Great-West Investments Capital Markets Perspective

Week in Review: June 1st – 7th

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
Dow Industrials	Lg. Cap Eq.	27,110.98	6.8%	-5.0%
S&P 500®	Lg. Cap Eq.	3,193.93	4.9%	-1.1%
NASDAQ Comp.	US Equity	9,814.08	3.4%	9.4%
Russell 2000®	Sm. Cap Eq.	1,507.16	8.1%	-9.7%
Stoxx 50	Europe Eq.	3,361.01	11.0%	-9.6%

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
FTSE 100	UK Equity	6,484.30	6.7%	-14.0%
Nikkei 225	Japan Equity	22,863.73	4.5%	-3.4%
EEM:US	Emkt. Equity	$40.92	8.5%	-8.8%
EFA:US	Non-US Equity	$63.82	7.0%	-8.1%
UST 10y (yield)	US Treasury	0.89%	+0.24%	-1.03%
B/Barc AGG	Fixed Inc.	2,336.45	-0.12%	5.01%

Big miss.

Sometimes it's far better to miss your target than it is to hit it. That was certainly true last week (and **no, I'm not referring to the stadium-sized rock** that passed close enough to Earth's atmosphere on Saturday to raise an eyebrow or two for fans of NASA's Asteroid Watch Widget – which is a real thing, by the way.[1]) **Instead, I'm referring to the even bigger miss by economists who tried in vain to forecast Friday's payrolls number** for May.

To be sure, that miss had a lot in common with Saturday's Foxborough-sized fly-by: both were on the world's collective radar for weeks, and both represented potential extinction-level events (**the jobs report could have ended once and for all any hopes that the post-COVID recovery would be V-shaped**, while the asteroid could have ended, well, us.)

But in at least one important way, last week's two big misses were quite *un*-alike: NASA's calculations were precise and accurately showed that **the space rock was never a serious threat** to life on Earth, while economists' calculations were anything *but* precise and concluded the US labor market definitely *was* a threat to economic life as we know it – at least here in the US. **The fact that neither of these catastrophes actually happened is one of the highlights of 2020 so far**. (Yeah, it's been that kind of year.)

So how big was the jobs error, anyway? Well, even the most optimistic **economists expected the US to shed more than 3 million jobs in May, but the economy had other ideas, *adding* 2.5 million instead**[2]. By some peoples' reckoning, that was the biggest miss by the forecasting community in the history of forecasting, and the fact that economists' forecasts were so wide of the mark actually mattered, because it **gave the stock market the one thing it likes best: a positive, model-busting shock that nobody saw coming.**

That was enough to send stocks sharply higher on Friday, leaving the **S&P 500 Index within a percent or so of positive returns for the year** as of Friday's close. It **also sent Treasury yields soaring, at least on the long**

[1] https://www.nasa.gov/mission_pages/asteroids/widget/index.html
[2] https://www.bls.gov/news.release/empsit.nr0.htm

end of the curve, with 10-year treasury yields up 0.24% on the week as investors sold out of the safety of treasury bonds and bought riskier things like stocks and high-yield bonds. That left the yield curve notably steeper and was the biggest spike in 10-year yields since last September, when progress in the US-China trade war created similar optimism about the outlook for economic growth.

In at least one sense, the fact that economists got the jobs numbers so wrong is also a little embarrassing for the profession: **there were at least a few indications that the payrolls number might not be as bad as feared,** starting with ADP's read on Wednesday (-2.76m jobs lost, versus expectations of 8 or 9 million[3],) and all four ISM/PMI readings, which unanimously met or exceeded expectations. Economists at Markit Economics, who compile the Purchasing Managers' Indices, even went so far as to suggest that **April might prove to have been "the eye of the storm as far as the production collapse is concerned**[4]."

To be clear, **there were still a few things not to like** in Friday's payrolls report, such as the BLS' comment that the **unemployment rate would have been 3% higher** than the 13.3% it reported if it had considered those "employed, but absent from work" as truly unemployed. Likewise, **hourly earnings were down a full percent, defying expectations for an increase of roughly the same amount**. That was of course a reflection of the types of jobs "created" (or more likely "restored,") in May: 1.2m jobs – or just under half – were in the relatively low-paying fields of leisure and hospitality. Those are still jobs, though, and **people returning to work is exactly what this economy needs, regardless of whether or not the market's reaction was a little overdone**.

