Inside Business

The Hampton Roads Business Journal | Insidebiz.com

JULY 13, 2020 $1.00

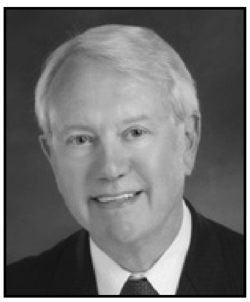
THE ECONOMY

2020 is most certainly a time of wild swings

By Jim Flinchum

Do you remember the year of 2010? That was the year of the "Flash Crash."

It happened on May 6 when the stock market suddenly fell almost a thousand points, losing a trillion dollars before recovering 36 minutes later. It was a market event … of temporary significance.



Jim Flinchum

Do you remember the year of 2020? That was the year of the "Flash Depression." It happened during the first half of the year when the economy was suddenly shut down. The stock market losttrillions of dollars before rebounding nicely. The overall economy will recover relatively soon, especially compared to the Great Depression. This has been an economic event … of gigantic proportion, albeit temporary.

Current real unemployment (about 19%) approaches the Great Depression (25%) during 1933. The estimated drop in GDP (20%) also approaches the Great Depression (26%). Admit it, we are already in a depression! Fortunately, it is not a great depression. Of course, it does not feel like a depression, because it has not lingered for many long years. We did not slip into this depression. It happened in a flash. Unfortunately, we will not exit this depression in a flash, but we will exit much quicker than we exited the Great Depression.

When this Flash Depression began, Congress actually rose to the occasion by passing several multitrillion-dollar packages. In econ-speak, these new deficit-spending programs support the aggregate demand for goods and services during weak economic conditions.

After the Great Depression, we installed a few automatic stabilizers into the American economy. For example, when unemployment rises, spending for unemployment compensation, welfare, and food stamps also increase somewhat. In econ-speak, these automatic stabilizers also help support the aggregate demand for goods and services during weak economic conditions.

The first half of 2020 is unlike anything in your life or in our economic history. It is a time of wild swings and economic records. For example, after falling dramatically, retailers enjoyed a record 17.7% increase in sales, from a depressed level but easily beating the previous record increase of 6.7%.

Consumer confidence rose to 98.1, easily beating an expected 91.5. Consumer sentiment has risen for the last two months. After a record drop, wages rose 2.5% in May but is still 8.6% below the pre-COVID level in February. After dropping 25% over three months, new home sales surged 16.6% in May.

Construction spending also peaked in February and then dropped 5.9%. Durable goods spiked 29% but are still at 2005 levels, which is 20% below its February peak. Both exports and imports collapsed, except for imported consumer goods, which rose at the fastest rate in three years. The more important level of consumer spending for services has dropped 19.8% from its February peak.

April was the most amazing month, with huge transfer payments from the government and a record increase in income, at the same time as a record collapse in spending. The following month, spending did increase a record 8.2%. A whipsaw month for sure.

Despite being crushed by the pandemic, the stock market then enjoyed one of the best quarters in 22 years, with the S&P 500 rising a whopping 20.54% since the March collapse. Before popping champagne corks, we should look a little deeper.

One of the most useful ways to look at stocks is the distinction between value stocks and growth stocks. Basically, value stocks use their profits to pay dividends to their shareholders, while growth stocks use their profits to reinvest into the company, for research and development or acquisition or whatever. Conservative investors usually opt for value stocks, while aggressive investors usually opt for growth stocks.

Historically, value stocks and growth stocks alternate as the best performer. This suggests that value stocks will soon reverse, taking the lead, but I do not believe so. Since the global financial crisis of 2008-2009, growth has continually outperformed value.

With 4.8 million new jobs in June, the unemployment outlook is looking

...continued

better, but the data remains confusing, since the government "miscounted" furloughed workers in April. Initial claims for unemployment benefits continue to drop but the rate of decrease is slowing. Continuing claims are dropping but that decline is also slowing. There are only 5.05 million job openings, which is the lowest since 2014. The number of people hired last month was only 3.5 million, the lowest in 20 years.

During the long sweep of economic history, budget philosophies have evolved. For many years, we believed the government budget should be balanced each year. This was called the Austrian approach. During the Great Depression, we believed it was acceptable to run a budget deficit during the bad times, as long as we ran a budget surplus during the good years. This was called the Keynesian approach. Of course, running a surplus during good times requires more discipline than either Republicans or Democrats can muster. Under Reagan, we believed that a tax cut automatically creates enough growth to pay for deficits. This was called the supply-side approach.

During 2020, we were forced to adopt the Modern Monetary Theory approach, which is a license for virtually unlimited budget deficits. MMT is based on the logic that debt does not matter since we can always "print" enough money to repay. If Japan can handle a 200% debt-to-GDP ratio, then surely America can, they say rhetorically. MMT is not sustainable, but many of us will be dead before it collapses.

Washington economists and Wall Street strategists are besieged with questions about this Flash Depression, but they should ask an epidemiologist instead, because this collapse was not caused by economic factors nor financial factors but biological factors.

Jim Flinchum *is a financial planner and investment strategist with Bay Capital Advisors in Virginia Beach, and a member of the National Association of Business Economics. Contact him at www.baycapitaladvice.com.*