

MACROCOSM

A Second Wave of Lockdowns?

Tuesday, July 14, 2020

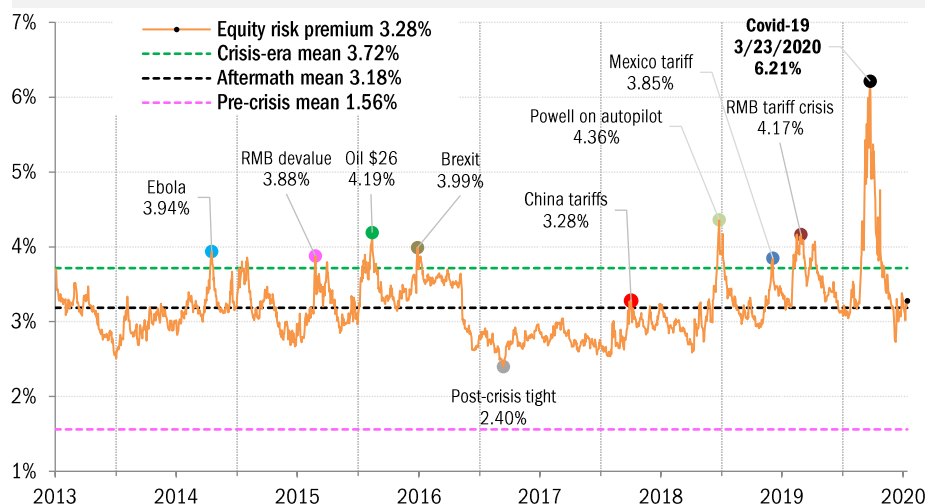
Donald Luskin

Blue California caves to the panic. But virus spread is worst in stoic Red states.

News that [California is reversing some of its economic re-opening](#), and will be [delaying in-person schooling](#) is probably responsible for yesterday's sharp reversal in US equities from what was, briefly, new recovery highs. As we've been saying, *the threat to asset markets is not what the media has been calling a second wave of Covid-2019* (see ["Spike! 'Surge! 'Precipice! \(Please Check One\)"](#) June 16, 2020), *but rather a second wave of policy errors like we saw in March*, when economies world-wide were shut down in an attempt to contain the spread of the virus which, by *ex post* evidence, was both highly costly and ineffective (see ["Video: What you're not hearing about bringing the economy out of lockdown"](#) April 27, 2020). *The last thing a V-shaped recovery needs now is more useless and harmful lockdowns just when we've passed the "point" of the V and are on the upswing* (see ["Data Insights: High-Frequency Post-Virus US Recovery Monitor"](#) July 9, 2020).

- More on the virus and lockdowns in a moment. But first it must be said that *risk assets were ripe for further correction anyway* – with the S&P 500 breaching the prior recovery high on June 8, when we pointed out that the equity risk premium had narrowed to near the post-financial crisis narrows (please see the chart below, and ["Do Equities Have a Valuation Problem?"](#) June 9, 2020). At the highs

S&P 500 equity risk premium from mid-year 2013



Source: Various, TrendMacro calculations

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Update to strategic view

US MACRO, US STOCKS: California's reversal of economic re-opening, still partial but the most substantive yet, triggered a dramatic one-day reversal in equities from new recovery highs. Equities were vulnerable anyway, with the equity risk premium not much wider than it was at the prior high in early June. We reject the idea of a second wave as fuzzy thinking, but there are in fact accelerating fatalities in Arizona, Florida and Texas; and California had a brief episode. But the magnitudes are small. And there remains no evidence that lockdowns help. Attitudes about economic lockdowns are now politically assigned. That's why Blue California which is suffering the least has done the most, while Red states that are suffering more have done less. The road to recovery is mostly clear because the acceleration of fatalities is occurring where the political appetite for lockdowns is least.

