The Wealth Report

COVID-19 brought more with it than just sickness, death, isolation and anxiety. It also spawned anger, division, loss of livelihoods and civil rights. And for some, it produced abundant wealth.

THE SHAPE OF ECONOMIC RECOVERY

Overview

Following the longest recorded economic expansion in history, the U.S. hit its peak in monthly economic activity in February 2020. And yet, this was quickly followed by two consecutive quarters of economic decline — thanks to the coronavirus invasion on U.S. shores. In fact, the second quarter of 2020 suffered the steepest quarterly drop on record (9.1%), having never experienced a drop greater than 3%.[1]

The fallout was immediate and severe. In April 2020, more than 20 million jobs were lost, wiping out gains achieved over nine straight years of job growth. Job losses were particularly egregious among lower-wage, lower-educated workers, as well as for women — largely due to layoffs in the leisure and hospitality industry.

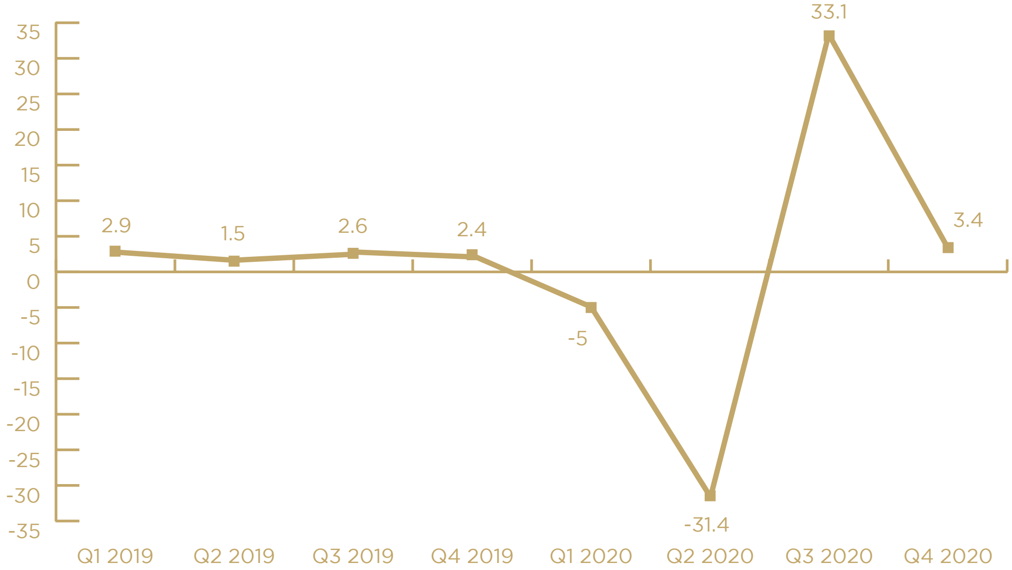
By June, the National Bureau of Economic Research (NBER) officially declared a recession, widely heralded as the worst since the Great Depression. However, quick moves by the Federal Reserve, a stimulus package passed by Congress and a concerted push by the Trump Administration to reopen the economy during the summer facilitated a remarkable turnaround. In the third quarter, the U.S. economy expanded by an annualized 33.1% — its biggest expansion ever.[2]

The rebound was not without drawbacks. Gross domestic product (GDP) was still 3.5% below pre-pandemic level, and reopening the economy proved to be devastating in terms of human life.[3] Whereas it previously had been prevalent mainly in large metropolitan areas and "hot spots" around the country, the coronavirus spread uncontrolled to virtually every state, city and town in the U.S.

While vaccines became available in December, the pandemic is far from controlled, and the economy may take quite some time to fully rebound. As of the end of 2020, only half of the jobs lost had been recovered.[4]

"The NBER defines a recession as 'a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production and wholesale-retail sales.'"[5]

U.S. GDP Growth Rate: 2019-2020[6]



The Shape of the Economy

In an effort to explain the various routes to recovery, economists describe these paths in various shapes, such as V, U, W and L. These letters, plotted on a line graph, offer a visual illustration of the trajectory of GDP, employment rates, industrial production indexes and other key metrics used to track economic conditions.[7]

Z-Shape

The Z-shaped recovery is not very common at all, as it is the most optimistic scenario. With a Z, there is a quick crash followed by a quick ramp up in consumer spending, attributed to pent-up demand. In other words, the economic decline was not so severe that people lost their income and assets, so they more than made up for lost time by shopping, dining out, taking vacations and engaging in other activities that were temporarily waylaid. The Z-shaped recovery is quick and relatively painless.

W Shape

The W shape is characterized by a sharp decline, followed by a rapid (false) recovery, then another sharp decline followed by a full recovery. This scenario usually takes a couple of years for full recovery and is often referred to as a double-dip recession.