Sticking with the "better-than-expected" theme, the **European Central Bank provided a positive surprise of its own** by announcing it would increase its pandemic-related QE program (appropriately named "PEPP") by €600 billion, **€100b more than was expected**. Moreover, the ECB also announced that it would continue re-investing PEPP proceeds through at least the end of 2022,[5] which means **the QE cannon will stay loaded for the foreseeable future.** That was enough to help European stocks outperform the already-notable performance of US stocks while also narrowing the gap between sovereign rates inside the EU itself.

But **please remember, none of this means the global economy is exactly in the clear**. While it's accurate to characterize last week's data as positive on the whole, it's just as accurate to describe things as **"still awful, just not as awful as everyone thought they might be**." Said another way, we should all remember that the global economy is **still in the midst of the deepest recession of our lifetimes**, **and that uncertainty still abounds**. At the top of the list worries that the virus will stage a comeback before there is a viable vaccine to combat it (although there were indications that Astra-Zeneca, for one, was confident enough in the efficacy of one of its vaccine candidates to secure significant manufacturing capacity to produce and distribute up to 2 billion doses by this fall.[6]) An on-again/off-again rise in US-China tensions are another wildcard, as is the potential for economic disruption related to continuing demonstrations both here and abroad sparked by the George Floyd tragedy.

And in case you were wondering, the skies aren't totally safe yet, either: NASA's near-earth orbit team reports that two more big space rocks will brush past the planet in June[7] (and although it would take a forecast error of the same magnitude of last week's payrolls miss, with luck, maybe the NASA scientists will botch their calculations and one of them will land in Yellowstone, stopping those annoying earthquakes that started to crop back up on the rim of the supervolcaono last week[8].) **Hope you're enjoying 2020 as much as I am**!

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[3] https://adpemploymentreport.com/2020/May/NER/NER-May-2020.aspx
[4] ISM data from instituteofsupplymanagement.org; PMI data from markiteconomics.com/public;
[5] https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.mp200604~a307d3429c.en.html
[6] Seekingalpha.com, https://www.bioworld.com/articles/435263-astrazeneca-moving-at-warp-speed-with-12b-in-barda-funding-for-covid-19-vaccine
[7] https://cneos.jpl.nasa.gov/ca/
[8] https://earthquake.usgs.gov/earthquakes/map.

What to Watch This Week: June 8th – 12th

What to Watch (June 8-12)

Monday: *No major economic releases expected*

Tuesday: JOLTS (April,) Redbook sales

Wednesday: Fed decision, CPI inflation

Thursday: PPI inflation, weekly claims

Friday: UofM Consumer Sentiment (preliminary)

Other than the **Federal Reserve's Federal Open market Committee (FOMC) meeting on Tuesday and Wednesday** (followed as always by Chairman Powell's obligatory press conference on Wednesday,) **it should be a fairly quiet week**. Beyond that, we will get two separate reads on inflation – consumer prices on Wednesday and wholesale prices on Thursday – as well as an updated look at consumer attitudes from the University of Michigan on Friday.

The focus will naturally be on the FOMC, not necessarily because anyone expects a change in rates (odds overwhelmingly favor a zero lower-bound through at least early 2021[9],) but instead for any hints about things like further Fed-sponsored accommodation, clues about how long COVID-related programs might last, or any additional jawboning the Fed chair might choose to indulge in regarding the need for additional fiscal stimulus by Congress.

In my view, Chairman **Powell will probably not disappoint**: last week's positive surprise by the ECB (in which it pumped another €600b into PEPP as discussed above,) could suggest that the Fed's tone will be equally supportive. That's because although the major central banks can't quite be accused of engaging in one-upsmanship, the policy response to COVID-19 so far seems to have been very closely coordinated: it would be surprising to see any of the major central banks – least of all the Fed – break ranks without a very compelling reason.

That said, I suppose one compelling reason for the Fed to go against the grain would be a big, ugly spike in inflation. If that were to happen, we might see it on **Wednesday when the Consumer Price Index (CPI) is reported, or on Thursday when Producer Prices (PPI) are released**, and a Fed response wouldn't be out of the question. (But for my money, I'd bet on "asteroid lands in the supervolcano" before I put money on a spike in inflation for May…)

Finally, the week closes with **yet another read of consumer sentiment from the University of Michigan on Friday**. As has been discussed over and over again, consumers have seemed perfectly willing to take the COVID shut-ins in stride – at least until very recently. Because **Friday's report by the UofM will include the period encompassing the bulk of the George Floyd protests**, they could bear closer scrutiny to see whether or not consumers are taking the same wait-and-see approach as capital markets seem to have taken so far.

Source for index data: Bloomberg.com; GWI calculations.

[9] Cmegroup.com