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INVESTMENT SERVICES

Weekly Relative Value

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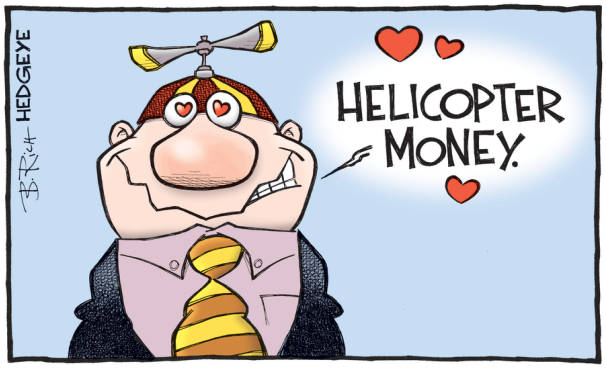
FREE MONEY?

Proverbs 26:11: As a dog returns to its vomit, so fools repeat their folly

"The pandemic has underscored the need to ensure that during a crisis, payments can flow quickly and to everyone: those with and those without a bank account."
- Cleveland Fed President Loretta Mester

Recently there has been an increased focus on a Federal Reserve project to make "direct payments" to households during an economic downturn or crisis. In March, legislation was proposed in the House and in the Senate to authorize the Fed to do this. The Fed Board of Governors' technology lab, staff from several of the Federal Reserve Banks, along with the Boston Fed in a partnership with Massachusetts Institute of Technology and the New York Fed in a partnership with the Bank for International Settlements, are working on a platform in which the Fed could send a lump-sum payment directly to all Americans.

More recently, Cleveland Fed President Loretta Mester stated in that the Fed was looking into ways in which it could make direct and instant payments to every American, even those that don't have bank accounts.



This new platform would be a "central bank digital currency." Under this system, each American would have an account at the Fed in which digital dollars could be deposited.

The amount could be set at for example, a certain percentage of gross domestic product (GDP), divided by the number of Americans. Each American would get the same amount.

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PORTFOLIO STRATEGY

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And it would happen instantaneously without the cumbersome mechanisms that Congress has to go through to send stimulus payments to consumers, some of whom still haven't received them. To be clear this is very different from the stimulus checks recently sent, because the government had to borrow the money that it sent to consumers.

Between the lines, the Fed is admitting that their policies have been a failure in allocating funds to the majority of households where they're needed since consumer spending is 70% of the economy. By sending money directly to all Americans during an economic recession or crisis, people could spend it and crank up consumption, and increase the growth rate of the economy and inflation. Voilà!

On the surface this sounds like a terrible idea. And I would agree. But I have to admit it's a lot less terrible than what the Fed has been doing over the past decade via asset purchases, which have only distorted and inflated asset prices, which has only benefitted the wealthy while greatly increasing wealth inequality in America.

How would this work? There are approximately 210 million adults in the U.S. If the Fed decided to throw $3 trillion, not at the markets as it has done since March, but at Americans directly it would translate into a lump-sum payment of about $14,000 for each adult. So, a household of two adults would get $28,000, whether this household is made up of a couple living in a tent or a couple shuttling between their mansions with billions of dollars in assets. Undoubtedly, there would be known and unknown costs, but at least all Americans would benefit the same – not just the wealthy.

The relatively small percentage of wealthy people wouldn't spend a dime of this money, but the lower 60% or 70% or 80% on the income scale would likely spend most or all of it over time, thereby creating demand for goods and services, and pressure on consumer prices.

In addition to economic activity from increased spending, many people would use the money to reduce debt or replenish savings to a reasonable level. Reducing debt levels would help restore the economy to a healthier balance.

Finally, there is much work that needs to be done and no final decisions made. But in my humble opinion, replacing the existing horrible policies with a policy of sending money directly to consumers, with each American, rich or poor, getting the same amount is a slippery slope but would be better than what has been happening over the past decade.

JOB GROWTH SLOWS

I hate to be the skunk at the picnic, but the job data released last week were disturbing, and the recovery remains fragile.

