Making Sense of the Economic Implications of COVID-19 and the Response in Communities Across the United States.

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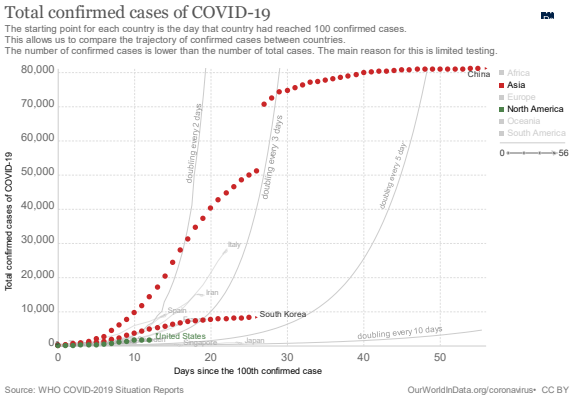
[abstract] At the beginning of the COVID-19 outbreak, we began our analysis of the virus' economic impact, we based our figures on the impact of the virus itself in the US economy. Having seen similar outbreaks many times in the past, the evaluation was relatively clear. The response across America has been anything but typical. It is extremely difficult to model the path of a disease with any degree of certainty, and it is equally challenging to model the future of an economy. What is becoming increasingly more certain is that the general hysteria sweeping across the country will cause significant additional challenges, both to the economy and public health. Many communities have not adequately followed CDC recommendations and have issued shutdowns and self-quarantine orders prematurely paralyzing their local economies and diminishing their ability to respond when they actually need to.

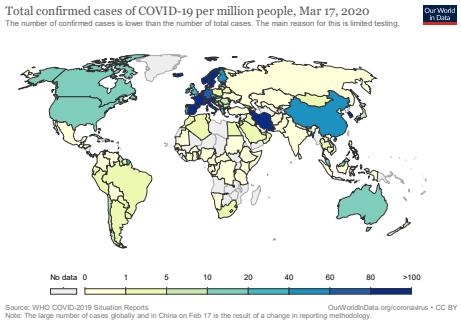
We must follow CDC recommendations and protect those who have substantial risks with extreme vigilance. At the same time, we should refrain from unnecessary closures (those prior to evidence of spread in the community) as they cause joblessness and homelessness along with other financial and social hardship without adding any positive impact to "the curve."

Several days ago, Brian Wesbury, Chief Economist at First Trust Advisors, updated their economic outlook for the second quarter of 2020 to show a 10% drop in GDP with a relatively rapid recovery (Read / Watch). We agree with First Trust's assessment and are updating our models accordingly. ***Understanding the virus, the misconceptions surrounding it as well as those surrounding the recommended preventative actions will be key in making rational decisions to protect human lives and prevent recession. The risks of continuing down the frenzied path we are on may increase the spread of the virus and will amplify the negative economic impacts—perhaps to a level yet unseen.***



We are a few days into our nations 15 day "social isolation" push to slow the spread of COVID-19. So far, the U.S. response has been remarkably

effective at addressing the spread of the disease. While I'm not a doctor, my profession is understanding data and bridging the gap between quantifiable data and the practical. It doesn't take a data scientist to see that the United States of America has done an exceptional job at slowing the spread of COVID-19 to date (3/17/2020). Presently only 10.5 people per million have contracted the virus in the United States. I'm proud of our country's response and of how our community leaders and business leaders are coming together to support one another and help the people around them. Outbreaks like this are among the most sobering human tragedies we experience.



Initially, the economic impact of the virus appeared to be small. Even though we saw a rapid and broad-based decline in the US Stock Market prices (measured by the S&P 500), of around 15%. When OPEC failed to agree on production terms and a "price war" ensued, it appeared as though we would have a decline in GDP growth for on quarter, which would put us at about 0% growth in the second quarter of 2020. The massive drop in oil prices actually gave some support to our economy to offset the challenges of COVID-19, and in our initial estimate, we still projected about 2% growth for the year.

Economics of COVID-19

When COVID-19 began to spread in the United States, it became clear that we all would need to adjust our expectations for the year. The question has been how to gauge the impact of our response on the economy. The virus itself causes almost no damage on its own. "Social Isolation" hurts some parts of the economy, but helps other areas (I don't know how much of our GDP is attributable to toilet paper sales, but I promise that its up). The most significant challenge, however has been the unmitigated panic we've embraced together. I'm glad that we have chosen as a society to value human life over economic expansion. We have determined to "flatten the curve," so that we can better respond to COVID-19. The CDCs recommended response has shown to be one of the most effective in the world. What measures have been taken so far to protect our economy?