[\[Strategy dashboard\]](#)

yesterday the ERP didn't get as narrow as it was in June, in large part because the 30-year Treasury yield is now 33 bp lower. At the same time, forward earnings are 2.8% higher – which may not seem like a big change, but it is in fact a huge change over just five weeks. Despite those mitigating explanations, *the ERP is showing stocks valued relative to Treasuries as though we weren't still struggling to get out of a deep recession, and as though we weren't facing policy risks that could throw us right back into it.*

- That's not to say equities won't work higher as the recovery we expect unfolds – they will. *But from here that recovery has to actually happen. There is no panic premium in equities.*
- Now let's talk about the virus and the policy response.
- We stand by our conviction that there is no second wave in the US. In one sense it's just a matter of semantics – we don't think it helps to imagine that viruses move in “waves” (that's just technical analysis applied to epidemiology) and if certain parts of the US are experiencing outbreaks later than other states did, that's not “second.” It's just later. Dispensing with imprecise words is important because we think in words, and the words we think in determine our responses.
- We stand by our conviction that the apparent outbreaks in certain US states are driven in large part – at least the scary optics of seemingly large numbers of new cases – by vastly increased testing (see [“Video: What you're not hearing about the paradox of the so-called ‘second wave’ of Covid-2019”](#) July 6, 2020).
- So if we can start by dispensing with prejudicial words, and not getting overly alarmed by the raw number of cases, let's be realistic: yes, *there really is an acceleration of the spread of Covid-2019 in some US states.*
- The best way (or, given the indeterminacy of epidemiological data, the least bad way) to see this is by looking at the days-to-double fatalities in the states in question (please see the chart below).

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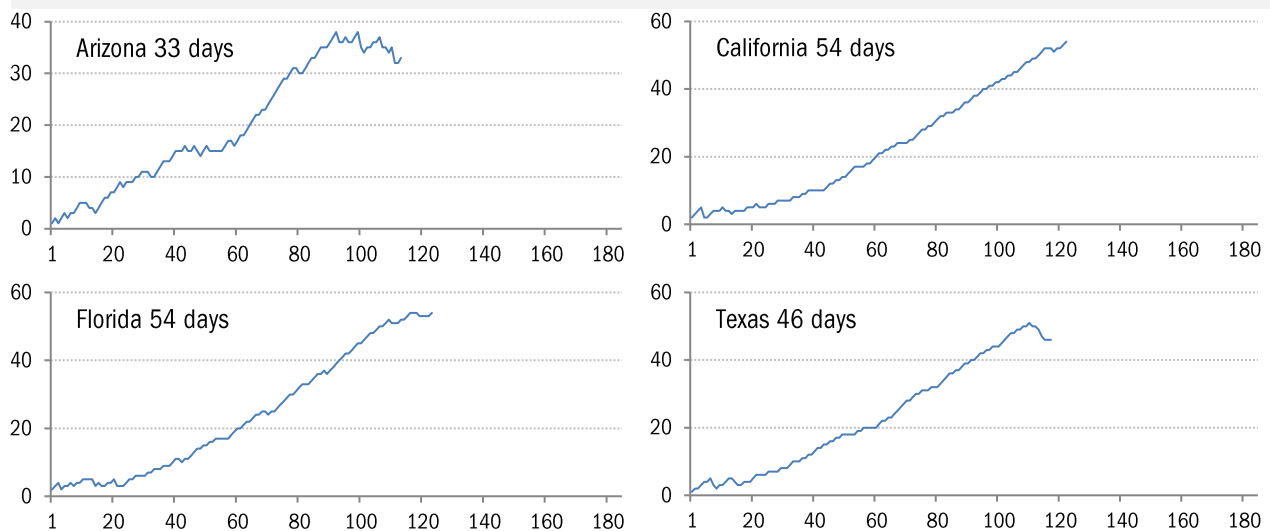
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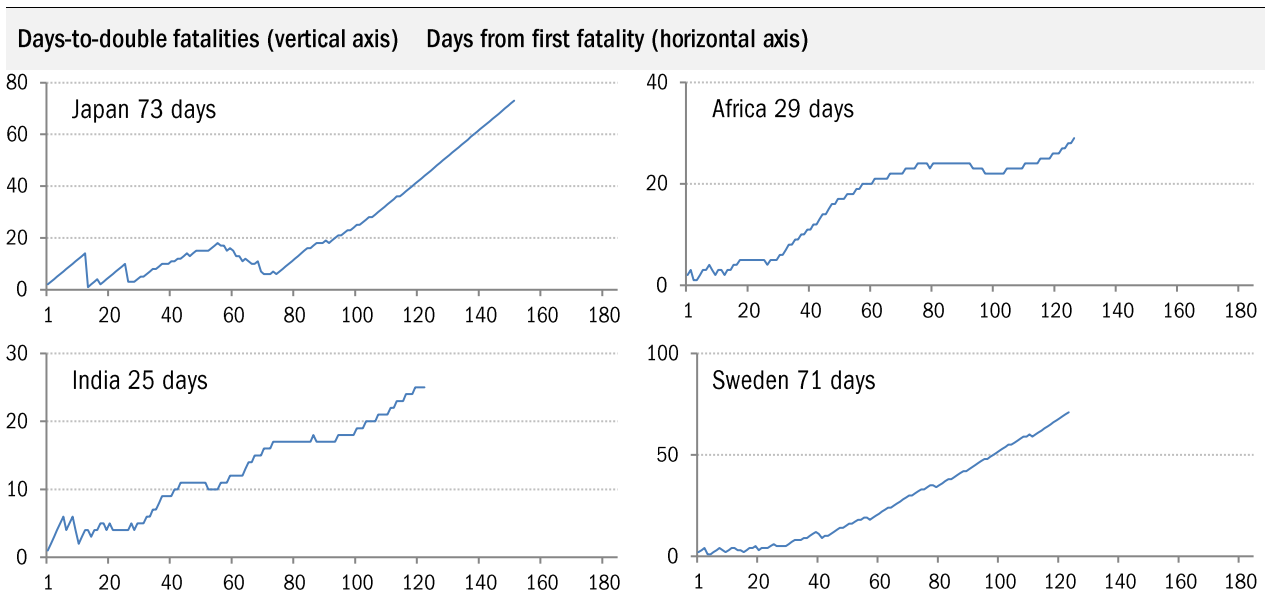
[\[About us\]](#)

