

Investors continue to struggle with conflicting forces on the health front, a tug-of-war that, aside from the election uncertainty, has been a key catalyst behind market moves in recent weeks. Simply put, the battle pits positive news regarding vaccine development against the negative influence of rising infection rates. While this conflict has been ongoing since the spring, it reached a feverish pitch this week. News that the pharmaceutical company, Pfizer, is conducting a trial for a vaccine that has been 90 percent effective and could reach the market within the next few months sent stocks and yields sharply higher. But even as investors are processing this joyful news, they are also confronted with a harsh reality that takes the bloom off the rose: coronavirus cases are surging at record rates. With the nation heading into the colder winter months that could accelerate this ominous trend, the near-term outlook, as noted by Fed chair Powell this week, looks extremely challenging.

The spike in Covid-19 cases – which hurtled above 150 thousand a day this week – is prompting more states to impose restrictions on various forms of activity. Curfews and limits on diners at restaurants are already taking root; school closings are being considered in a growing number of states; and government officials are more aggressively urging residents to comply with social distancing measures and to stay at home whenever possible. Hence, the race is on to bring a vaccine to the market before the spike in virus cases prompts even tougher lockdown restrictions that threaten to derail the recovery. As one pundit expressed it this week, the V-shaped recovery is looking ever more like a Vaccine shaped recovery.

At this juncture, the economy is bending but not breaking under the weight of the escalating health crisis. People are still spending and businesses are still rehiring. Almost 80 percent of workers that were temporarily laid off in March and April have been rehired, accounting for most of the rebound in job growth over the past six months. That trend has resulted in fewer people filing for unemployment benefits. First time claims for regular state benefits slipped to 709 thousand in the most recent week, down by 48 thousand from the previous week and the lowest since Covid-19 struck the U.S. in March, when initial claims surged to a peak of nearly 7 million in the final week of the month. The downward trend has been virtually uninterrupted; first-time claims fell in 27 of the 32 weeks since that peak was reached.

That's the good news. The bad news is that even at the reduced 709 thousand level, more people are filing for jobless benefits than anytime during the 2008-09 recession – or any recession before that. Importantly, filings for regular state benefits tell only part of the story. Nearly 300 thousand additional workers filed for special benefits under a separate Federal program created under the CAREs act. Indeed, more than 13.5 million individuals are receiving unemployment benefits from pandemic-related Federal programs set up during the spring, accounting for over 60 percent of the 21.2 million unemployed workers receiving benefits of any kind. The emergency benefits are set to expire at the end of the year. Unless Congress extends them, a vital source of income for this distressed segment of the population would be extinguished.

Even as most temporarily laid-off workers have been rehired, the pace of permanent layoffs is accelerating. About one-third of total unemployed workers have been out of a job for at least six months, compared to 4.1 percent in April and the highest share since mid-2014. What's more, the workers who have been lucky enough to regain their jobs are the very ones most at risk of being furloughed again. For the most part, companies in services industries, such as restaurants and bars, have been doing the rehiring as the lifting of lockdown restrictions in the spring and summer enabled them to reopen for business. But these firms, as well as others in the leisure and hospitality spectrum, are now in the cross hairs of the coronavirus, as they are the ones most likely to feel the brunt of renewed restrictions in coming weeks and months.

If, as is likely, workers in these industries are forced back to the unemployment lines, they will be competing with a vast pool of other job seekers vying for positions. In September, there were just under 2 unemployed workers for every job opening, a ratio that is less than half of what it was at the height of the pandemic but more than double the pre-pandemic level. But the competition is set to intensify as job growth continues to slow and job openings start to diminish. The latest data on openings from the Labor Department are for September, but high-frequency data indicate that listings are already softening, particularly among the aforementioned service industries.

No doubt, the generous fiscal support provided under the CAREs act, including direct stimulus checks and enhanced unemployment benefits, helped tide workers over the periods of unemployment, both past and now unfolding. That support expired at the end of July and the Pandemic-related programs are scheduled to end in January, unless renewed by Congress. The prospect of losing those benefits together with fears of job losses associated with escalating cases of Covid-19 may already be depressing household sentiment. The University of Michigan reported on Friday that its sentiment index tumbled to the lowest level since August during the first ten days of November, reflecting a sharp deterioration in expectations over business conditions. To be sure, a political dynamic had a big influence on the survey results, as the entire decline in expectations occurred among Republicans. However, the Biden victory did little to bolster sentiment among Democrats, so underlying fundamentals clearly contributed to the downbeat mood among households.

