GPA GOVERNMENT PORTFOLIO ADVISORS

Weekly Economic Update—November 9th, 2020

It's been a wild ride from Wall Street to the Beltway this week – and the rocky trip may not be over yet. As of Friday, former Vice President Biden was close to collecting enough electoral votes to move him into the White House on January 20. Not surprisingly, the probable outcome has triggered a wave of litigation from the Trump team that is likely to unfold for weeks on end. A contested election was always one of several options weighing on the minds of investors, but few political analysts expect the likely results to be upended. Still, a lot of unnerving rhetoric will garner attention in coming weeks, diluting the calming influence on the markets that an election verdict would ordinarily bring about.

The preliminary returns indicate that Republicans will retain control of the Senate while Democrats retain control of the House, with the White House flipping from Republican to Democrat. Assuming this makeup of the three branches of government prevails in 2021, the financial markets are behaving in a predictable manner. Historically, the stock market performs better under a divided government during the first year of a presidential election than under a single-party regime. As the probability this scenario would materialize grew over the past week stock prices roared ahead, notwithstanding a modest setback on Friday. In a sense, investors view a divided government as a Goldilocks scenario, resulting in a fiscal policy that doesn't produce too much stimulus nor too little. Nor would it lead to more government meddling in the form of higher taxes and stricter regulation, but neither would it be completely hands-off.

Likewise, this mindset has had a predictable influence in the fixed income market over the past week. The polls suggesting a "blue wave" on Election Day sent bond yields sharply higher, with the 10-year Treasury yield surging to a nine-month intra-day high of 0.93 percent. Fears that such an outcome would lead to more government spending and higher inflation underscored the move. But as incoming elections returns pointed to a divided government, those fears were tamped down and yields followed suit, with Treasury yields settling back comfortably to within the 0.70-0.90 range in effect since the spring. With less stimulus than otherwise forthcoming, the bond bulls also drew comfort from expectations that the Federal Reserve would have to do more of the heavy lifting to keep the economy growing. That means keeping rates lower and sustaining bond purchases longer than would otherwise be the case.

Indeed, following this week's policy meeting Chair Powell noted that the Fed still has more bullets in its toolbox to sustain the recovery should the economy falter in coming months. The meeting itself produced no surprises given the sensitivity to any unexpected policy shifts in the midst of an election. However, the policy statement reinforced the dovish sentiment expressed at the previous meeting and Powell emphasized the growing risks facing the economy, once again urging Congress to provide more help to contain the damage from Covid-19. In this regard, Senate majority leader Mitch McConnell did agree that some form of stimulus would be forthcoming, although how much support for a muscular bill he will get from his Republican colleagues remains very much in doubt.

From our lens, the economy will need more fiscal support than is likely to be forthcoming. The resurgence of the virus, which is hitting new records both in the U.S. and abroad, is an ominous portent of the headwinds that will restrain growth in 2021. It is widely acknowledged that a full recovery will not be accomplished until the virus is brought under control. To be sure, an effective vaccine that would be widely distributed is becoming a reality in record time, much quicker than most health officials thought possible six months ago. But that encouraging prospect is losing luster in the face of the sudden climb in infection rates, which signals more lockdowns and social restrictions just as the economy is regaining its footing.

HEADQUATERS:
2188 SW Park Place Suite 100
Portland OR 97205

No doubt, the nation has less tolerance for a virtual shutdown of an entire economy than it did in March and April. At the same time, a Biden administration is likely to put more emphasis on curbing the health crisis at the expense of the economy's performance than would a Trump administration. Just how much of a tradeoff is likely to occur would depend on the amount of fiscal aid that ultimately comes out of Capitol Hill. We suspect it will be somewhat smaller than the muscular $2-$2.5 trillion bill proposed by the House Democrats but bigger than the skinny offer of less than $500 billion proposed by the Republicans. The wide gulf between the two parties reflects in part the wide divergence in perceptions over the economy's current and expected performance.

Coming off of a vigorous rebound in the third quarter, the economy continued to show decent momentum at the start of the fourth quarter, despite the fading influence of the fiscal stimulus put into effect last spring. The latest surveys of the manufacturing and services sectors by the Institute of Supply management show that activity remained firmly in expansion territory in October, with the manufacturing index surging to the highest level since September 2018. However, the index for the much-larger services sector did slip a bit from September, consistent with slowing momentum. Indeed, the services index was the weakest since the recovery unofficially began in May.

