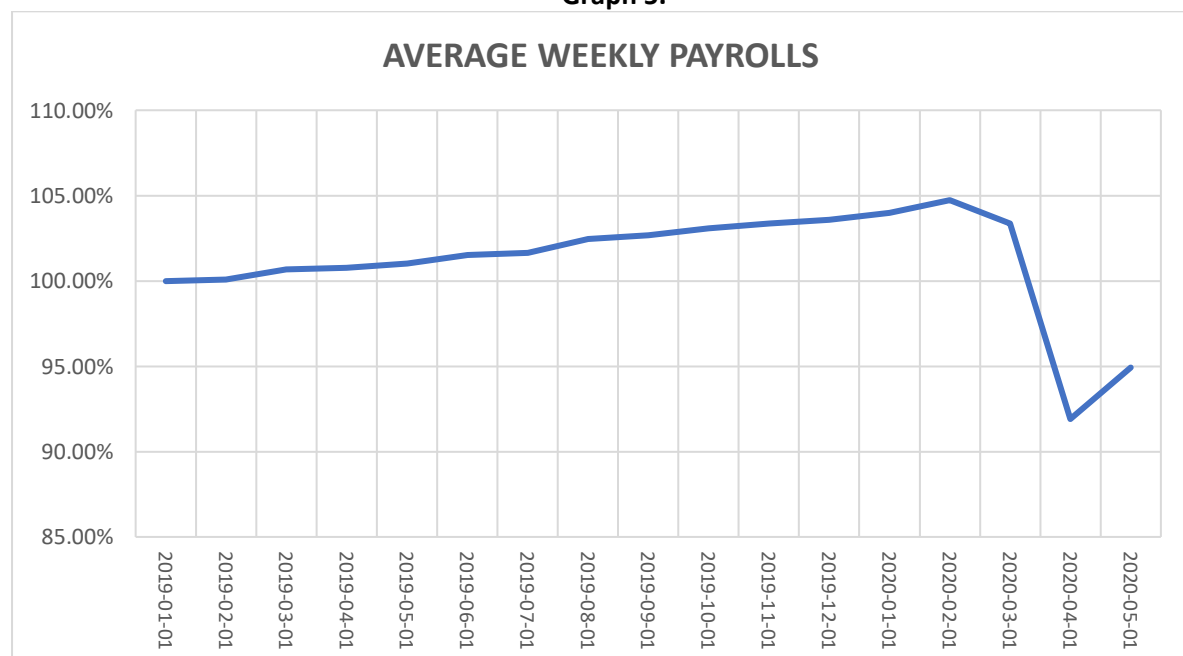
Moving on. All graphs that follow are based on All Employees Privately Employed. The next graph indicates changes to the aggregate hours worked, which is the most important indicator of labour employed. For ease of comparison, this graph is indexed. It shows that hours fell from 101.4 in February to 84.4 in April (-17) before rising to 88.1 in May (+3.7) a reversal of 22%.

**Graph 4.**



This compares to the fall in payrolls from 104.7 in February to 91.9 in April (-12.8) before rising to 94.9 in May (+3) a reversal of 23.5%.

