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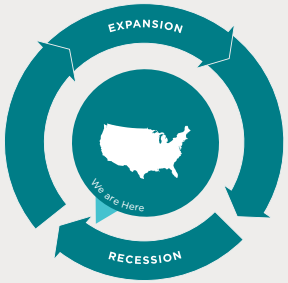
Cycle Watch | Ready for recovery

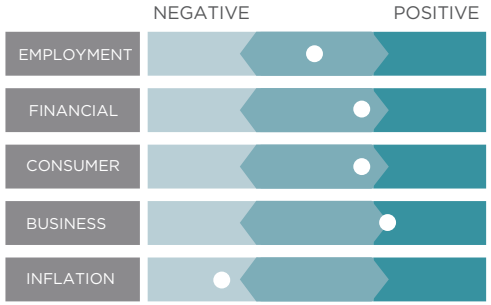
Economic and financial commentary as of August 2020

Business Cycle Update



Real GDP plummeted at an annualized rate of 32.9 percent for Q2—more than three times the previous largest decline since 1947 (when the quarterly data first were officially estimated). Combined with the 1st Quarter's decline, the U.S. economy contracted by 10.6 percent (not annualized) during the first half of 2020. There is broad consensus that Q3 will bring a sharp rebound, which may start a period of above-trend growth that extends for at least a couple of years as the economy heals from the COVID-19 recession. Near-term risks including spikes in new virus infections following the reopening of local economies could cause a pullback in consumer activity or renewed/expanded government restrictions in the months ahead.

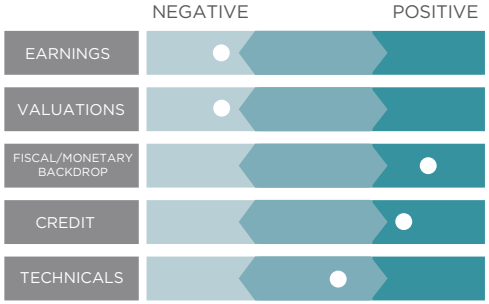
Economic Review



Nationwide Economic Dashboard, August 2020

The broad re-opening of the economy over the past couple of months created momentum that carried through July. Retail spending recovered strongly as low interest rates, pent-up demand and record government transfer payments stimulated consumer activity. The business sector showed expansion again too, with a surge in production, new orders and overall survey data. However, the unemployment rate and weekly jobless claims remain stubbornly high, despite some improvement in recent months. There are still risks to the recovery as a recent surge in virus infections and renewed government pullbacks threaten to stifle consumer activity.

Financial Review



Nationwide Financial Market Dashboard, August 2020

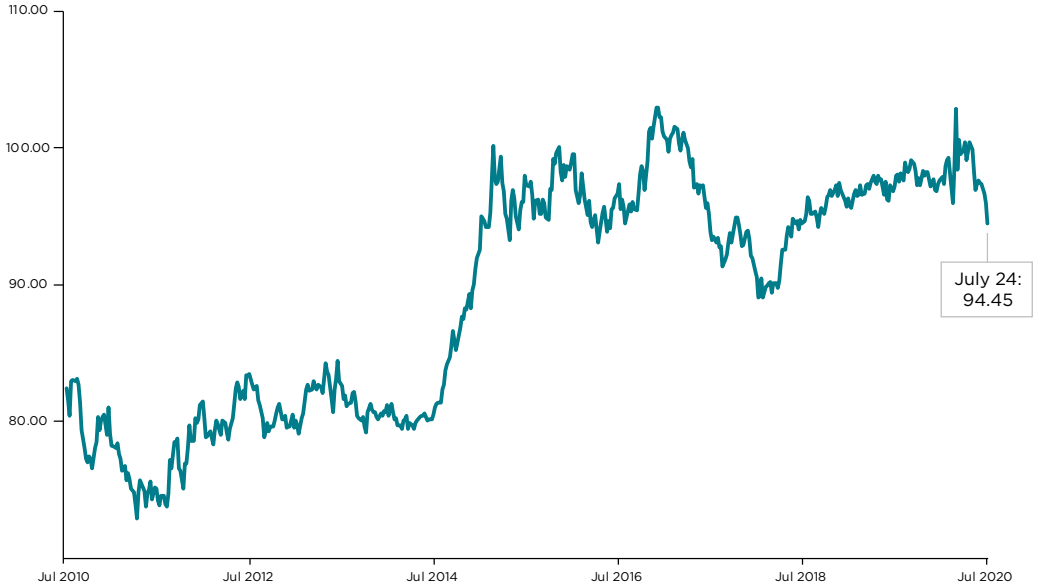
In July, the broad equity market continued its recovery from the March lows as investors remained optimistic about the reopening of the U.S. economy and continuing accommodative monetary policies from the Federal Reserve. However, there is an emerging disconnect between the stock market's sanguine outlook and the gloomier prospects for a worsening pandemic. The slide in long-term Treasury yields through July reflected this more pessimistic view as investors sought the relative safety of government-backed bonds. A fresh round of fiscal stimulus would provide a welcome recharge for economic activity, but as of this writing it's uncertain what the stimulus would be or when it would arrive.