But the first important report containing hard data for the fourth quarter – the October jobs report – hardly portrays an economy that is falling off a cliff. Nonfarm payrolls increased by a sturdy 638 thousand during the month, modestly less than September's 672 thousand gain. But the slowdown was due entirely to weakness in the government sector, where 268 thousand workers lost their jobs. That, in turn reflects the end of the decennial Census count, which removed 147 thousand temporary government workers from payrolls, as well the ongoing squeeze on state and local budgets, prompting the layoffs of 159 thousand education jobs.

In contrast, the demand for labor in the private sector was robust. Companies added 906 thousand workers to payrolls, which is a step-up from the 892 thousand added in September. Some of the stand-out industries that recovered swiftly from the pandemic continued to hire workers at a sturdy clip in October. Most notably with housing activity on a tear, construction payrolls increased by 84 thousand and are up by nearly 800 thousand over the past six months. That exceeds any full-year gain on record. But against the massive 1.5 million layoffs in March and April, construction jobs are still almost 350 thousand below their pre-pandemic level. Similarly, manufacturing added an impressive 38 thousand jobs in October and 742 thousand over the past six months. But that still recovered less than 60 percent of the 1.36 million jobs lost in March and April.

While the October's jobs report indicates that the labor market is healing, it also highlights how much ground it still has to make up from the pandemic-related losses. Hence, the robust 12.1 million job gains over the past six months still leaves about 10 million workers on the sidelines among the 22 million who lost their jobs in March and April. At the current pace of job growth, that ground would not be recovered until at least early 2022. That, of course, assumes the current pace of job gains would be sustained through the period, a prospect that seems unlikely unless given a major assist from another round of Federal stimulus.

Importantly, any stimulus bill needs to target the unemployed first and foremost, as the lifeline provided by the extended unemployment benefits expires at the end of this year. That means workers who have been out of a job for more than six months would be cut off, removing a safety net that would greatly amplify the plight of this segment of the population, most of which are low-wage workers. Their plight is becoming ever-more alarming, as the number of long-term unemployed workers jumped by over 1 million in October, the largest monthly gain on record. The previous record for a month, 716 thousand, occurred at the tail end of the Great Recession.

It's also important for legislators not to be blinded by some of the apparent strengths in the latest employment report. The sharp drop in the official jobless rate, from 7.9 percent to 6.9 percent, greatly exaggerates the ease with which unemployed workers are finding jobs. The drop does not account for people that have dropped out of the labor force, either voluntarily or because they are too discouraged to

look for job. Nor does it account for a large number of workers that are misclassified as jobholders but are absent from work. The civilian labor force has shrunk by nearly half-million from its pre-pandemic level and the labor force participation rate, while up slightly in October, is still, at 61.7 percent, hovering near the lowest levels since the early 1970s.

FINANCIAL INDICATORS

INTEREST RATES	November 6	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.10	0.10	0.11	1.56
6-month Treasury bill	0.11	0.12	0.13	1.57
3-month LIBOR	0.21	0.21	0.22	1.90
2-year Treasury note	0.17	0.18	0.17	1.67
5-year Treasury note	0.37	0.38	0.34	1.75
10-year Treasury note	0.82	0.88	0.78	1.94
30-year Treasury bond	1.61	1.66	1.58	2.43
30-year fixed mortgage rate	2.78	2.81	2.87	3.69
15-year fixed mortgage rate	2.32	2.32	2.37	3.13
5/1-year adjustable rate	2.89	2.88	2.89	3.39
STOCK MARKET				
Dow Jones Industrial Index	28,323.40	26,501.60	28,586.90	27,681.24
S&P 500	3,509.44	3,269.96	3,477.14	3,093.08
NASDAQ	11,895.23	10,911.59	11,579.94	8,475.31
COMMODITIES				
Gold ($ per troy ounce)	1,952.70	1,878.80	1,934.70	1,459.20
Oil ($ per barrel) - Crude Futures (WTI)	37.43	35.72	40.54	57.38

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/ Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Trade Deficit (September) - $blns	63.9	67.0	63.4	59.8
ISM Services Index (October)	56.6	57.8	56.9	55.3
Nonfarm Payrolls (October) - 000s	638	672	1,493	2,012
Unemployment Rate (October) - Percent	6.9	7.9	8.4	9.6

DISCLAIMER: This communication has been prepared by Government Portfolio Advisors LLC solely for informational purposes for institutional clients. Sources for this commentary include Bloomberg and Stone McCarthy Research Associates. It is not an offer, recommendation, or solicitation to buy or sell, nor is it an official confirmation of terms. It is based on information generally available to the public from sources believed to be reliable. No representation is made that it is accurate or complete or that any returns indicated will be achieved. Changes to assumptions may have a material impact on any returns detailed. Past performance is not indicative of future returns. Price and availability are subject to change without notice. Additional information is available upon request.