



# THE ONLY CONSTANT IN LIFE IS CHANGE:

## The Pandemic's Ebbs and Flows



In math, a triangle is used as short form for change. This triangle comes from the Greek alphabet letter D, or Delta. So, it only feels appropriate that the COVID variant that is spreading rapidly in the United States and changing everyone's fall plans is named Delta. Just when it felt like life was starting to return to normal, the Delta variant has thrown a wrench into the equation.

### Cases on the Rise

First detected in India, epidemiologists believe the Delta variant landed in the United States in April or May of this year. It didn't take long for the variant to become the dominant strain, and the declining cases trend line in the U.S. was broken in June. On a nationwide basis, the rolling seven-day average of new COVID cases is still noticeably below the January peak, but there are numerous states seeing cases at the highest level they've been during the pandemic.

If there is a silver lining to this latest wave, it is that we have some experience and tools to deal with the surge. While not proving to be the silver bullet, data suggests that the vaccines are helping. There are several data points that seem to conflict in terms of the efficacy of the vaccines in preventing symptomatic disease. For example, an Israeli study showed only 40.5% efficacy in preventing symptomatic disease, although the obvious disclaimer is that the efficacy was much higher for those with a more recent dose: 79% effective in preventing symptomatic disease for those that received two doses in April versus 16% effective for those that received in January. A study in England showed 88% efficacy – even against the delta variant. Importantly, both studies demonstrated strong efficacy (both studies reported north of 88%) against severe illness, hospitalization, and death. In the U.S., only 12,908 out of 173 million vaccinated individuals have been hospitalized or died at the time of this writing, according to the Centers for Disease Control.



# Consumer Spending Impact

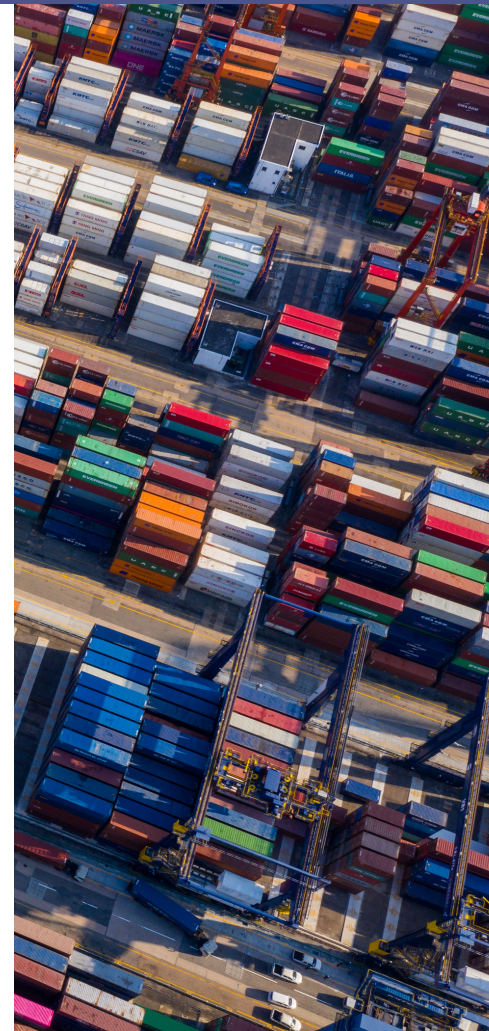
The psychological impact of having effective shots in arms will not only allow consumer spending to remain solid – even if there is a modest, temporary setback in consumption – it will also allow local and federal government officials to avoid more draconian lockdown measures, in our opinion. While masking appears to be returning, restaurants and other indoor-based businesses are remaining open. While a cynic might argue this is due to political considerations in the face of a pandemic-fatigued electorate, vaccine effectiveness arguably provides the air cover to do so. This is a critical distinction for the U.S. economy since consumer spending makes up over two-thirds of GDP.

Consumer spending in Q2 of this year matched 2019 highs when adjusted for inflation, as the wallet share continues to gradually shift back to the service sector and away from goods. To be fair, there is no doubt government transfers continue to bolster consumer spending. For example, unemployment insurance benefits, as measured in personal income reporting, are still an eye-watering 1,387% above pre-pandemic levels. In a vacuum, this would be very alarming, but context is key because labor demand remains extremely robust with job openings continuing to hit new highs each month. Unemployment insurance is 73% below the pandemic peak yet consumer spending has increased since then. It is a delicate balance, but as long as labor demand remains strong if and when government transfer payments normalize, we believe consumption will remain robust. Thus, even if the Delta variant keeps people at home more often this fall, we think consumer spending is likely to simply shift back to more goods-based expenditures, rather than plummet as it did when lockdowns were implemented in March of 2020.