At a federal level: The speed at which government has been working in response to COVID-19 has been quite astonishing. This is true both on the medical and public health policy front as well as in working to develop economic stimulus to mitigate the damage to our economies. This is a very unique situation.

We are acting very preemptively to prevent mass outbreak and an overload of our medical system, but these actions have significant negative impacts on our economy. One could easily argue that the prevention measures of mass shutdowns will have a far greater and longer lasting impact on our economy than if we let the virus run rampant. In the face of these challenges, we have chosen, as a nation, to value human life and health over money.

At this time, the House and Senate are working on Phase 3 of the response to COVID-19. Phase 1 addressed funding for health resources to address the virus outbreak itself, Phase 2 addressed paid medical leave for sick or quarantined workers or those that must care for family members, and Phase 3 will likely address funding for affected industries (primarily airlines), small businesses, cuts in payroll taxes or direct payments to individuals. At this point it is looking very likely that the Federal Government is going to send direct payments to Americans very soon. In fact, since 90% of individuals have filed electronic returns the funds may even be direct deposited into your bank account.

H.R. 6201: Families First Coronavirus Response Act (Phase 2) includes the following provisions:

- Free COVID-19 Testing for everyone who needs a test
- Establishes a federal emergency paid leave benefits program to provide payments to employees taking unpaid leave due to the coronavirus outbreak,
- Expands unemployment benefits and provides grants to states for processing and paying claims
- Require employers to provide paid sick leave to employees
- Treat personal respiratory protective devices as covered countermeasures that are eligible for certain liability protections, and
- Temporarily increase the Medicaid federal medical assistance percentage (FMAP)
- Requires the Occupational Safety and Health Administration to issue an emergency temporary standard that requires certain employers to develop and implement a comprehensive infectious disease exposure control plan to protect health care workers

In addition to the actions being taken by the House and the Senate, the Federal Reserve has taken drastic actions to provide liquidity to individuals and businesses throughout the nation. The Federal Reserve has cut interest rates as low as they possibly can and injected more liquidity into our economy. Overall, the federal government has done an excellent job responding to the economic impacts of the virus.

At a grassroots level: In some ways, we've done more harm than good. We're doing everything that we can to protect those we care about from the virus, and I have personally initiated the closure of a number of events. When making decisions that affect people around us, we need to be prudent. From a data perspective, however, we may have been a little

overeager to shut-down. There are presently 7038 cases in the US according to the CDC, but approximately 59% of the cases are in CA, WA, & NY.[1] Many states have just a few cases (25 states have less than 50). Most of our communities are still insulated and not at risk, yet we are shutting down schools, forcing people to use what sick time they have to flatten a curve that hasn't yet come close to our communities. Purely from a data-perspective:

- Self-quarantine is needed when reason to believe you've been exposed to the virus.
- Social distancing is helpful when the virus is found in your area.
- Shutdown becomes effective when the virus begins to spread in a community. Note: shutdown has no preventative value when isolating unaffected people.

> "Each community is unique, and appropriate mitigation strategies will vary based on the level of community transmission, characteristics of the community and their populations, and the local capacity to implement strategies."
>
> *-CDC Community mitigation Framework*

This perspective is consistent with CDC recommendations.[2] While large cities who are effected have needed to take aggressive measures, like forcing the closure of restaurants and other public spaces, smaller communities who have yet to experience transmission may find such closures to be catastrophic to their economies and increase transmission when the outbreak reaches their community.

The CDC lists a number of factors communities must consider in evaluating their response and timing it properly. These include epidemiological factors (including transmission rate), community characteristics (population density, public transit, etc.), Healthcare capacity, and the capacity of the healthcare system.[3] At present, it appears as though much of these factors are being ignored at the community level and response is being mandated long before transmission exists. If our communities continue down this path, transmission will increase because few community members will have the financial capability to self-quarantine and engage in other effective measures to control the virus.