Last week, Walt Disney announced plans to lay off about 28,000 workers (13% of its total workforce of 223,000) from the U.S. theme-parks. Layoffs are an indication that recovery is unlikely before a COVID-19 vaccine.

And last Friday in "Up to Half of the City's Restaurants Could Shut Down" (WSJ). After reading that article you can't help but to get an appreciation of the permanent damage this coronavirus has unleashed on the economy.

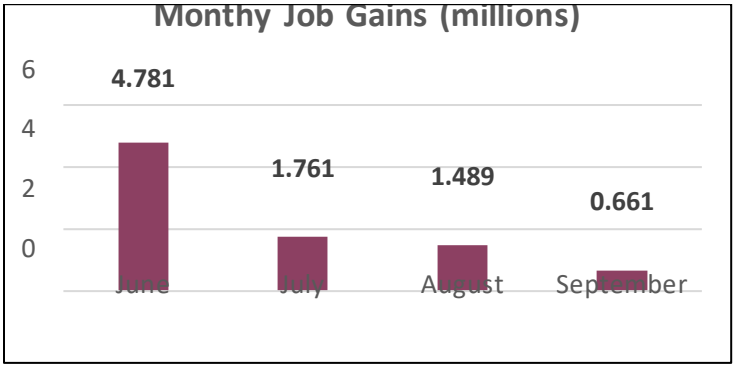
It's important to understand that amusement parks, airlines, hoteliers and restaurants cannot stay in business at 50% capacity (or even 75% in the case of restaurants).

On average these sectors, like restaurants, spend 30% on labor, 30% on rent and 30% on food – they have a 10% margin. Prior to the pandemic, these sectors supported 32 million jobs, or about a third of the private sector workforce, and many believe that half of them are not going back to their old jobs.

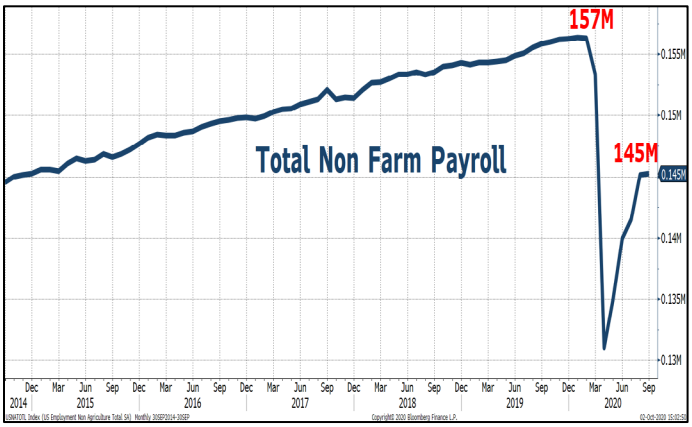
Moving on. New monthly jobless claims for September were reported at 837,000. Continuously north of 800 thousand are truly mind-blowing. To be convincingly out of recession, the claims number must approach 500 thousand. And for a "normally" functioning economy, these claims numbers tend to be closer to 200 thousand. We are light years away from that. This week, the consensus is for another 800,000 plus increase.

In addition, the Challenger Job Report layoff announcement data were rather shocking in September – soaring 186% from year-ago levels to 118,804 positions. For perspective, in September 2008, the month that Lehman collapsed, the pink-slip figure was 95,094.

Finally, the non-farm payroll report said jobs rose 661 thousand in September, badly missing the consensus estimate of +859 thousand and snapping a five-month streak of better than expected data. September's tally was the weakest since April. Year-to-date, payrolls are still down at nearly a 9% annual rate. How bad is that? In no post-WWII recession did employment ever even decline at more than a 6% annual rate over this time span. The hole is so deep that even if we created 661 thousand jobs every month (which we won't), it would be the end of 2021 before we would recoup the pandemic-induced job loss.