## Supply Chain Setback

Just as its predecessor did, the Delta variant is disrupting supply chains and creating more inflationary conditions. Over the past several months, China has started shutting down ports in response to COVID cases. With China being a key supplier to the U.S., this gyration can send sizable ripple effects through supply chains. Our last supply chain discussion noted many metrics were still substandard but moving in the right direction. In many cases, this has now reversed. For example, the number of anchored container ships waiting at the Port of LA-Long Beach is now the highest it has ever been – just in time for inventory stocking ahead of the holiday season.

Even with vaccines helping some Americans return to the office, the Delta variant is still causing labor disruptions in supply chain jobs. The latest estimates of Delta's  $R_0$ , a key transmissibility metric, show it being two times, or perhaps more, contagious than the original strain that started the pandemic. This estimate suggests the Delta variant is more contagious than the common cold and even smallpox. Furthermore, studies suggest the Delta variant builds similar levels of virus in nasal passages in vaccinated individuals as unvaccinated people, meaning vaccinated people can spread it even as their immune system fights it off. Thus, many employers are maintaining precautions for employees with known exposures, positive tests, etc. This is continuing to hinder labor productivity and costs as healthy employees are often paid overtime to cover for those that must miss work.



## What Does This Mean for Portfolios?

Even in the best of times, diversification is of utmost importance when building portfolios. With the Delta variant changing the pandemic trajectory, diversification across industries is a very important consideration for equity investors. Predicting peaks and troughs in new COVID cases, or whether a “gamma variant” overtakes Delta, is less important than being diversified as consumer spending patterns oscillate more frequently in the near term, in our opinion. We continue to focus on high quality companies – in each sector of the economy – with dividend growth potential and strong management teams that can thrive in constantly changing environments.

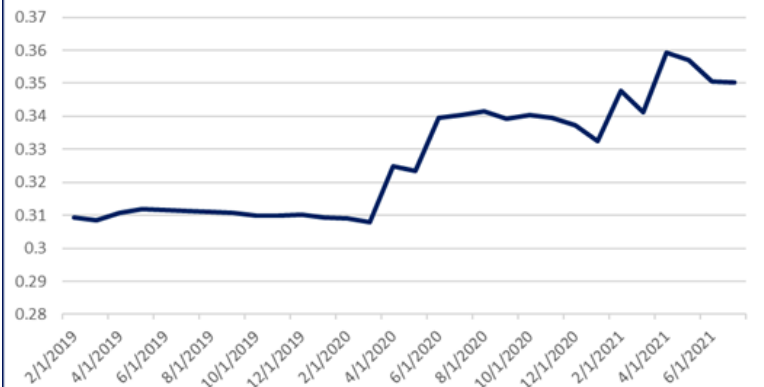
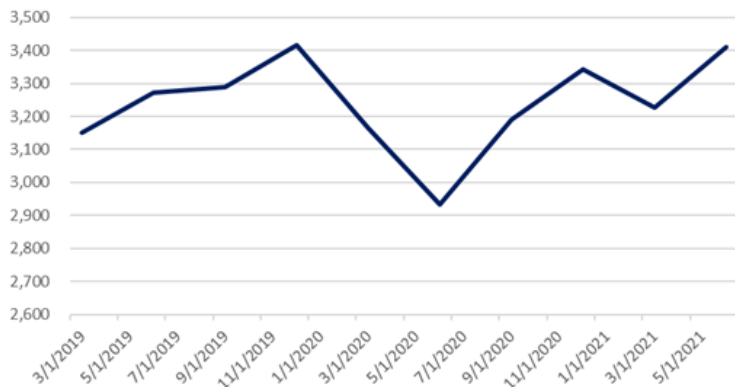
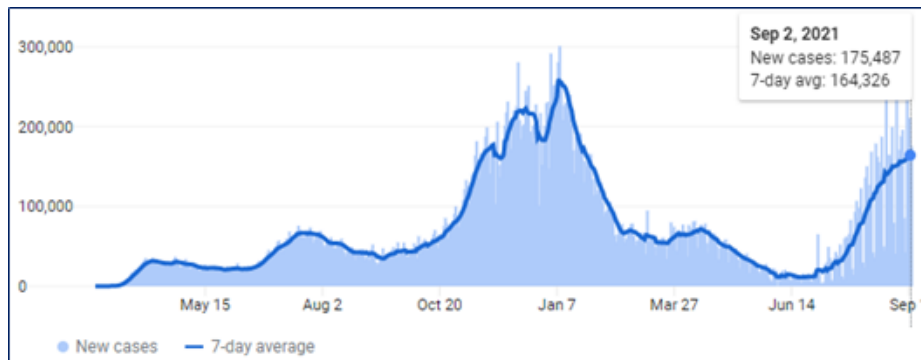
Diversification is important across asset classes as well, which brings us to the disrupted supply chain's implications for portfolios: inflation will remain with us for a little longer. We still believe inflation is likely to subside within a year or two, but the supply chain setbacks likely add several months to the healing process.

