OLD POINT TRUST

Investment Commentary **August 2020**

As the worst of the novel Corona Virus of 2019 seems to be behind us now and we await the looming Presidential Election on November 3rd, the economy has bounced back sharply, corporate earnings are far exceeding expectations, the housing market is roaring over historically low interest rates, the Federal Reserve has pledged almost unlimited stimulus and the stock market has regained everything that it lost in the spring of this year and more so.

To be sure, there are many folks that are still not working, many small businesses that have closed their doors for good and far too many people that have suffered the loss of a loved one. I certainly want to acknowledge those facts and offer my sincerest sympathy.

As we look at the economy though, it is clear to me that if you had to call it a recession, the self-inflicted shutdown and economic downturn of March, April and May will surely go down as the briefest recession on record. Some have called it a "V-shaped" recovery. I like to call it a "Capital V". This virus will be vanquished and our economy will ultimately recover. Of course parts of the economy will take longer to recover. The airlines are instituting furloughs as I write this. Travel and leisure companies are taking longer to get back to their full capacities. Yet other industries are adapting to the new circumstances and are actually flourishing in this new normal.

We are all wearing masks now and doing our best to maintain proper social distancing and everyone's life has changed as a result of the pandemic of 2020. Beyond that though, businesses continue to reopen, the un-employed continue to decrease in number and the overall economy has proven to be far more resilient than almost anyone had anticipated. As we witness the social unrest and fractured politics of the day, at least I find some comfort in the strength and durability of the U.S. economy. I find inspiration in the speed and brilliance of American ingenuity. Our country's pharmaceutical companies such as Johnson & Johnson, Pfizer and Merck have made significant progress in the treatment of Covid-19 and in the development of immunizations against the new virus. We should all take pride in our country's "stick-to-it-iveness" and perseverance.

The Job Market

Prior to the spread of Covid-19 in the United States, our country was experiencing historically low un-employment rates across almost every racial, sexual and age-related demographic. In 2018 the Un-employment rate started the year at 4.1% and slowly declined farther, running most of the year below 4%. In 2019 the Un-employment rate spent the majority of the year at 3.5 or 3.6%. That rate followed through into the first two months of this year, marking 3.6% in January and 3.5% in February.

Following the self-inflicted shut down of the entire non-essential U.S. economy, the seasonally adjusted monthly unemployment rate (U-3) reached a Covid pandemic high-water mark of 14.7% in April of 2020. That month we suffered a terrible and abrupt spike, the likes of which we have rarely seen. The jobless rate in April was the highest on record for the Bureau of Labor data, which goes back to January of 1948.

In May that rate dropped to 13.3%. In June it dropped to 11.1%. In July it again dropped, this time to 10.2%. Employers added 1.76 million jobs in July, about 300,000 more than economists had been expecting. When the report for August is released by the Bureau of Labor Statistics on September 4th, it is widely expected to drop below 10%. Here in Virginia, our state's un-employment has dropped from 9.0% in May to 8.1% in June and 8.0% in July. More and more people are getting back to work again. If you would like to see more details for each state, they can be found at: https://www.bls.gov

The Leading Economic Index is Looking Up

The U.S. Leading Economic Index rose 1.4% in July according to a report issued by the Conference Board on August 20th. The estimate had been for a rise of only 1.1%. Although the 1.4% increase in the Index would be considered very good monthly reading during normal times, the number was off from the exceptionally strong readings that we saw for June and May, which were up 3.0% and 3.1% respectively.

The biggest positive contributor to the Index in July was the average workweek, which increased 0.56. The biggest negative contributor was the average of consumer expectations, which declined 0.11. As the name implies, the Leading Economic Index looks forward and it includes 10 variables that tend to move before changes in the overall economy. These indicators provide an expectation for the state of the economy looking out over the next 6 months or so.