While Biden's victory is likely to withstand the myriad legal challenges from the Trump camp, the makeup of the Senate is still in doubt as a runoff election for two seats in Georgia is scheduled for January 5. Hence, there still could be a 50-50 split if the Democratic candidates pick up both seats, which would put the party in control of the chamber since Vice President-elect Harris would cast the deciding vote on any evenly split decision. If that were to happen, a more progressive agenda than otherwise would likely emerge from the Biden administration. That, in turn, would up the odds of renewed fiscal support that would target unemployed workers as well as provide more funds for Democratic priorities, including help for cash-strapped State and Local governments.

That said, it's unlikely that a robust stimulus bill in excess of \$2 trillion advocated by House Democrats would get passed even under one-party control. We are assuming that a bill with about a \$1 trillion price tag will get through Congress either in the lame-duck session or early next year. That, together with a successful development of a vaccine should keep the economy on a positive growth trajectory in 2021. But it will not be easy sailing over the next six months or so. For one, the deteriorating health crisis is posing a severe headwind now, even as the fiscal support has all but vanished. On the surface, the economy's main growth driver, consumer spending, appears to be holding up well. But the sturdy increase in spending in September may have reflected a last gasp effort by many lower and middle-income households using their shored-up bank accounts from government stimulus funds to finance purchases.

There are signs that those funds are drying up, if not already depleted. Households have drawn down \$3.9 trillion in savings over the past five months, almost 80 percent of the \$5.0 trillion accumulated in March and April when the government checks and extra \$600 weekly unemployment benefit payments hit mailboxes. For many unemployed workers, those funds provided more income than they were earning on their jobs, which afforded them the opportunity to also pay down debt as well as pad savings accounts. However, those halcyon days are nearing an end, and it appears that households are once again going into debt to finance purchases. In September, consumer-revolving debt – mostly credit-card purchases – increased for the first time since February.

One month does not make a trend, of course. But it is unlikely that households suddenly decided to take on more debt to make big-ticket purchases, confident that future earnings would easily cover servicing charges. That's a time-honored behavior during a rapidly expanding economy when household optimism and inflation expectations are rising. Nothing could be further from that scenario now. With the job market softening and destined to come under more pressure from Covid-19, households are hardly confident about future earnings prospects. Meanwhile, the inflation environment is not one that inspires a buy-in-advance

mindset. Both the consumer price index and the core CPI that excludes volatile food and energy prices were unchanged in October, the lowest reading for both indexes in five months.

The flat month-to-month inflation reading reflects in part an unwinding of the spike in prices during the pandemic, when lockdown restrictions caused widespread shortages of many goods. But the momentum readings are equally telling, with the annual increase in both the headline CPI and the core index slipping further below the Federal Reserve's 2 percent target last month. As much as anything, the benign inflation trend reflects the long climb the economy still has to make to reach its potential output. Not only does the wide gap between actual and potential output require another round of fiscal stimulus to close it, but the Federal Reserve will also need to sustain its easy policy for the foreseeable future. We expect the Fed to willingly follow that path. However, the denizens on Capitol Hill may have to be coerced to go along. We think the economy will provide them with persuasive evidence in coming months.

FINANCIAL INDICATORS

INTEREST RATES	November 13	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.10	0.10	0.11	1.57
6-month Treasury bill	0.10	0.11	0.12	1.58
3-month LIBOR	0.22	0.21	0.22	1.90
2-year Treasury note	0.18	0.17	0.15	1.61
5-year Treasury note	0.41	0.37	0.32	1.66
10-year Treasury note	0.90	0.82	0.75	1.84
30-year Treasury bond	1.65	1.61	1.53	2.31
30-year fixed mortgage rate	2.84	2.78	2.81	3.75
15-year fixed mortgage rate	2.34	2.32	2.35	3.20
5/1-year adjustable rate	3.11	2.89	2.90	3.44

STOCK MARKET				
Dow Jones Industrial Index	29,479.81	28,323.40	28,606.31	28,004.89
S&P 500	3,585.15	3,509.44	3,483.81	3,120.46
NASDAQ	11,829.29	11,895.23	11,671.56	8,540.93

COMMODITIES				
Gold (\$ per troy ounce)	1,888.20	1,952.70	1,902.90	1,467.60
Oil (\$ per barrel) - Crude Futures (WTI)	40.12	37.43	40.78	57.83

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Consumer Price Index (October) - % change	0.0	0.2	0.4	0.3
Core CPI (October) - % change	0.0	0.2	0.4	0.2
Producer Price Index (October) - % change	0.3	0.4	0.3	0.4
Small Business Optimism Index (October)	104.0	104.0	100.2	100.3

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