As shown below, even after five months of re-opening and unprecedented fiscal stimulus we are still short 12 million jobs or about half of the 22 million employment carnage since the pandemic began. This is a deeper loss than the 8.7 million at the depth of the recession a decade ago

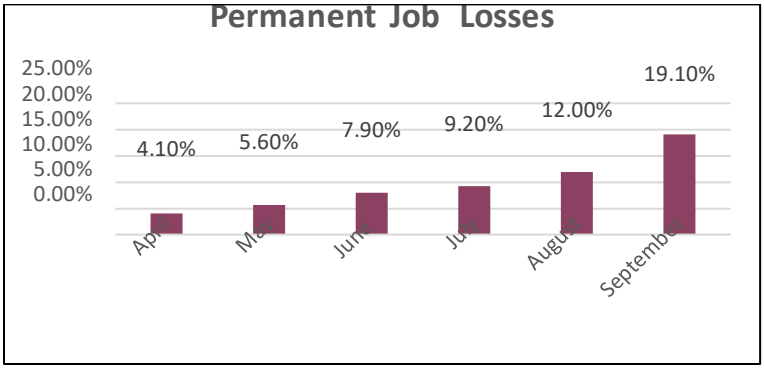


And making matters worse is the fact that the easy part of the job's recovery is in the rear-view mirror. The share of the unemployed persons who have been seeking work for 27 weeks has steadily increased since April. There are now 3.7 million Americans that experienced job losses for 27 weeks (19%).

When the first waves of layoffs hit in March and April, most of the newly unemployed believed their job losses would be temporary, and reported they were not looking for work. Without a mass surge of hiring significantly above the levels seen in September, the "tsunami" of unemployment is poised to hit in the next couple months.

The struggle to find jobs is unmistakable. Fully 58% of unemployed workers in September had been out of work for at least three months —including 19% off the job for at least six months.

Going forward, it is going to be a whole lot tougher to bring the idled workforce back into re-engagement. It is not appreciated that a wide swath of businesses is gone for good. Online business directory Yelp said that, as of mid-September, 60% of the closed businesses (nearly 100,000) have no plans to re-open. This was underscored by one disappointing statistic in the payroll report —that for the first time in this "recovery/re-opening" phase, temporary help services posted no growth at all in September. And it's clear that possibly as many as 5 million jobs, which is the equivalent of two years' worth of employment growth, are gone forever. For anyone who tries to spin the latest employment data as good news, give them some lipstick to put on his pig.



The Household survey was even weaker with employment showing a 275 thousand gain. This was the weakest result since April and a tiny fraction of the 3.76 million surge in August. Below the surface, the details were even more troubling – only 54 thousand full-time jobs were created last month.

Furthermore, all the job growth was in youth and, dare I say, low-skilled/low value-add industries. Employment in the 16-24-year age cohort soared 718 thousand. That's nice. They'll support Mom and Dad, because the number of jobs in the 25+ age group plunged 372 thousand, and the number of people employed with a high-school diploma, or less, soared a record 1.5 million! The strongest increases were in restaurants, accommodation, and the like.

Those with a college education saw employment plummet 2 million, which was the second sharpest decline on record. While the pandemic has hurt the unskilled and uneducated the most, there are now 5.1 million university-educated people who have lost their jobs since the beginning of the year.

The unemployment rate fell to 7.9% from 8.4% in August. But this is because 656 thousand people dropped out of the labor force last month! Without that, we would have seen the jobless rate come in at 8.3%. Furthermore, with 25 million Americans collecting unemployment benefits, the "real" unemployment rate is closer to 10-12%. Undoubtedly, that is much better than the 14.7% peak in April, but we started the year at 3.5%.

BACK TO NORMAL

Magic pills work only in fairy tales.

I watched the first of three presidential debates last week. As President Trump and former Vice President Biden took the stage, I assumed I would witness something interesting to write about. And sadly, I did. First off, any high school/college student on any debating team will tell you that was not a debate. It was a schoolyard fight between a 74-year old and a 77-year old. It was pitiful and painful to watch. Suffice it to say the debate was so bad that circus workers say it's offensive to call it a circus.

