Economic Update

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Dr. David Kelly, CFA | Chief Global Strategist for J.P. Morgan Funds

This weekly update provides a snapshot of changes in the economy and markets and their implications for investors.

Growth

2Q20 real GDP fell 32.9% q/q at a seasonally adjusted annual rate following a 5.0% q/q decline in 1Q20. The second quarter should mark the end of a severe but short recession, with a peak to trough decline of 10.6% in real terms. While 3Q20 could see a 25% q/q bounce, the recovery is likely to be gradual, and the 4Q19 peak in GDP may not be surpassed until 3Q21. However, housing continues its v-shaped recovery, with housing starts rising 22.6% m/m, building permits rising 18.8% m/m and existing home sales rising 24.7% m/m in July. Manufacturing and services PMIs reached 19 and 17-month highs at 53.6 and 54.8, respectively.

Jobs

Nonfarm payrolls increased by 1.76 million in July, pushing the unemployment rate down to 10.2%, with gains driven by leisure and hospitality, retail, education and health care. The economy has now regained 42% of the 22.1 million jobs lost between February and April. Wages grew 0.2% m/m for all workers but fell 0.4% m/m for production and non-supervisory workers, up 4.8% y/y and 4.6% y/y, respectively. Progress in employment growth is welcome but slowing, underscoring the need for further monetary and fiscal support.

Profits

With 461 companies having reported (91.9% of market cap), our current estimate for 2Q20 earnings is $26.10 with EPS declining 35.0% y/y. Thus far, 83% of companies have beaten on EPS estimates, and 59% have beaten on revenue estimates, both well above long-term averages, reflecting overly bearish initial estimates. Still, shutdowns, lower oil prices and dollar strengthening have weighed heavily on corporate results. From a sector perspective, consumer discretionary and energy have seen very negative earnings, while technology, health care and utilities have held up well on a relative basis.

Inflation

June headline PCE rose 0.4% and core PCE rose 0.2% m/m, rising 0.8% and 0.9% y/y, respectively. Headline and core CPI rose 0.6% m/m in July, rising 1.0% and 1.6% y/y, respectively. The gasoline index continued to rise after increasing sharply in June and accounted for about one-quarter of the monthly increase. However, food at home declined 1.1% and airfares rose 5.4%, reflecting further reopening of the economy. Strong increases in July suggest a partial rebound in year-over-year inflation as measured by the consumption deflator.

Rates

The FOMC maintained the federal funds target rate at a range of 0.00%-0.25%. Asset purchases are expected to continue indefinitely to provide support to market functioning, and the Committee will maintain its current pace of gross purchases of U.S. Treasuries and agency mortgage-backed securities at roughly $80 billion and $90 billion per month, respectively. The Fed also extended its credit and lending facilities to December 2020. No major changes to policy were announced, although the Fed may consider outcomes-based forward guidance, such as tying rate moves or asset purchases to target inflation, in the future.

Risks

• The U.S. recession and recovery could be at a slower pace than markets are anticipating.
• Political headlines could foment market volatility.
• Inflation could spike in the medium term.

Investment Themes

• Quality with a dash of cyclicality should be a focus for U.S. equity investors.
• Fixed income investors should move up in quality, and look to core bonds for portfolio ballast.
• Long-term growth prospects and cheap absolute and relative valuations support international equities.

Denotes updated information
Data are as of August 24, 2020

Past performance does not guarantee future results.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

The S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market. This world-renowned index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 Index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market. An investor cannot invest directly in an index. Indexes are unmanaged.

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