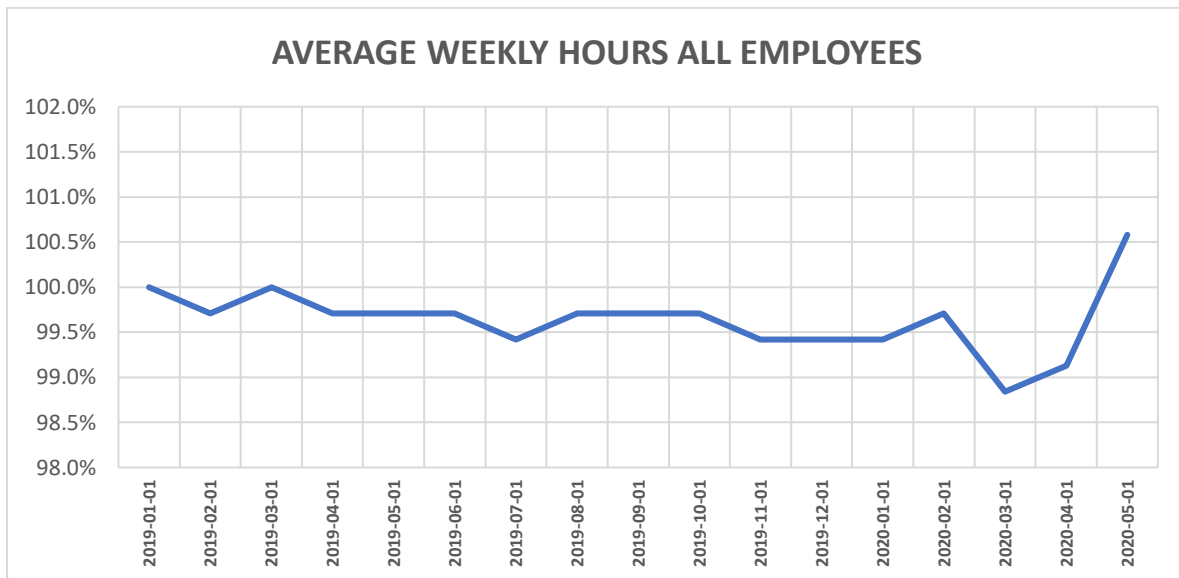
**Graph 5.**



(Sources: Fred Tables AWHAE for aggregate hours index & CES0500000017 for payroll index.)

Immediately an anomaly arises as it always does with the BLS. The movement in aggregate hours exceeds that of payroll numbers by 40% when compared to the payroll data. Hours fall by 17% while payroll numbers fall by 12.8. Perhaps this can be accounted for by the change to the average week. In February the average working week was 34.4 hours. It fell to 34.2 hours (-0.2) in April before rising to 34.7 hours in May (+0.5). In percentage terms it fell from 99.7 to 98.8 in March before ascending to 100.6% in May. Thus, the fall in the working week of less than 1% cannot account for the greater fall in aggregate hours on the way down to April. On the other hand, on the way up to May, the increase in the working week does cover the rise in hours. We can conclude that the BLS underestimated the original loss of jobs, therefore understating the real unemployment rate. Additional support for this proposition is found in the disproportionate fall in part-time workers discussed later.

**Graph 6.**



(Source: Fred Table AWWHAETP)

The change in earnings demonstrates the disproportionate firing of lower paid workers.