And the just-released NBC News/WSJ poll now shows "Sleepy Joe" with a huge 14-point lead (53%-39%). Before the debate (though it was more like a shout down), Biden's lead was closer to eight points. Even on a "fake-adjusted" basis, there is no path to an Electoral College win for the President with a gap this huge. And there's a month to go. Here are a few more stats: 44% of those who watched the "debate" think Biden won; 24% say Trump won (that has to be his hardened base) and 17% said neither won (that's more appropriate).

Speaking of debates, there is a raging debate as to whether life ever gets back to "normal," whatever that means. For example, there is a belief that with a vaccine or not, Americans are getting fed up with COVID-19, and everyone is aching to go out and eat and drink and gamble and browse at the malls. That is not the reality.

The polls show attitudes shifting on a secular basis. Consider what's going on in housing. Housing activity is being driven by single-family homes in suburbs and away from urban and multi-family units. Americans have grown a new appreciation for "open space" and that is not going to change in the future. Neither will working from home, for those that can.

UBS reported a consumer survey that found 54% of respondents saying they didn't expect to be comfortable attending a large public event for at least six more months. In the same survey, 47% said they wouldn't feel comfortable traveling for at least six more months.

The Chicago Fed conducted a survey and found that three-quarters of firms say the U.S. economy needs at least a year to fully recover from the pandemic. There were 670 respondents in the poll and half told the Chicago Fed that the recovery will take between one and two years to develop. The other half was split between a recovery in less than a year or one that would take more than two years.

A Washington Post/University of Maryland poll shows that only 56% of consumers across the nation intend to shop at the supermarket. Only 33% say they are comfortable entering a retail store. And a mere 22% say they are willing to dine in a sit-in restaurant. All these polls say basically the same thing – it will not be "business as usual."

Obviously, the downcast mood could change if a vaccine emerges but even if that happens, the logistical challenges of distributing any vaccine to the broad public are likely to weigh on theme parks and other mass-entertainment businesses well into next year.

Hope is good but we are all in the risk management business. Magic pills work only in fairy tales.

COVID-45

"It affects virtually nobody," Donald Trump, September 21 rally.

President Trump, who had shown disdain for masks at every turn and talked and acted like he was medically invincible, announced last Friday he and First Lady Melania had tested positive for coronavirus.

Out of caution, President Trump was moved to Walter Reed last Friday. According to news sources, to fight COVID-19, Trump took a large dose of an experimental drug made by Regeneron.

"This is not a matter of politics. It's a bracing reminder to all of us that we have to take this virus seriously."
- Former Vice President Joe Biden during an appearance in Grand Rapids, Michigan

Trump remains at Walter Reed and is being treated with a mix of experimental drugs, some of which are only usually given to the very ill patients. There are reports that the President's medical condition is improving, and he should be released from the hospital as early as today.

Even still, Trump's weight and age adds more risk to the situation (people aged 65-74 are five times more likely to require hospitalization than those between 18 and 39 —he is 74, weighs 244 pounds and reportedly is clinically obese with a BMI of 30.5). But remember what happened to Boris Johnson in the spring (he was out of commission for a month). Even moderate symptoms can involve chest pains, headaches, cold spasms, and extreme fatigue. And many clinical experts agree that the most important (dangerous) phase is week two.

The surprise shock has political, medical, financial, and national security ramifications. Will Trump be able to carry out his day-to-day duties? What happens to the next debate, scheduled in two weeks? Election Day is 30 days away. Markets hate uncertainty, and we now have the biggest X factor in the world.

This is almost certainly negative news for the economy because the chances of a significant relaxation in lockdown provisions in the U.S. have just been sharply reduced. It was much easier to argue for reopening the economy when a large part of the population truly believed that the pandemic was a hoax. That will change, and many individuals' behavior will probably alter even without an adjustment in the official rules.