A prime example of the W-shaped recovery began in early 1980 when the U.S. economy experienced an initial recession, entered a recovery phase for almost a full year, but then sank back into a second recession between 1981 and 1982.[8]

While economists continue to debate the shape the pandemic recovery will take, some assert that we are already in the second wave of the W after the initial spike and then dramatic rise last summer. As students returned to school and flu season began in the fall, the U.S. experienced a much worse strain of outbreaks than before, and once again small businesses shuttered, students were sent back home for e-learning and corporations delayed plans for investment and expansion.

V Shape

Similar to the Z shape, the V features a sharp decline followed by a quick and full recovery, generally lasting less than one year. Initial observations, mainly fueled by political optimism, claimed that the pandemic recession would follow a V shape after the initial drop and summer reopening and recovery. Alas, that was short sighted, as the coronavirus followed its own airborne path of contagion and economic destruction.

U Shape

The most common economic recovery is the U shape, which accounts for about half of the U.S. recessions since 1945. It usually lasts between one and two years and is characterized by a gradual economic drop, followed by a period of stagnation and then a steady rise. It usually takes several quarters before GDP restarts an upward trajectory, but then there are no slides after recovery has begun. Examples of U-shaped recoveries include the 1973-75 recession during the Nixon years (which featured extremely high inflation), and the 1990-91 recession that followed the savings and loan (S&L) crisis.

The Great Recession is another good example of the U-shaped recovery. While technically the recession lasted only 19 months (December 2007 to June 2009), it took many years for employment levels to resume pre-decline levels.[9]

L Shape

The L shape looks a bit like a checkmark, with an initial sharp decline followed by a gradual recovery on an upward trendline. The initial decline can be quite severe, potentially a depression. It often features persistently high unemployment and usually takes several years to recover.

The L shape is widely considered the worst-case economic scenario because large numbers of workers remain unemployed for long periods of time. This tends to leave factories and equipment idle or underutilized — stunting the opportunity to revitalize growth and consumer spending.

The Great Depression followed an L-shaped recovery starting with the stock market crash of 1929. Real GDP contracted sharply, unemployment peaked at 23% and stagnant growth persisted for more than 10 years.[10]

K Shape

The K shape refers to an uneven recovery. In other words, some aspects of the economy begin to recover while others sink even lower. As the pandemic wears on, many economists and politicians have begun to point out discrepancies in the economic recovery that can best be described by the K shape.

For example, look at unemployment. Many professional white-collar jobs have been able to transition to a remote model in which people can work from home. Also, essential workers — ranging from health care employees to truck drivers to grocery store clerks to mail carriers — find themselves in high demand and remaining gainfully employed, although at greater risk for contracting the virus.

But then there are other jobs, such as pilots and flight attendants, specialist physicians and therapists, and a whole range of hospitality workers who have been laid off or had their hours reduced. Working mothers dropped out of the workforce as childcare centers closed and someone needed to be home to oversee children's online schooling. According to a Local Economic Impact Report, nearly 100,000 small businesses permanently shut down during the pandemic — including hair salons, daycare centers and tattoo parlors.[11]

There are recovery discrepancies by industry. For example, technology and e-commerce have taken off, as companies adapt to demand for more online transactions, whether ordering groceries online or conducting Zoom conference calls among colleagues working from home. And yet, even in the health care field, things like elective surgeries and dental work are discouraged to preserve much-needed hospital beds and help slow the spread of the virus.

Interestingly, as consumerism dropped, the U.S. personal savings rate soared to its highest recorded level. Furthermore, the stock market fully recovered from its dramatic drop in the spring of 2020. However, simultaneously, millions of households are behind in their rent or mortgage and have difficulty paying bills and even keeping food on the table.

These are all examples of how the K-shaped recovery works. One "arm" of the K falls as some demographics suffer financially, while the other arm shoots upward as facets of the population increase their wealth as a result of the pandemic.

It's worth noting that a K-shaped recovery often leads to fundamental changes in the structure of the economy or the broader society. There will likely be an effort to beef up publicly funded safety nets and private opportunities for more equitable income and wealth distribution.

Final Thoughts

With the deployment of vaccines underway, the prognosis for a 2021 recovery is strong. Most economists observe that the economy is on a slow but steady path trending upward. However, for thousands of businesses and millions of people, the progression to pre-pandemic financial levels may be quite different. Many shuttered jobs may not rematerialize as companies replaced them with automation or learned to function without them. Small-business owners who had to close up shop or file for bankruptcy may suffer financial consequences for many years to come.

The final shape of the economy is usually determined in hindsight. There are always many variables to consider, but that is particularly true now — with a new president, a new set of priorities and no way to predict the long-term health and economic fallout of COVID-19.

Whatever shape the economy eventually takes to recover, we recommend you take a long-term view of your own finances and get them in tiptop shape. If you have suffered financial setbacks, explore what financial options are available to help protect you in the future and offer income predictability during retirement. If you found yourself prospering during 2020, work with an advisor to position your investment portfolio to provide both growth and income in the future.

We wish you a happy, healthy and prosperous new year.

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