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ROHR ALERT!! Sustainable Strength or More 'Normalcy Bias'?

1 message

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Dear Subscribers,

As noted in Friday's "Normalcy Bias' Fosters Return of Bifurcation" ALERT!!, there is a tendency to ignore looming negative news in the context of current bright spots in the data. And this morning has indeed brought a bit more joy in the form of improved global Advance PMIs. While Japan is lagging, the rest are up toward or into the 50.0 balance point. In the US PMIs were a bit weaker than estimates yet still up hear that 50.0 balance point while both the Richmond Fed and New Home Sales came in waaaaay better than expected. Very upbeat.

And in response to this as well as Trump administration Trade Advisor Navarro walking back comments on problems with the US-China trade deal (which had knocked the US equities briefly overnight), the September S&P 500 future is back above the interim 3,100-30 range. This is important due to front month S&P 500 future (June contract last week prior to Friday's expiration) having pushed above it multiple times last week without posting a daily Close above it, making it a very interesting level to watch this week. Even if it escapes, bigger resistance remains into the 3,200-30 December-February congestion where the June contract stalled two weeks ago despite a very strong US Employment report the prior week.

What we know is that for a brief while three weeks ago there was a true 'risk on' psychology across all asset classes. US equities surged along with strength in emerging currencies and even the developed currencies against the US dollar. That also saw the first real weakness in a while hit global govies. It seemed to dissipate late in the week two weeks ago on renewed COVID-19 infection fears hitting Latin America as well as select US states committed to reopening.

Yet as we have noted, the cross currents on various fronts are becoming more complex, including especially the COVID-19 fears in the US. What the researchers are finding is that much of the increased infection rate is among the younger population, with little critical illness. While there are some states on alert for the impact of hospitalizations, in general there is less fear of the virus at this time.

However, in the future is the consideration of whether the US government will be providing more relief to economically hard-hit individuals and sectors. It is the case the highly partisan nature of the US political divide makes that problematic. However much the Democrats continue to point out the looming problems, many Republicans are averse to more spending on top of the roughly \$3.0 trillion the US Congress has already approved. Sen. Toomey (R-PA) has repeatedly been on various media outlets voicing the more parsimonious GOP view of late.

In our cynical centrist view, the Democrats will continue to push this extended government spending agenda for three reasons. In the first instance, there are instances where it actually makes a lot of sense (more below.) Secondly, they have now bought into a variation of Modern Monetary Theory (MMT) proposing no limit on government spending due to the

ability to control inflation (even if that is a specious proposition.) Thirdly, they see political advantage in casting the GOP as unwilling to support segments suffering under COVID-19 economic pressure.

The Dems view this as a win-win in either being able to take credit for additional spending in the face of GOP resistance, or being able to thrash the Republicans into November's election if worst case impacts hit the US economy; especially for lower income brackets heavily affected by the closures in key industries (dining, travel, hospitality, personal health and beauty, etc.) spilling over into housing.

In his semiannual Senate testimony Fed Chair Powell was very supportive of all manner of continued COVID-19 relief to offset the pandemic economic disruption. No surprises there, and you can view his full Senate testimony and extended Q&A from a week ago at <https://bit.ly/3e8WDBG>. Senator Doug Jones (D-AL) from 1:53:00 is especially pointed on the ways in which this affects the black community in the current context of anti-discrimination and fair policing efforts.

Aside from the heavier burden of unemployment and business closures on the minority community, there is a telling housing impact that could turn into a crisis this summer. Especially note what Powell has to say on this from 1:57:30 right after his additional warning on the problems of many more black businesses closing than their white counterparts. According to a weekend Reuters article (<https://reut.rs/2AJJ6Cm>) US evictions are likely to soar once moratoriums expire.

New York state's expired on Friday, even if (likely many) residents who can show COVID-19 impacting their ability to pay will be granted an additional two-month grace period. So what? These 'forbearance' programs never implied there was 'forgiveness', and with more months of back rent or mortgage payments due, what are the chances those occupants will be able to maintain their residences? Yet this is a deferred crisis, as the federal moratorium runs through August.