Let me end by saying a "sick" economy cannot be a strong and vibrant economy. For the health and welfare of this country can we place our political bickering aside and all come together? Imagine, how much better off the country would have been had we adhered to the epidemiologists, "science" and the simple, straightforward advice from Fox news anchor Chris Wallace below?

"Forget the politics. This is a public safety health issue… I'm going to say something and, folks, I'm just trying to give you the truth… Dr. Scott Atlas is not an epidemiologist, is not an infectious disease specialist — he has no training in this area at all… Listen to people like Anthony Fauci, listen to people like Deborah Birx, who have been largely cut off. Listen to the independent people who do not have a political ax to grind, and I frankly don't think Scott Atlas is one of those people… Wear the damn mask!"

"Wear the Damn mask!" - Fox News anchor Chris Wallace

MARKET OUTLOOK AND PORTFOLIO STRATEGY

"We are in a depression – not a recession, but a depression. And I think the dynamics of a depression are different than they are in a recession because depressions invoke a secular change in behavior. Classic business cycle recessions are forgotten about within a year after they end—the scars from this one will take years to heal. - David Rosenberg

COVID-19 is far from going away as the global case count approaches 34 million and deaths top 1 million. The numbers are rising now in over half the U.S. states and the caseloads are rising by 0.6% daily. Across the United States, the newcase count (up 50,000 yesterday,to 7.38 million) has topped the 14-day average for three straight days (deaths are on the decline, mind you —still, for most of us over 50, this is not a disease you want to have in your life). The seven-day average of new cases has been above the 14-day average in 31 states. Texas, California and Michigan are still big problem areas.Be prepared for a winter of discontent.

Mounting evidence suggests the May/June bounce was just that, a bounce, and not a return to prior trends.

The small businesses that are hanging on are in major distress. A Lending Tree survey shows 43% have seen revenue drop by half or more, and 6% have already dissolved. We have never seen anything like this in history. This is not the material from which V-shaped recoveries are created.

Consumer spending has held up due to the initial pandemic relief. Now many live on savings, if they have any. We are getting ready to fall off an economic cliff without more relief. The markets remain hopeful that Mnuchin and Pelosi will strike a fiscal deal imminently. And while the odds have improved, it is still not clear that a package will occur prior to the election. But almost assuredly after the election (no matter who wins), a significant stimulus package will be forthcoming.

Math shows that if not for the gift that keeps on giving from the gobs of fiscal stimulus already handed out, real GDP would have contracted at a 10% annual rate in third quarter as opposed to the ballyhooed +30% consensus view. The economy is a bicycle on training wheels and the data has been pumped up by over $5 trillion of fiscal and monetary pump-priming this year, which has more than doubled the actual economic loss from the pandemic.

In essence, the economy has become heavily sedated by unprecedented fiscal and monetary policy stimulus. Beneath that veneer, there is rot. We shall see how long the government can mask what is really happening organically in the economy – at some point, the well will run dry. Nothing lasts forever, not even what seems for now to be an endless lifeline of government support.

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> – Darin Higgins, President of Western Illinois Credit Union

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> – Rhonda Schroeder, CEO of Blackhawk Area Credit Union

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MORE INFORMATION

For more information about credit union investment strategy, portfolio allocation and security selection, please contact the author at tom.slefinger@alloyacorp.org or (800) 782-2431, ext. 2753.

Tom Slefinger, Senior Vice President, Director of Institutional Fixed Income Sales, and Registered Representative of ISI has more than 30 years of fixed income portfolio management experience. He has developed and successfully managed various high profile domestic and global fixed income mutual funds. Tom has extensive expertise in trading and managing virtually all types of domestic and foreign fixed income securities, foreign exchange and derivatives in institutional environments.

At Alloya Investment Services, Tom is responsible for developing and managing operations associated with institutional fixed income sales. In addition to providing strategic direction, Tom is heavily involved in analyzing portfolios, developing investment portfolio strategies and identifying appropriate sectors and securities with the goal of optimizing investment portfolio performance at the credit union level.