Following is a table of how each of the ten components of the LEI has fared lately:

	July	June	May	April
Leading Index	104.4	103.0	100.0	97.0
Average workweek	0.56%	0.28%	0.72%	-2.03%
Building permits	0.50%	0.10%	0.38%	-0.70%
Jobless claims	0.37%	1.35%	1.90%	-1.44%
Stock prices	0.13%	0.24%	0.22%	0.16%
ISM New orders	0.12%	0.02%	-0.48%	-0.58%
Interest rate spread	0.06%	0.07%	0.07%	0.07%
Non def. Cap goods orders	-0.06%	0.13%	0.05%	-0.27%
Consumer goods orders	-0.06%	0.95%	0.44%	-1.37%
Leading credit	-0.08%	-0.07%	-0.09%	-0.13%
Ave. Consumer expectations	-0.11%	-0.02%	-0.08%	-0.12%

The Housing Market is Ablaze

Record low interest rates have fueled robust demand and applications to build new residences have surged by the most in three decades. Applications to build increased 18.8%, the most since January of 1990. The median estimate was for 1.33 million applications and they came in at a rate of 1.5 million, surpassing the pre-pandemic rate in February.

Housing Starts jumped 22.6% in July, the most since October of 2016, to a seasonally-adjusted annualized rate of 1.5 million, according to data released by the Commerce Department on August 18th.

According to the National Association of Home Builders Housing Market Index, Homebuilder Optimism jumped to a level of 78 in July. That is the highest level since 1998. (A reading above 50 indicates that more builders view conditions as good than they do poor.) The reading matched a record high over the 35 year history of the survey. "Housing has clearly been a bright spot during the pandemic and the sharp rebound in builder confidence over the summer has led NAHB to upgrade its forecast for single-family starts," said Robert Dietz, chief economist at the NAHB. "Single-family construction is benefiting from low interest rates and a noticeable suburban shift in housing demand to suburbs, exurbs and rural markets as renters and buyers seek out more affordable, lower density markets." See www.nahb.org

Sales of Existing Homes surged by the most on record in July. Closings increased 24.7% from June, reaching an annualized rate of 5.86 million. This is the highest rate since 2006 according to data from the National Association of Realtors, released on August 18th. (See www.realtor.org) The median estimate of economists in a Bloomberg survey had only called for a rate of 5.41 million. The NAR report also showed that existing home prices jumped 8.5% from a year earlier, to the highest on record. The median home price increased to an all-time high of $304,100, up from $280,400 at the same point last year. The NAR report also showed that houses stayed on the market for an average of 22 days, which is the shortest time frame in their data. Purchases of previously owned single family homes increased 23.9% and sales of condominiums were up nearly 32%.

Existing home sales increased across the entire country, with a 19.4% rise in the South and a 30.5% rise in the West. Purchases climbed 30.6% in the Northeast and rose 27.5% in the Midwest. Previously owned home sales account for approximately 90% of all U.S. home transactions. The remainder would be mostly in new home sales.

Not to be left out, New Home Sales surged 13.9% to an annual rate of 901,000. That is the highest level since 2006, according to data from the Commerce Department. (See www.census.gov/newhomesales) Median new home prices rose by 7.2%, year-over-year, to $330,600. The average selling price for a new home was $391,300. Most of the growth in new homes sales in July occurred in the south, where 513,000 new homes were sold. There were 221,000 new home sold in the West. The Midwest had 127,000 new home sales and the Northeast trailed the pack with only 40,000 new homes sold.

Interesting to note, 17% of the new homes sold in July cost more than $500,000 and 4.0% of the new homes sold cost in excess of $750,000. Houses costing between $150,000 and $300,000 represented 40% of the new houses sold. Those costing between $300,000 and $400,000 represented 29.0% of the new houses sold.

Corporate Revenue and Earnings are Exceeding Expectations

As of August 28th 440 companies in the S&P 500 have reported their earnings for the second quarter ending June 30th. Of those companies, 83% have beaten their earnings estimates. This compares favorably to last year's second quarter when only 75% of the S&P 500 reported beating analysts' earnings estimates. Approximately 13% of the companies have reported worse than expected earnings, which is also better than last year when 18% reported worse than expected earnings. This trend was also apparent with revenues where companies have topped analyst's estimates 59% of the time and have come in below estimates 27% of the time, for the second quarter of 2020. Last year in the second quarter, only 34% of the S&P 500 beat revenue estimates while 26% missed their estimates.