And in inflationary environments, we reiterate our recommendation to stay nimble with fixed income portfolios and focus on the short end of the yield curve versus the long end.

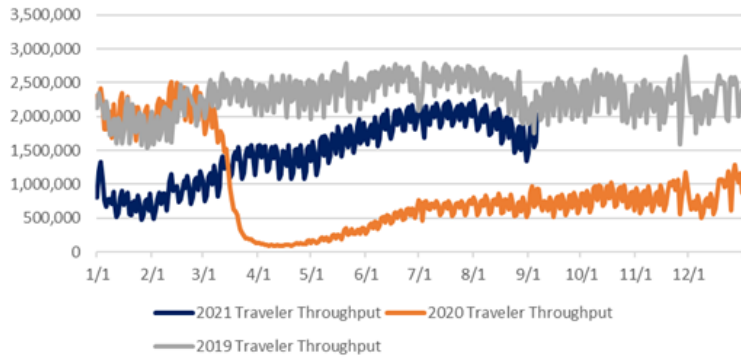
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## Chart Appendix

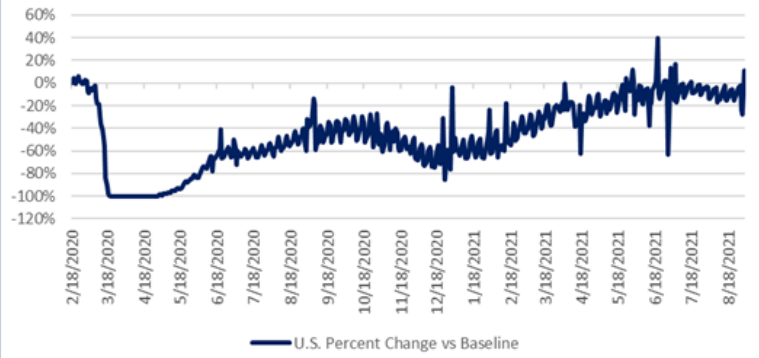
Sources: New York Times, Bureau of Economic Analysis, OpenTable.com, Transportation Security Administration, Bureau of Labor Statistics, Bloomberg, Marine Exchange of Southern California & Vessel Traffic Service of L.A./Long Beach



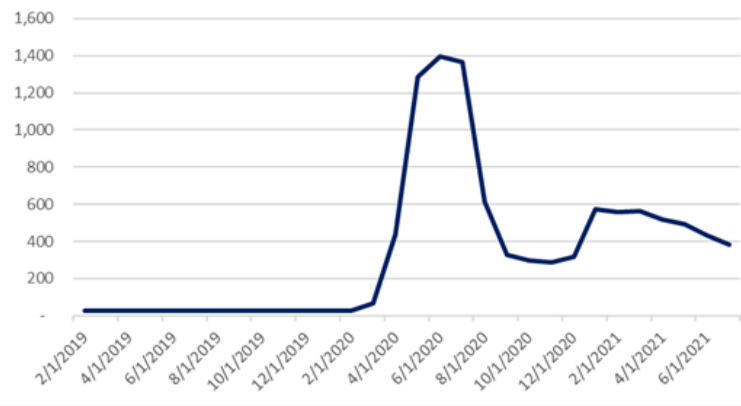
Rebounding Spending on Services: TSA Checkpoint Data



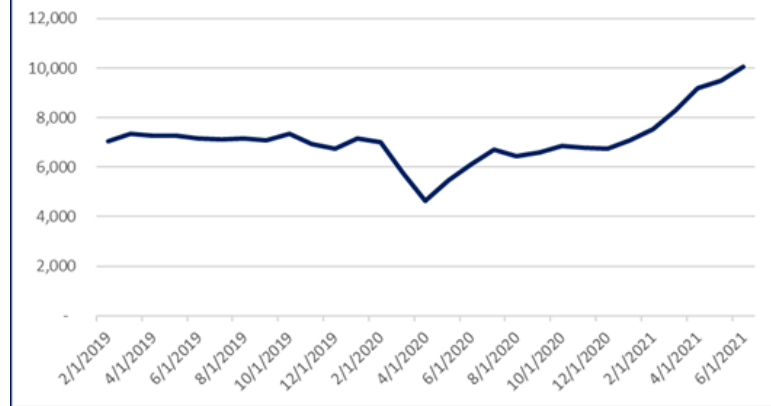
Rebounding Service Spending: OpenTable.com Seated Diners



Personal Income: Unemployment Insurance Benefits



US Job Openings



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