

US jobs were a bright spot for June, but rising infections threaten long-term progress

Weekly Market Compass: How long can economic data improve while infections continue to spread?

July 06, 2020 | Kristina Hooper, Chief Global Market Strategist

Last week, the US issued its employment situation report for June. For the second month in a row it was an impressive report, handily beating expectations in terms of both non-farm payroll growth and the unemployment rate. However, I have two key concerns:

- We have to remember that this was a snapshot in time (from mid-May to mid-June), which doesn't reflect the recent re-imposition of more stringent measures in certain parts of the US where the COVID-19 virus has not been controlled. That means the July jobs report could be less positive - especially if infections continue to rise and lead to greater stringency in economic lockdowns. This in turn could cost significant jobs in particular areas of the economy where we saw the biggest gains in the June jobs report: the leisure and hospitality industry as well as the retail industry.
- Another concern is that this positive jobs report could deter Congress from providing more fiscal stimulus. While the House of Representatives passed another substantial stimulus bill in May - the HEROES Act - Senate Republicans have been clear that they want to take a "wait and see" approach before providing any more stimulus. However, fiscal stimulus contributed to the better-than-expected May and June jobs reports, so I believe it would be a mistake to overlook that.

Economic data around the world improved in June

Other economic data in the US has been very encouraging as well. For example, the ISM Manufacturing Purchasing Managers' Index (PMI) reading for June came in better than forecast at 52.6 - a nice improvement over the previous month's reading of 43.1.¹ In fact, it proved to be the best reading in this series since April 2019. What's more, the new order sub-index saw a major bump - up from 31.8 in May to 56.4 in June - which bodes well for the future.¹

And the US is not alone. Economic data in Europe and Asia are showing an improving economic situation:

- In Europe, PMIs showed significant improvement. The composite PMI reading for June was 48.5, well higher than May's composite reading of 31.9. Manufacturing PMI came in at 47.4, up from 39.4 in May, while services came in at 48.3 versus 30.5 in May.²
- In Asia, PMI readings in June also improved. The official PMI reading from China's National Bureau of Statistics as well as the PMI reading from Caixin both continued to show a gradual improvement. For example, the private Caixin figures for manufacturing in June were 51.2 versus 50.7 in May, with services at a strong 58.4 versus 55.0, the fastest rate of growth since April 2010.³ Japan, Taiwan and South Korea also showed very modest improvement in some data, in my view.

Rising infections remain a critical concern in the US

The critical difference between the US and these other economies is that in the US, COVID-19 infection rates are on the rise. Several weeks ago, I wrote about the US dilemma – how economic data is improving while the infection situation is worsening – and I wondered how long the situation was sustainable. I am not sure it can last much longer if more fiscal stimulus is not forthcoming. In my view, more fiscal stimulus is clearly needed as so much of the stimulus already enacted is very temporary in nature. In addition, we are seeing a growing number of companies announce layoffs and file for bankruptcies while others are voluntarily re-closing stores.

Several weeks ago, US Treasury Secretary Steven Mnuchin shared his view at the Bloomberg Invest Global event that the US would be out of recession by the end of the year. I don't disagree, but I believe gaining control of the virus and providing ongoing fiscal support will be important to enabling the US economy to grow solidly. The US could continue to follow in the economic footsteps of China and Europe – but it will need to follow in their epidemiological footsteps and achieve success in “bending the curve.” I worry that is becoming increasingly difficult because a significant cohort of Americans are resistant to wearing face masks. It's worth noting that there was resistance to wearing masks in the US during the 1918 Spanish flu pandemic as well – so much so that an “Anti-Mask League” was formed in San Francisco – although most complied because they viewed it as a patriotic duty in order to protect American troops coming back from World War I.

Rising infection rates – especially if accompanied by a failure to enact more fiscal stimulus – could finally have a more-than-fleeting impact on stocks – at least US stocks – especially as earnings reports roll in. Nearly 40% of companies in the S&P 500 Index have dispensed with earnings guidance this year – but they haven't dispensed with earnings reports.⁴ And that could provide a significant reality check for equities. According to FactSet Research Systems Inc., the estimated earnings decline for the S&P 500 for the second quarter is -43.8%.

Conclusion

June's positive jobs report and PMI data for the US are certainly nice to see, but I feel less positive about the US than I do about Europe and China. I would not be surprised to see US economic data lose momentum in the coming months if policymakers become complacent. I believe investors need to be prepared for that possibility and for the market volatility that could likely follow.

For now, I continue to believe that the massive monetary policy accommodation by the Federal Reserve and other central banks provides an upward bias to stocks. But I also maintain my long-held view that a three-tiered approach to this crisis – encompassing monetary policy, fiscal policy and public health policy – is necessary for solid economic growth. In other words, while central banks are doing what they can, I believe more fiscal stimulus and better control of the virus's spread are needed to support the economy until a vaccine can be developed and efficiently deployed around the world. And while the stock market has decoupled from the economy in recent months, there is the potential that earnings season could reunite them, albeit temporarily, and make stocks more sensitive to rising infection rates as well as a possible lack of fiscal stimulus. And so we will, of course, be following earnings season closely.

Source

¹Source: Institute for Supply Management, July 1, 2020

²Source: IHS Markit

³Source: Caixin

⁴Source: FactSet Research Systems Inc.

Important information

Purchasing Managers' Indexes are based on monthly surveys of companies worldwide, and gauge business conditions within the manufacturing and services sectors.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

The opinions referenced above are those of the author as of **July 6, 2020**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.