Days-to-double fatalities (vertical axis) Days from first fatality (horizontal axis)



Source: [Covid Tracking Project](#), TrendMacro calculations

- We prefer measuring fatalities instead of cases. With fatalities, there may be some question as to the cause of death, often one among several co-morbidities. And [there are financial incentives](#) for hospitals to blame deaths on Covid-2019. But the sample universe is objectively determined – death itself is an objective fact. With case-testing, the universe is arbitrarily determined based on various reasons people have to seek testing in the first place. But the major reason fatalities are important is that they are what we are trying to prevent -- we wouldn't even care about cases if some of them didn't become fatalities.
- Tracking the days-to-double fatalities allows us to measure the rate of spread of the virus. If the number of days between doublings is expanding (that is, the lines in the charts are upward sloping), that means the spread is sub-exponential, and getting more so with time. If the line is flat, the spread is perfectly exponential (a chart of Moore's Law would be flat at 18 months between doubling of transistors on a chip). If the line is pointing down, it means the spread is supra-exponential and accelerating. Based on this metric, exponential spread is slowing in California after a very brief acceleration (that is, it's not exponential); steady in Florida; and accelerating in Arizona and Texas.
- That's not good for Florida, Arizona and Texas. But in terms of new lockdowns that might damage the recovery...
- ...in all four states in question, setting aside the rate of spread, the actual number of deaths is small, both in absolute terms and as a share of population. For example, at the worst for New York, for most of April, fatalities were never fewer than 400 per day or 0.20 bp of population. The worst of the four states in question today in absolute numbers is California, where fatalities have averaged 73 per day over the last three weeks; and in terms of share of population, Arizona, where there have been only 5 days when fatalities exceed 0.10 bp of population – that is, a tenth of a

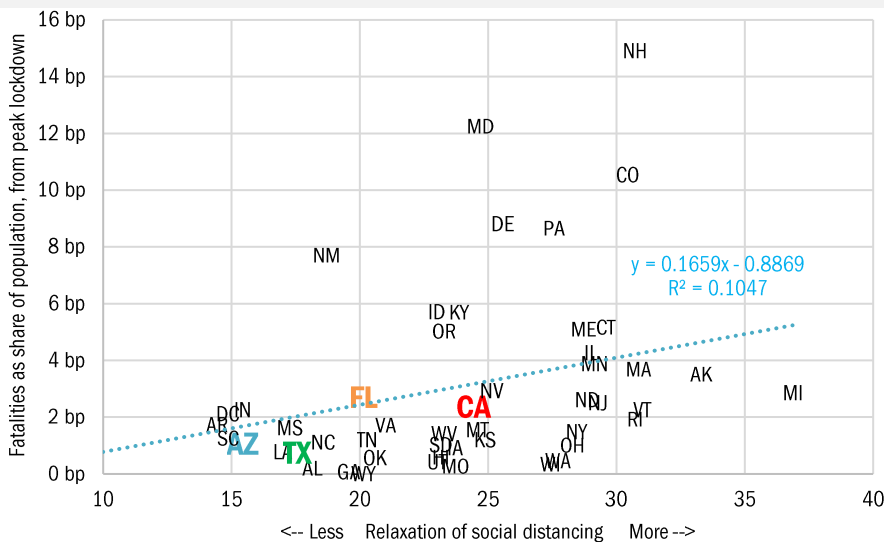


Source: [European Centre for Disease Control and Prevention](#), TrendMacro calculations

thousandth of a percent.