We first questioned the impact of the 'forbearance' efforts right after they were announced (see our March 27th 'Think Implementation...' ALERT!!) The issue was and remains what does this mean in the chain of financial responsibility? As we specified back then, *"'Forbearance' is a term the US government has bandied about quite a bit in recent suggestions on how we can all get through the crisis. Fair enough. Sounds very comforting and optimistic. But will it withstand the test of commercial reality? That regards, 'Forbearance' has a legal definition: refraining from exercising a legal right, especially enforcing payment of a debt."*

Further, *"Might the landlord want to show 'forbearance'? Sure. But does that landlord own the building, or does it have a mortgage? Chances are good it is the latter in most cases; and it likely counts on rents to make monthly mortgage payments. So now we move on to whether the lender will show 'forbearance'."*

And on it goes into what needs to be addressed on multiple commercial fronts (ultimately government support for banks to allow mortgage forgiveness) that will have little chance of serious review (much less bipartisan legislation) in highly partisan election year politics. While the Dems might feel they'd like to help, on a cynical *realpolitik* level they will as likely see advantage watching the COVID-19 health crisis turn into a lower income individual residency and business crisis.

To be clear, this is neither partisan criticism of Democrats nor the Republicans... we are always an equal opportunity critic from a fully centrist POV (point of view.) For the uninitiated, ALWAYS expect the worst kind of partisan foolery in US general elections years, exacerbated of late by the generally partisan atmosphere.

The key point here is the looming if still deferred problems likely to flow from the COVID-19 economic impacts which are not yet being anywhere nearly addressed by the US political class; other than Democrats raising the issues without much actual legislative action. We have repeatedly noted the degree to which the 'stabilized' level of economic activity as the 'reopening' of the US economy will already be below the early 2020 expectations based on the growth prior to the COVID-19 pandemic. This will mean lower economic and business turnover.

If our (along with others') concerns come to fruition, then the further drags on the US economy short of any additional expansive government relief programs will be even worse than currently anticipated. The impact of 'at risk' populations like more well-to-do older folks rightfully not fully participating in the reopening was already going to restrain top line growth. If that is intensified by a late-summer housing crisis in the lower income community spreading to affecting landlords and the banks, it will only be that much more of a drag from a key demographic; one that can usually be counted on to spend 100% of its disposable income.

It will fully confirm that the current upbeat economic and market psychology is classical 'Normalcy Bias' as opposed to heralding sustained economic and US equities strength. Just to be clear, much like the 2007- 2008 Housing and Credit Bubble, this is a deferred impact which will need to be monitored. Yet wouldn't it be ironic if the US were back in a partial Housing and Mortgage crunch (more so in the poorer neighborhoods) after the government thought it had done all that was necessary to offset the COVID-19 impact? Sad but ultimately typical.

[For more on 'Normalcy Bias', see that chapter in David McRaney's 'You Are Not So Smart', 2011 Copyright Gotham Books, Penguin Group, New York, New York.]

This is the critical consideration

COVID-19 virus spread caused US equities intermediate-term bull psychology to 'crack'. Front month S&P 500 future was already back below key congestion around the mid-2019 3,030-00 previous all-time high congestion. That was below support from the push above the multi-year topping line at 3,070 as well, and left a late-February intermediate-term up channel 2,970 DOWN Break.

The subsequent DOWN Break below the front month S&P 500 future 2,600 area major up channel seemed to indicate more of a near-term failure. That was from the early 2016 low (<https://bit.ly/31fEdeO> updated through Friday.) That was the key higher resistance it had violated on its mid-April push above its 2,675 trading high Tolerance from prior to the DOWN Break (including monthly MA-48.)

As such, it is reasonable the front month S&P 500 future will now treat the low 2,600 area (with a Tolerance to the mid-2,500 area) as support, with interim levels at 2,850 and 2,750 that were important in the recent up trend. And the front month S&P 500 future pushed out of the broad higher range top in the 3,030-2,970 area three weeks ago and sustained it, with the 3,200 area the next higher meaningful resistance that has a 3,230 Tolerance. That is obviously what the market knew once it exceeded the 3,030 area, as it rallied directly to 3,200 into early June.

It stalled all three days early the following week up against that 3,230 Tolerance with no sign it was going to push further. After the following Wednesday's friendly Fed communication yet with no additional stimulus announcement into a still weak economic situation (see the Thursday's ALERT!!), the US equities were extremely disappointed. In the context of recent hypervolatility, this opened the potential to retest that more prominent confluence of technical factors in the 2,970-3,030 range, which it vigorously tested into early last week.

That congestion is reinforced by the manner in which the market churned up against the low end into May. It is now churning in the interim 3,100-30 middle of those major ranges pending clarification of the future 'macro' factor psychology.

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