June 22, 2020

OBSERVATIONS

- Covid-19: Brazil reported cases now exceeds 1 million people. Of the 10 most affected countries, the U.S. has the highest 5-day moving average of confirmed cases (30,610) as of 21-June.[1]
- Retail sales in May increased a record 17.7% MoM – doubling the median forecast of 8.4%. All categories increased, however, more than half of the gain came from sales of motor vehicles and restaurant receipts.[2]
- National Association of Homebuilders (NAHB) Market Index jumped a record 21 points to 58. *"Builders report increasing demand for families seeking single-family homes in inner and outer suburbs that feature lower density neighborhoods," Robert Dietz, NAHB Chief Economist.*[2]
- Opportunity Insights Economic Tracker[3], as compared to 1-Feb:
  - High earners not spending – spending by low income consumers is down -4%, while high income consumer spending is down -17%.
  - Job postings with extensive education requirements are down -27.6%, while positions with minimal education requirements are down -12.3%.
- The number of debt accounts in some type of deferment or relief program now exceeds 106 million: 79.2 million student loans, 11.5 million credit card accounts, 7.3 million auto loans, and 5.5 million mortgages.[4]
- Used vehicle prices now +4% YoY and +16% from the COVID-19 crisis lows. The luxury car segment saw the highest price increase, 5.7% on a YoY basis.[5]
- Month-to-date high yield debt issuance through 19-June has exceeded $45.5bn – on pace to be the busiest month ever (April, May, and June of 2020 rank as the top 3 months).[2]

EXPECTATIONS

- The Fed announced it will be buying corporate bonds, in part as a replacement to the prior corporate bond ETF purchase program announced in mid-March.
- As the mid-year draws near, expectations for calendar year 2020 are for revenues and earnings to decline by -21.4% and -3.4% YoY, respectively. Analysts estimates for 2021 revenue growth are 8.5%, with earnings growth of 28.6%.[6]
- Some signs of normalization in travel – Delta adding 1,000 flights in July & August, getting the airline's domestic capacity up to nearly 60% of prior levels.

ONE MORE THOUGHT

Historically, bonds have served two primary functions in an investor's portfolio – (1) to provide income and (2) to decrease overall portfolio volatility. Over the past four decades interest rates have steadily declined, U.S. government debt has surged, and the share of lower quality corporate debt has increased. The characteristics of the Bloomberg Barclays U.S.

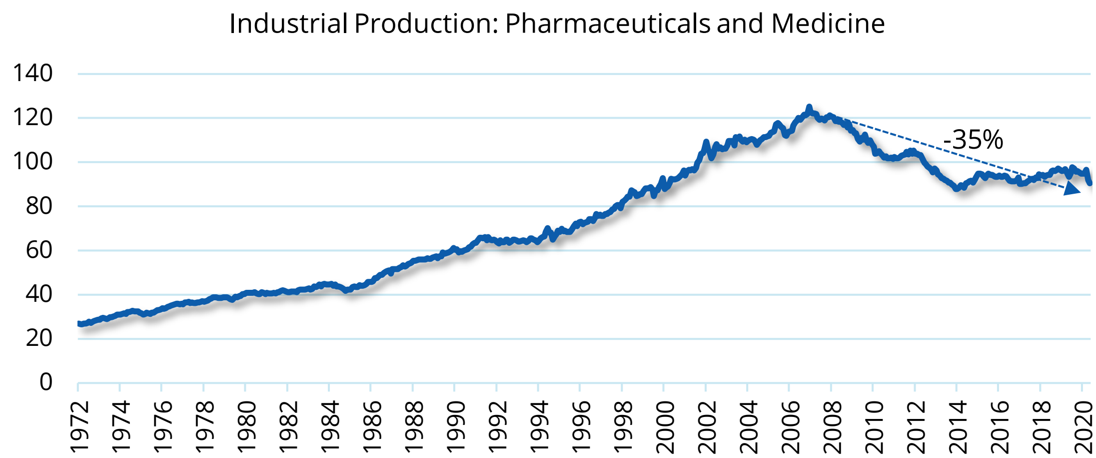
Bloomberg Barclays U.S. Aggregate Bond Index [2]

	12/31/2005	5/31/2020
Yield-to-Worst	5.08%	1.34%
Duration (Years)	4.57	6.01
% of Index in U.S. Treasury	25%	37%
% of Index in U.S. Corporate Bonds Rated "BBB"	8%	15%

[1] *Johns Hopkins University, https://coronavirus.jhu.edu/data/new-cases*
[2] *Bloomberg LP*
[3] *Opportunity Insights, Tracktherecovery.org, Harvard, Brown, Bill and Melinda Gates Foundation, data as of the week of 12-June*
[4] *WSJ, Transunion, Top 4 categories*
[5] *Bloomberg LP, Manheim Used Vehicle Value Index Mid-June Report, WSJ*
[6] *Factset Earnings Insight, data for S&P 500 as of 12-June*

Aggregate Bond Index, a widely followed fixed income market benchmark, reflects these changes in the investment grade universe. As U.S. government debt swells ever larger, low yielding U.S. Treasury securities with longer durations will grow in dominance, while the increase in lower rated "BBB" debt makes the corporate debt allocation more sensitive to changes in the economy *(BBB is one step away from 'junk' status)*. In an environment of low inflation and elevated unemployment, "lower for longer" is the foreseeable interest rate outlook. As such, fixed income portfolios benchmarked to the Aggregate Index are likely to generate lower income, be more exposed to lower rated debt and, due to the increase in duration, much more sensitive to changes in interest rates. Fixed income investors are expected to be faced with declining income, increased volatility, and less ability to protect the overall portfolio.

CHART OF THE WEEK



Source: Clearstead, Board of Governors of the Federal Reserve System (US), Industrial Production: Nondurable Goods: Pharmaceutical and medicine [IPG3254S], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/IPG3254S, June 16, 2020. H/T St. Louis FRED BLOG.

Production of pharmaceuticals and medicine have declined by nearly 35% since peak production in 2006. The U.S. has steadily increased imports as manufacturing has shifted to China, India, and Ireland given the lower cost of production or tax incentives. The pandemic has shed light on the risks of relying so heavily on foreign countries and global supply chains for the nation's health.

Carl Tippit, CFA
Head of Investments
Clearstead

Aneet Deshpande, CFA
Chief Strategist
Clearstead