Financial market insight: Is the dollar telling a different recovery story?

Investors have fixated on the equity and fixed income markets this year, but there have been interesting shifts in trends in in the U.S. dollar market, as well as in gold prices. Back in March, the dollar index spiked to its highest level in 17 years as investors rushed to safety at the outset of the coronavirus pandemic. Since then, the dollar has lost nearly 8% of its value. Coronavirus cases peaked earlier in parts of Asia and Europe, so these economies are further along in their recovery efforts. Plus, the Fed's balance sheet and the federal budget deficit have ballooned, giving global investors reason to pause when considering how to allocate to dollar assets. A strong dollar dampens inflation and keeps interest rates low, so a weaker greenback would have the opposite effect and potentially squeeze the economic recovery.

Dollar drops as inflation worries mount

ICE U.S. dollar index, July 2010 to July 2020



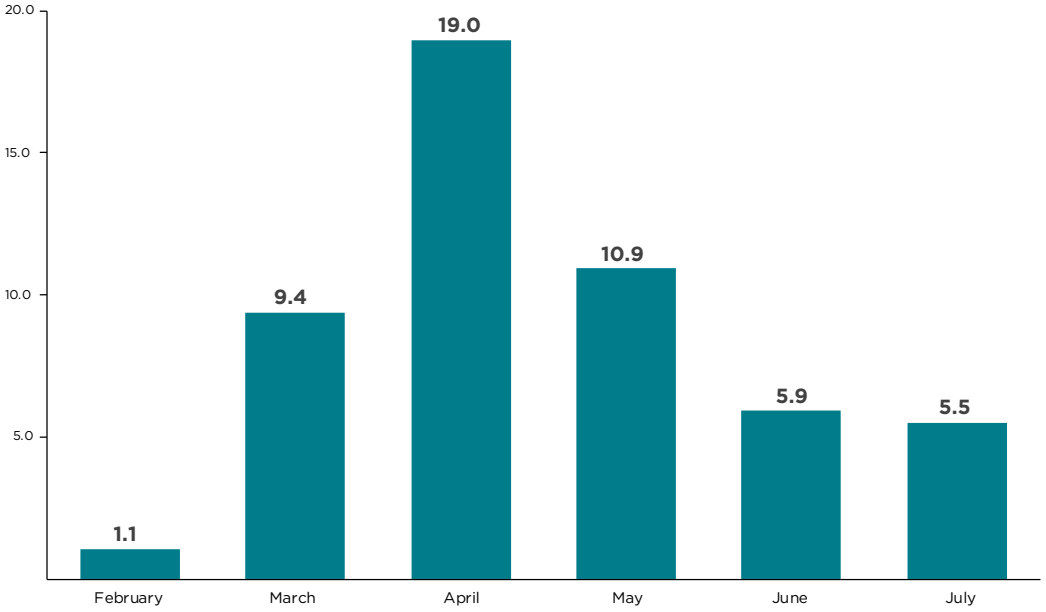
Source for chart data: FactSet Research Services

Economic Insight: Elevated jobless claims pose a continual risk for recovery

Layoffs remained much higher than pre-COVID levels through July, as weekly initial jobless claims leveled off. Through the week ending July 25, 5.5 million total claims were filed in the month, which was only slightly lower than the total for June. While sales and production have improved in recent months, businesses seem hesitant to rehire furloughed workers, concerned that the burgeoning recovery could falter. With jobless claims still very high, many unemployed workers may still struggle to find new jobs. Lengthy spells of unemployment could significantly hit consumer incomes, especially when combined with the reduction or cessation of the $600 weekly added benefit provided by the CARES Act. A persistent lack of improvement in jobless claims adds further risk to the outlook for consumer activity and the pace of economic recovery for the months ahead.

Stalled improvement in unemployment claims

Cumulative initial jobless claims by month, 2020; = millions



Source for chart data: U.S. Dept. of Labor

Key takeaways

1

Investors remain optimistic about the recovery economy, but uncertainty about the direction of the pandemic persists.

2

A fresh batch of fiscal stimulus, combined with continuing monetary stimulus, would likely support the economy recovery.

3

Emotional investors are likely to drive volatility; investors should continue to check their emotions and stay focused on long-term goals.

Cycle Watch is a collaboration between Nationwide Economics and Nationwide's Chief of Investment Research. Our goal is to present a monthly update of where we are in the business cycle and insights from both perspectives to help investors and advisors understand the factors driving economic and financial market performance.

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NFM-19430AO.4 (08/20)