**Graph 7.**



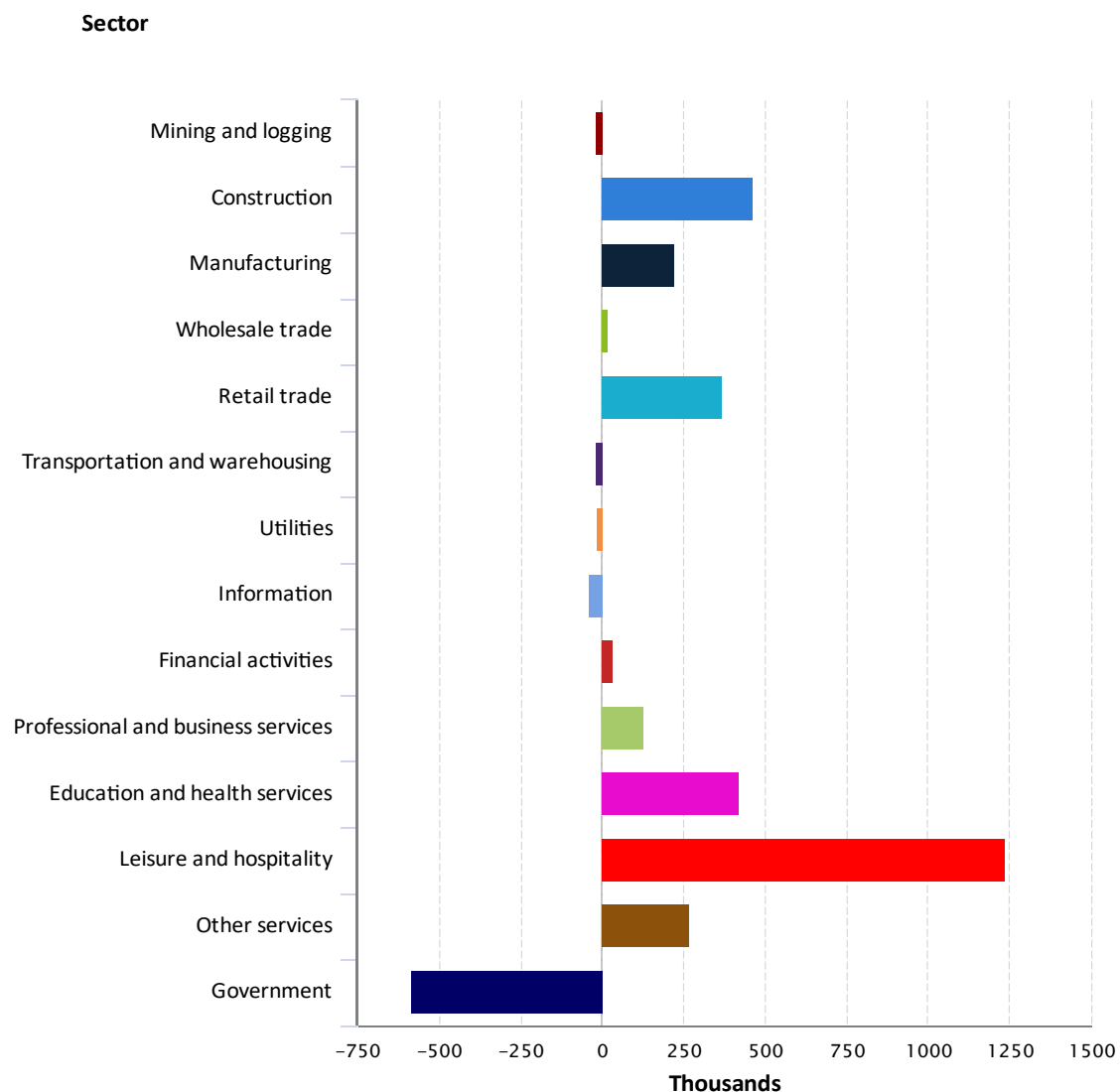
Average weekly earnings go up as employment falls. The obvious conclusion is that mass sackings are concentrated at the bottom of the earnings scale, leaving better paid workers at work, thereby raising the average pay. An additional factor provided by Table A-9 is the fall in part-time workers from 21.1% relative to full-timers in February to just 17.7% in May. Thus, the higher presence of full-time workers helps elevate pay. The weekly pay rate continues to increase in May though the hourly rate falls by 29 cents to a level still \$2 dollars higher than in February. Thus, while pay rates fall 0.9% month on month payrolls increase by 2.2%. Tellingly, within that figure, the bulk of the newly employed in May, consists of part-timers, at 58% (1.793 vs 3.094 million Table A-9).

Furthermore, the composition of employment further weighs on weekly pay. Half of the rise in employment is located in just one industry, where pay is notoriously low, the Leisure and Hospitality Sector. Only the rise in manufacturing and construction would provide better paid jobs, but they accounted for just over half the increase found in the Hospitality sector.

**Graph 8.**

**Employment change by industry, May 2020, seasonally adjusted, 1-month net change**

Click on bars to drill down



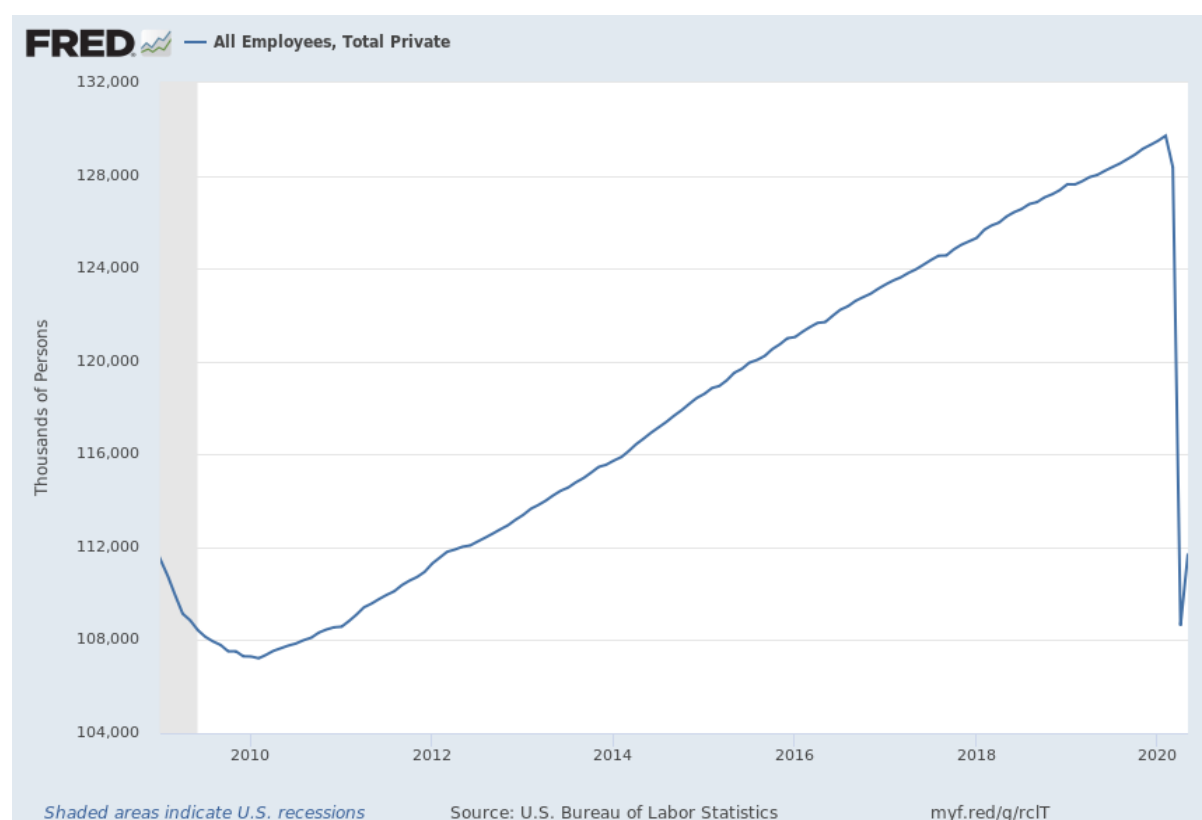
Source: U.S. Bureau of Labor Statistics.



