Zacks Investment Management

# Mitch on the Markets

Portfolio Manager Investing Insights

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## A One-of-a-Kind Economic Recovery

The current economic recovery – which can now be deemed an economic expansion, in my view – has no historical precedent. All economic recoveries and expansions look different, of course. But we have never seen such a deep economic collapse followed immediately by a boom of this magnitude. It's a first-of-its-kind event.

Take the economic recoveries from the 1990-1991, 2001, and 2007-2009 recessions, for example. In each of those downturns, companies slowly resumed the hiring process, reluctant in many cases to grow the labor force when demand and growth were only trickling back to life. Unemployment in each case remained high for years after the recession.[1]

Not the case today. Our portfolio management and research teams at Zacks Investment Management see stories every day of businesses struggling to bring on new workers, with reported shortages all over the labor markets. In the early stages of an economic recovery, there are typically too many workers seeking too few jobs. The opposite is true today.

Other fundamentals point to a recovery of never-before-seen magnitude. The rate at which workers quit their jobs – which signals worker confidence in the labor market – is the highest since before the dot.com bubble burst. American household debt-service burdens are at their lowest level since at least 1980. Personal savings reached records during the pandemic. Home prices have jumped 14% since February 2020. Businesses are scrambling to bring more production online, often facing input shortages in the process.

Many 'experts' predicted the pandemic would take years to recover from, but the reality is the U.S. economy may surpass its pre-pandemic size *by the end of this quarter*.

I think it is important to examine why this recovery looks so different from previous recoveries. Here are two reasons.

1. **Spurred by Event-Driven Forces, Not Cyclical Forces**

Generally speaking, recessions historically are spurred by cyclical forces – rising interest rates, inflation, declining asset values, incomes, employment, or some structural issue in the credit markets, for example. Economic downturns tend to discourage consumers from spending and businesses from investing, exacerbating the weakness.

None of these conditions existed during the pandemic-induced (event-driven) recession and a bear market. Consumers and businesses went into defensive mode, but more out of fear of the virus versus fear that the economy was facing long-term damage. The federal government and the Federal Reserve provided extraordinary backstops, almost immediately, to keep businesses and consumers afloat. Many emerged stronger after the pandemic than before it.

There was a study performed in 2018 of New Orleans residents, in the years following Hurricane Katrina. The study examined individual tax returns and found that after a major hit initially, victims' incomes recovered within a few years and even surpassed, on average, those of unaffected workers. In short, event-driven downturns can recover more quickly than cyclical downturns.

2. **Households and Businesses Were in Good Shape in February 2020**

Event-driven bear markets and recessions can cause serious economic damage *if* households and businesses are in weak financial shape when the crisis occurs. We're seeing this outcome across much of the developing world. But here in the U.S., households and businesses were in solid economic shape going into the pandemic, which set the table for a rapid recovery once the event risk faded.

What's more, Americans were able to save money in record amounts during the downturn, thanks to government stimulus payments combined with business closures that essentially forced savings. U.S. households were saving at an annualized rate of $2.8 trillion in April 2021, which is two times higher than the savings rate before the crisis. By comparison, the annualized savings rate was $734 billion in June 2009 (following the Great Recession). Accumulated savings today amount to a wall of consumer liquidity poised to power the expansion.

Balance sheets for households and businesses are also historically strong. For households, the delinquent share of outstanding debt fell to 3.1% in Q1 2021, which is the lowest rate since records began in 1999. The ratio was 11.1% in 2009.

Banks also had strong capital positions entering the crisis. The New York Federal Reserve estimates that financial institutions have loss-absorbing capital equal to 16.5% of risk-weighted assets, which again is the highest share in over 20 years. When banks are well-capitalized and in strong financial shape, they are generally in good condition to lend, which is great for the economy.

**Bottom Line for Investors**

Many have been (pleasantly) surprised by the robust economic recovery thus far, and it appears the issues in the economy today are more about supply falling short of demand, which is a good problem to have, in my view. These imbalances (jobs, supply chain issues) should work themselves out in time.

