



Five Minutes with Commerce Trust's Chief Economist – Scott Colbert 8/20/21

Scott Colbert:

Good afternoon. It's Thursday, August 19th. About two weeks since we've last talked. Since then, the S&P 500 continued on to a record high. Monday it was up almost 20% on a year-to-date basis. Even more than that, including dividends. Driven up primarily on the back of an expanding economy, explosion in corporate earnings, and even a very, very positive employment report that we referred to in our last report. Since then, however, just in the last couple of days, it's clear that the storm clouds are brewing and the market has fallen about 2%. And what are the worries that the market has? Well primarily, let's face it, it's the outlook for growth, and people are pulling back their outlook for growth in the second half of the year. Just today, Goldman Sachs pulled their outlook for third quarter growth down from 9% to something above 5%. That's quite a change in direction.

We, too, at Commerce have pulled ours down about 1%. We may have to revisit that too, and we may not have the growth that we're even expecting the second half. All of this outlook for growth or the cooling and the outlook for growth is largely driven by what? The surge in the Delta variant of the coronavirus. Hospitalizations are up materially, probably almost half of what they were at the peak. And that's very close to tracking with what we hear regionally. Specifically there is a hospital in our region that that told us at the bottom, there were only 15 coronavirus patients, at the top there had been about 125, and they're back to having 75 patients now in the ICU under treatment. So more than a double from the bottom, essentially in terms of cases, but not quite back to where they were.

So this slowdown in economic growth is weighing on the market. In addition, there are some other troubles brewing, okay. Let's face it, over in China they're clearly cracking down on basically their largest companies. The four largest companies in China, Tencent, Alibaba, jd.com and Baidu, essentially their versions of Amazon, and Google and Microsoft, and then basically all things internet combined have fallen from 48 to 60%. And Chinese stocks are now down 16% on a year-to-date basis, down about 32% if you track the Morgan Stanley ETF, which is probably the broadest, easiest way to invest in China in aggregate. The third problem, of course, is given the coronavirus, are supply chain disruptions. I had thought and we had hoped that by now there would be some easing in these supply chain disruptions, but the boats are still backed up as much as they've ever been in Long Beach.

You've probably all heard that the third largest port in the country in China is partially shut down. It happens to sit at the mouth of the delta of the Yangtze River, and it's where almost all the auto parts, and industrial and commodities that we use, particularly in Europe and North America, originate from. And this is translated into things like Ford Motor Company cutting back on its F-150 production right now this very week in Kansas City. And even the auto manufacturer, who's done the best job of handling their supply chain, Toyota, cutting back September production by 40%. So the combination of China, the coronavirus, supply chain disruptions, and then probably let's face it, add to it the fact that inflation is still fairly high, the CPI came in at a 5.4% pace, identical to the previous month's and really showing very little signs of tempering.

There might be some optimistic signs going forward. It's not all bad news. Lumber prices have cracked. You've probably seen energy prices crack. And of course, we've had this modest correction in the stock market. And we still expect employment to grow awfully well in the second half of the year. So basically, I think what we're saying is we have expected, most people had, the summer to be a transitory period. Typically the markets have their toughest months in August and September, and that seems to be playing out as is typical by the



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playbook. And we view this as mostly a storm, hopefully a short-term storm, as vaccinations continue to progress. In fact, vaccinations are accelerating to push back on the coronavirus. We hope to see supply chain disruption fade. We hope to expect to see inflation basically peak and begin to roll over, although I think it's a slow and transitory roll over, and basically get the outlook back for growth on a more positive track.

If nothing else, pent up savings is huge. Wealth effect, very positive. Employment growth, exceptionally positive. And we are still in the position, still in the part of the recovery where we're handing it off from stimulus to that of a natural, self-sustaining economic recovery. So, essentially, we simply see this as a storm that we're going to have to get through on our way to our long term, positive economic outlook. We'll make it through this. It's not the start of a new downturn. And we'll get back to talk to you about what's happened in the most recent couple of weeks in early September.

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