In summation. Given the greater fall in aggregate hours worked, and given the disproportionate fall in part-time jobs, it is likely that the fall in payroll numbers up to April is significantly underestimated. This seems to be confirmed by the BLS in an article reported in the Washington Post. <https://www.washingtonpost.com/business/2020/06/05/may-2020-jobs-report-misclassification-error/> This underestimate could easily have exceeded the increase in payrolls between April and May. For the first time, all the ducks line up when viewing the May data, which is itself a cause for suspicion because this rarely happens with the BLS. The ADP and BLS data have drifted apart on occasion in the past, but seldom in different directions and certainly not to the extent of a 5.8 million difference in payroll estimates.

Whatever the case, the final graph shows what a long way business has to go to put the business back into the economy.

**Graph 9.**



## Conclusion.

Talk of a V shaped recession is now back in vogue on Wall Street. Despite the return of low paid workers to vulnerable sectors, the economy has not yet bounced back, it has merely got less bad. This is clear from the May data starting to filter through. Motor Vehicle sales rose from April's 8.7 million to 12.2 million which is still down a third on last year's annual rate. The ISM new orders index for May stood at 31.8 vs 27.1 for April. Last week's EIA Petroleum Report showed overall product demand was still down 19.4% from last year with gasoline down 22.5%. The GDP Nowcast released on the 4<sup>th</sup> June, admittedly before the employment data, has barely moved still showing half of economic activity continues to be lost. On the other hand, the New York FED Nowcast, which does include the payroll numbers shows an improvement in its estimate from -35.53 on May 29th to -25.48% on June 5<sup>th</sup>.

Together they show a contraction of around 35% currently for the first quarter. I am assuming a 30% fall for the quarter and have not revised a projected 15% fall for the entire year. No V shaped recovery. The N.Y. FED shows a fall of -12% for Q3. <https://www.newyorkfed.org/research/policy/nowcast> <https://www.frbatlanta.org/cqer/research/gdpnow> In the next few days the Congressional Budget Office will be bringing out the US government's receipts and outlays for May. In April total receipts were down 55% as the government hurtles towards a 4 to 5 trillion Dollar deficit. The CBO projects a deficit of \$3.7 trillion but that was before Congress began discussing a further budget stimulus.

On the other hand, there is a sliver of good news. This virus does respond to seasonal factors. This is not due to the virus mutating making it less virulent. The flare up of cases in Latin America is testimony to that. Rather with sunnier and warmer weather hosts are healthier and the half-life of the virus between hosts is shortened meaning that more robust people are getting smaller particle doses less frequently. The real test of course will be the winter in the Northern hemisphere.

But before winter, there will be another test for the markets, the second quarter corporate reporting season in July.

Brian Green, 7<sup>th</sup> June 2020.