Perhaps there should have been little surprise that the U.S. economy could deliver such a strong rebound in such little time, for the two reasons I detailed above. The same goes for the stock market – many wondered how the stocks could have delivered such strong returns in the midst of the crisis last year. The economy today should offer a clear explanation.

**ABOUT MITCH ZACKS**

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] Wall Street Journal. June 2, 2021. https://www.wsj.com/articles/the-economic-recovery-is-here-rebound-jobs-stock-market-unemployment-biden-aid-package-11622642152

**IN FOCUS THIS WEEK**

- Hot jobs' market desperate for workers
- Wages on the rise
- Keystone XL pipeline project winding down
- China experiencing inflation

## The Hot Jobs' Market is Desperate for Takers

The number of job openings in the United States hit a record 9.3 million in April, according to the Labor Department. The demand for workers underscores the race for businesses to come fully back online as the economy heats up. The number of job openings nearly matches the 9.8 million Americans who remain unemployed and looking for work, signaling we could see the unemployment rate come down further in the coming months. Interestingly enough, however, the rate at which workers quit their jobs – which is a sign of confidence in the jobs market – also hit a record in April. Many workers likely believe they can find a better job at a higher wage, in such a competitive environment for labor. Most job openings currently are in areas of the economy like food service, hospitality, tourism, and warehousing, where wages are generally low but could see some upward pressure. In the meantime, teenagers have been increasingly sweeping up many of the low-wage jobs. The unemployment rate for 16- to 19-year-olds fell to 9.6%, which is its lowest level since 1953. The share of teenagers who work also touched a decade-plus high, at 33.2%.[1]

## Wages are on the Rise

Many argue that the supply/demand imbalance in the labor market is due to employers paying too-low wages. Many businesses are responding in kind: the average hourly earnings rose 0.5% following a 0.7% increase in April, a reasonably robust pace for month-on-month readings. The sectors with the biggest shortages in workers are seeing the most wage pressures, which makes economic sense. In leisure and hospitality, for example, hourly earnings rose 1.3% in May from April, and are 7% higher than they were in February 2020, when the pandemic hit. At restaurants and bars, hourly pay for non-manager employees is up 6.3% from February 2020. If companies hope to fill some of the record 9.3 million job openings, they may need to follow suit.[2]

## Keystone XL Pipeline Project Goes Offline

The long saga of the Keystone XL pipeline project may officially be winding down. This week, the developer of the pipeline, Canada's TC Energy Corp., said they are scrapping the project. The company gave little information about its full rationale for abandoning the project, but its failure to secure a critical construction permit was likely part of its last straw. The company said it would be shifting its focus to building businesses in shipping and storing natural gas, liquid fuels, and power to align itself with the U.S.'s shifting energy market.[3]

## China is Experiencing Inflation, Too

We have written many times about inflationary pressures in the U.S., but the world's second-largest economy is feeling it too. In May, China's factory-gate prices rose by the most in 13 years, and its producer-price index also jumped 9% from a year earlier. China says that rising price pressures in crude oil, iron ore, and metals are fueling the pressure, and businesses around the world are growing concerned that rising input costs could trickle through the supply chain. China's government has been instituting guardrails to try and contain the issue, by issuing rules against commodity/input hoarding and attempting to set price controls. The key issue to monitor going forward is if these price pressures persist throughout the year, or if they are just short-term spikes corresponding to the full economic reopening in the U.S.[4]

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[1] Wall Street Journal. June 8, 2021. https://www.wsj.com/articles/job-openings-are-still-rising-but-labor-demand-is-easing-in-some-sectors-11623144602

[2] Wall Street Journal. June 8, 2021. https://www.wsj.com/articles/job-openings-are-still-rising-but-labor-demand-is-easing-in-some-sectors-11623144602

[3] Wall Street Journal. June 9, 2021. https://www.wsj.com/articles/keystone-xl-oil-project-abandoned-by-developer-11623272010?mod=hp_lead_pos2

[4] Wall Street Journal. June 9, 2021. https://www.wsj.com/articles/chinas-surging-manufacturing-prices-put-pressure-on-beijing-to-do-something-about-them-11623222635

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