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Market Update: 2nd July 2020

The Fed Hints at Further Support as Virus Cases Rise

With a resurgence in virus cases across the US threatening the recent rebound in the US economy and expectations for a second half recovery, US policymakers are under increasing pressure to do more to support the economy over the coming weeks via further rounds of stimulus. At this stage, It is unclear exactly what the next round will entail, however it is clear that stimulus will have to be well targeted and send a strong signal to markets and consumers about the commitment within congress and the central bank to support the economy throughout the pandemic.

The Fed's Untapped Firepower

On Monday, Federal Reserve Chairman Jerome Powell described the US outlook as "extraordinarily uncertain", with the near-term outlook depending both on containing the coronavirus and on government efforts to support the recovery. Economic activity has picked up in recent weeks after months of shutdowns to slow the spread of the coronavirus, with the economy recovering faster than expected so far. Powell highlighted the welcome increase in activity, however also warned of the need to keep the virus in check to sustain the recovery. He also noted the importance of policy actions taken at all levels of government to provide relief and to "support the recovery for as long as needed".

So far, the Fed has cut rates to near-zero, bought trillions of dollars of bonds and rolled out credit backstopping programs to boost the economy and steady markets. At the same time, the central bank has pledged to use the "full range of tools" to support the US economy throughout the pandemic. On Monday, Powell signalled that more help may be needed to support the economy, noting that the Fed's yet untapped $600 billion Main Street lending facility may prove valuable in the months ahead for firms hit by a dramatic fall in activity during the pandemic.

Alongside the Main Street facility, the Fed's emergency credit facilities have so far only lent $95billion, well below the $4.5 trillion potential firepower, suggesting that the Fed still has plenty of scope to support the economy further over the coming months. At the conclusion of the June FOMC meeting last month, the Fed announced that it intends to continue the pace of its net QE asset purchases at least at its current pace of $30billion per week, suggesting another $780billion in the second half of the year. This still leaves room for the Fed to increase purchases.

Calls for Government Stimulus

While Congress has also done its part in promising aid to the economy in recent months by issuing around $3 trillion in aid to date, there are growing calls for further stimulus in the coming weeks as virus cases escalate across the country. While both sides have discussed the next round of stimulus and what this may entail, negotiations won't begin in earnest until the Senate returns from recess on 20th July. Economic data over the next month is expected to shape much of the debate over how much stimulus is required.

So far, most of the discussion in Congress and the Trump administration about the next round of stimulus has focused on the following key items:

- Additional aid for businesses and the unemployed
- Another round of checks to individuals
- Liability limits for employers
- Healthcare and infrastructure funding
- Aid to state and local governments

June Jobs Data Boosts Stocks

When negotiations start later this month, efforts to prevent the current weakness in the labour market from becoming longer lasting issues are expected to be top on the agenda. Today's jobs data showed that the rebound in the labour market accelerated in June as broader reopenings spurred more hiring, although filings for unemployment benefits remained elevated last week as coronavirus cases increased. According to today's Labour Department report, payrolls rose by 4.8million in June after an upwardly revised 2.7 million gain in May. The unemployment rate fell for a second month by 2.2% to 11.1%, still extremely high and far above the pre-pandemic low of 3.5%.

The jobs data (which reflects a snapshot of mid-month conditions) shows a flurry of rehiring in the service sector after lockdown restrictions were relaxed, however the data should be taken with a pinch of salt. Some of those plans may now be halting as some states dial back reopening plans following an increase in virus cases. This does not come as a surprise, as the pace of reopenings in some states sparked concerns over a resurgence in virus cases, however how the issues are dealt with on a state level will be very important for the US recovery momentum moving forward.

Adding to the job gains in the coming months is likely to be critical to President Trump's re-election chances, so we are likely to see further government support in this area, while the extension of a US stock market rally will also be important, with the President expected to put more pressure on the Fed in the lead up to the next meeting at the end of this month. In reaction to the jobs data, US stocks advanced as optimism over a second half recovery partially offset virus concerns over the week.

Positioning

Overall, while the US grapples with a resurgence in virus cases, it is clear that significant risks lie ahead for the US economy in the near term, which is why we remain underweight US assets within the portfolios, with greater return potential to be had in UK and European markets moving forward in our view. At the same time, we are expecting to see further stimulus from the Fed and Congress in the coming weeks to provide further support to the US economy and markets during this period of weakness. For this reason, despite the near-term outlook remaining highly uncertain, our medium-term outlook remains unchanged as we still see further support and continued (albeit more gradual) recovery ahead, however we maintain an underweight allocation to the region for now.