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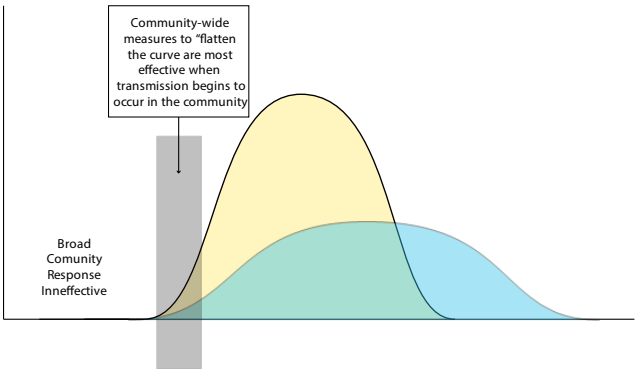
[1] http://www.cdc.gov 3/17/2020

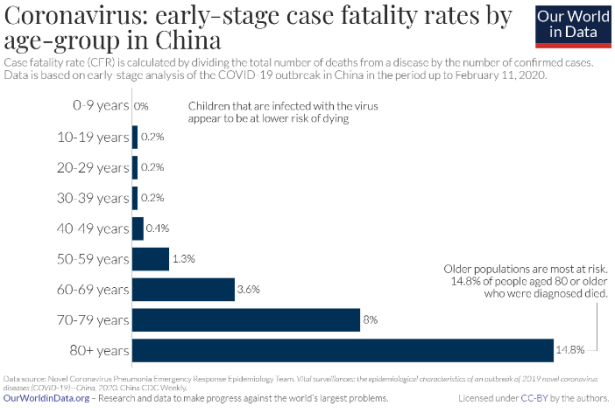
[2] Cf. https://www.whitehouse.gov/wp-content/uploads/2020/03/03.16.20_coronavirus-guidance_8.5x11_315PM.pdf; https://www.cdc.gov/coronavirus/2019-ncov/prepare/prevention.html; https://www.cdc.gov/coronavirus/2019-ncov/downloads/workplace-school-and-home-guidance.pdf

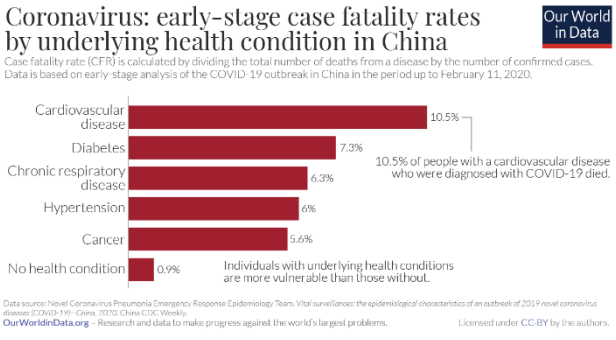
[3] https://www.cdc.gov/coronavirus/2019-ncov/downloads/community-mitigation-strategy.pdf



If our local governments and businesses continue to over-embrace shutdown for an extended period of time, the ramifications, both economic and human-centered, have the potential to cause more damage than the virus—and damage that will be more difficult to repair. We must practice patience in shutting down our communities because "flattening the curve" extends the duration of the outbreak and its impact. If small businesses are forced to use their reserves too soon… If parents are forced to use their sick time too soon… If we exhaust the resources we have to flatten the curve before the time is right, then we may be forced to embrace the curve on its own terms or enjoy layoffs and small business collapse. The federal government has enacted fiscal stimulus measure to help mitigate this potential catastrophe, but good decision-making by local governments can make this much more effective.

We are making rapid improvements to testing and learning a great deal about the virus. Calculations of fatality rates among reported cases are becoming more clear and we have identified how the virus affects different age and health demographics. The total number of fatalities is less than initially predicted, with the total among reported cases around 3.5%. In addition, we are beginning to understand the number of cases that were mild enough to be unreported in our early numbers. A multi-university study recently published identified that approximately 86% of cases studied why the W.H.O. in their final report on Wuhan may have been unreported.[4] These would have most likely occurred among young, healthy individuals.





There is a lot we can learn from the data, but it can also obscure many things. If we look at the 3.5% fatality rate that has been reported, we understandably assume that is the probability

[4] **Substantial undocumented infection facilitates the rapid dissemination of novel coronavirus** R. Li *et al.*, *Science* 10.1126/science.abb3221 (2020). [link]

we will pass away from the virus. Just working with the reported cases, we should look at age and health. For the elderly, or those suffering from other disease, COVID-19 is quite lethal. For a 30 year-old in perfect health, the data indicates a rate lower than .2%.