On Target

Of particular note is Target, which has had one of the largest revenue surprises. On August 19th, Target reported its strongest quarterly growth in the company's history. Its total revenue was $22.9 billion in the second quarter of this year compared to $18.4 billion in the second quarter of 2019. This huge beat was driven in a large part by a near tripling of digital and online sales. Sales through digital channels accounted for $3.9 billion or approximately 17% of Target's Q2 revenue. Not all of this revenue came from the "shop from home" movement or from delivery services that have become so popular during this pandemic. Target also saw a pop in purchases from in store visits during the second quarter. The retailer posted a 10.9% increase in comparable sales for its traditional brick & mortar stores.

Reconstitution of the Dow Jones Industrial Average

The Dow Jones Industrial Average (DJIA) was first calculated on May 26th 1896. It was created by Charles Dow, the editor of the Wall Street Journal and was named after Dow and his business associate and statistician Edward Jones. The components of the DJIA have changed 54 times since 1896 and the 55th change is now upon us. On August 31st, 2020, three long-standing members of the Dow Jones total of 30 members will be removed and replaced by three new members. The three companies that are exiting the DJIA are ExxonMobil, Raytheon Technologies and Pfizer. They will be replaced by Salesforce.com, Honeywell International and Amgen Inc.

The changes were prompted when Apple Inc. announced that it would have a 4 for 1 stock split on August 31st. Currently Apple, at a price of about $500 per share, represents 12% of the 30 stock DJIA, which is a price-weighted index. Post-split, there would be less influence of computer and software companies when Apple trades at approximately $125 per share. Concurrently, Energy related stocks have lost size and influence in the Index. Exxon, which was the world's largest company as recently as 2011, is now trading at approximately $40 per share but was trading at over $100 per share as its peak in 2014. After Exxon is removed, Chevron will still represent Energy within the DJIA. Salesforce.com's addition is meant to demonstrate the added influence of computer and software companies. Otherwise, Amgen for Pfizer is a Healthcare to Healthcare switch and Honeywell for Raytheon is an Industrial to Industrial switch.

Recovery of the Honeybee

For years now I have been following the plight of the Americanized Honey Bee. (Our Honeybees are a domesticated species that is not native to the United States.) The USDA counted a record 5.9 million Honeybee Colonies in 1947. By the mid 1980's that number had fallen to a little more than 3 million. Part of that decline had occurred on account of increased foreign competition from imported honey. Part of the decline had come from the advent of and then widespread use of artificial sweeteners such as saccharine and aspartame. However the most ominous detriment to the American Honeybee for the last 15 years has been from something called "Colony Collapse Disorder", where the workers all left the Queen behind.

Colony Collapse Disorder affects not only the price and availability of Honey. Bees also pollinate clover, hay and other forage crops and the loss of this pollination can also become a big drag on the dairy and livestock industries. According to the USDA, "Pollination by managed honey bee colonies adds at least $15 billion to the value of U.S. agriculture annually through increased yields and superior-quality harvests." (See www.ars.usda.gov/oc/br/ccd/index) In 2019, Beekeepers reported revenue of $309.6 million from pollination services and just $309.1 million alone from the sale of honey.

Thankfully the USDA now reports that the number of Honey Bee Colonies is on the rise again in the U.S. and the incidents of Colony Collapse Disorder have continued to decline. Now that is truly some Sweet news!

Looking Ahead

According to a poll of 66 economists conducted by Bloomberg News from August 7th to August 13th, the average forecast was that the U.S. economy will expand by 20% in the third quarter of 2020. The survey also showed that these economists expect the economy to expand another 6.1% in the fourth quarter of the year.

In the meanwhile, Hang in there and Stay Safe!

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