- As we have seen every day by tracking this metric around the world now for months, slowing spread is overwhelmingly the norm, with only very brief exceptions. As a rule, this virus has only rarely and briefly spread exponentially, and has shown intermittent fluctuations in speed (see some examples in the chart on the previous page, and most recently, [“Data Insights: Daily Covid-2019 Monitor”](#) July 14, 2020).
- Most critically – even if, unlike us, it is your judgment that even a small number of fatalities and a probably temporary acceleration of them is completely unacceptable – there is no evidence ex post that economic lockdowns have any capability to help matters. For example, we challenge you, with respect to Japan, Africa, India or Sweden – or California, for that matter (again, please see the charts on the previous pages) – to provide any narrative or evidentiary connection between lockdowns and the shifting shapes of the curves.
- Now, about three months since peak lockdown in the US, there is only the faintest correlation among states between the degree of re-opening and increase in fatalities over the same period, and the four states in question have performed better than the regression-implied expectation (please see the chart below).

Reduction from peak in Social Distancing Index (horizontal) vs growth in fatalities (vertical)



Source: [University of Maryland Transportation Institute. Covid Tracking Project](#) TrendMacro calculations

- Yet who wouldn't like to "do something" – or, if you're a government official, also be seen as "doing something," especially in the face of constant media bombast about a second wave and the failure of government to prevent it?
- But the "something" that officials are actually doing is quite small-footprint compared to the draconian stay-at-home shutdown orders of March and April. That is, in some cases, because officials have been exposed to evidence of the type we've been showing you, and know there's little point in doing much more than insisting people wear masks, or restricting business activity of highly

symbolic value such as public consumption of alcohol. In all cases, it is because officials have seen the dreadful human and economic cost of lockdowns, and intuit that their electorates won't stand for much of it at this point.

- California took the strongest measures yesterday, which is ironic, because of the four states in question it has had the least bad experience in fatalities – indeed, after a bobble of a couple days, its days-to-double fatalities is lengthening again. We can't read minds, but our strong guess is that this move was in large part political – which is to say that officials such as Governor Gavin Newsom believe that bearing some economic costs are in line with the political preferences of his electorate. It seems that in modern political life, on any given matter, one side is assigned to the Blue Team, and one side is assigned to the Red Team.
- With the virus, the opinion that high costs must be borne in the attempt to prevent any spread has been assigned to the Blue Team, while the opinion that it's better to spare the costs and just tough out the virus has been assigned to the Red Team. Once that assignment got made, we suspect people's attitudes are determined as much by that assignment as by any true opinion, informed or otherwise, about the trade-offs involved. Just take a look at [the policy paper](#) issued this week by United Teachers Los Angeles – the Los Angeles teachers union – conditioning re-opening the schools on defunding the police. We could probably find a symmetrical example from Florida for the Red Team.
- So we see California, the only Blue state among the four in question, taking the boldest steps away from economic re-opening. We have a hunch it has done so in a form of “selling the bottom,” a moment of maximum political pressure just when the problem was about to max out anyway.
- From the standpoint of sustaining momentum for a V-shaped recovery, it is fortunate that what the media is calling the second wave of the virus is, with the exception of California, in sun-belt Red states, where lockdowns will be politically difficult. The big urban Blue states got their big lockdowns done in March and April in what the media calls the first wave. So the road to recovery remains, at least mostly, clear.

Bottom line

California's reversal of economic re-opening, still partial but the most substantive yet, triggered a dramatic one-day reversal in equities from new recovery highs. Equities were vulnerable anyway, with the equity risk premium not much wider than it was at the prior high in early June. We reject the idea of a second wave as fuzzy thinking, but there are in fact accelerating fatalities in Arizona, Florida and Texas; and California had a brief episode. But the magnitudes are small. And there remains no evidence that lockdowns help. Attitudes about economic lockdowns are now politically assigned. That's why Blue California which is suffering the least has done the most, while Red states that are suffering more have done less. The road to recovery is mostly clear because the acceleration of fatalities is occurring where the political appetite for lockdowns is least. ▶