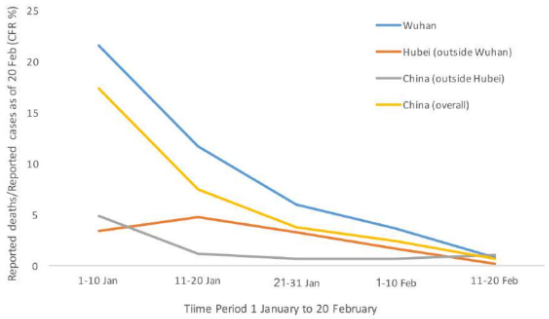


Figure 4 Case fatality ratio (reported deaths among total cases) for COVID-19 in China over time and by location, as of 20 February 2020

If we adjust the rates to include unreported cases, even if they are lower than 86%, mortality rates are at least cut in half—perhaps more. A step further, initial fatalities were much higher at the initial discovery of the disease than they were later on. This indicates that the simple ability to identify the virus makes a significant impact to survival rates. I believe this effect will continue and will only be improved as we find additional effective treatments.[5]

As we accumulate more information about the virus those who have it and have an actual representative sample of the population, we could see fatalities stabilize as low as .05%. Unfortunately, the change in data will present mostly among the least vulnerable population segments (those under age 50 and in relatively good health). We must follow CDC recommendations and protect those who have substantial risks with extreme vigilance. At the same time, we should refrain from unnecessary closures (those prior to evidence of spread in the community) as they cause joblessness and homelessness along with other financial and social hardship without adding any positive impact to "the curve." On a very personal and emotional level, I struggle to see these decisions, when ill-timed, as anything other than social injustice under the guise of public health.

We've seen the best from our businesses. From the largest corporations to the smallest businesses, the response has been one of compassion. Businesses are adapting as quickly as they can to whatever "social distancing" measures are forced upon them. They are choosing to dedicate cash reserves to help their employees whenever possible. They are sanitizing, giving employees flexibility to keep themselves safe, and making every conceivable effort to help us weather this great storm. Unfortunately, many small businesses lack the resources and

[5] The National Institute of Health has begun clinical testing on Remdesivere (Feb 25) and began Phase 1 of a vaccination study on March 16th. While sample size and time constraints have limited researchers' ability to adequately verify the efficacy of any one treatment, a number of antiviral drugs, including Chloroquine and Favipiravir have shown a great deal of promise in treating COVID-19. Cf. Chloroquine for the 2019 novel coronavirus SARS-CoV-2. Panel: Philippe Colsonab, Jean-Marc Rolainab, Didier Raoultab. *International Journal of Antimicrobial Agents*: Volume 55, Issue 3, March 2020, 105923.; COVID-19: combining antiviral and anti-inflammatory treatments. Stebbin, Justin, et al. *Lancet*. Feb 27 2020.

flexibility to accomplish this and are shutting their doors. This is damage to our communities that won't easily be repaired.

What does this mean for your Investments.

The S&P 500 recent price decline has been a reaction primarily created by fear of the unknown. There were three distinct, albeit nearly-contiguous, stages of the drop. First was at the end of February when fears of COVID-19 began to grow in the United States. During this time, the S&P 500 fell sharply and substantially, hitting valuation levels that were generally considered to be below fair value. The markets actually began their recovery when OPEC failed to reach an agreement. This began the second stage of the decline. The reduction in oil price should have buoyed the recovery; however, headlines reading "price war" fueled the public's hysteria and we saw more declines in the financial markets. Just as the selling reached a point of losing steam, COVID-19 actually arrived in the U.S. Overall, the markets have dropped substantially. We believe that in order to justify the market's declines, Corporate profits would need to decline by approximately 70%. We are nowhere near this level of crisis at present.

Investing in strong businesses through the capital markets has rarely been more attractive for long-term investors. It will be key to evaluate risks on a company by company basis as the COVID situation plays out. We believe market volatility will continue in the coming months and valuations will remain attractive for several months and recovery will be rapid when treatment options become widely accepted and "social distancing" policies begin to be implemented more appropriately by local entities. For the time being, our investment focus should be on purchasing strong, rising dividends at conservative values. Our personal focus should always remain on caring for the people around us.

Disclosures:

The COVID-19 outbreak is a rapidly changing issue, and the information in this article may have become outdated or obsolete by the time of its circulation.

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