Jobs, J.C. Penney Credit Cards & American Ingenuity

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Sometime in early 2009, I was in a meeting with Meredith and she said one thing that I thought was very profound (which I take to mean as something that is both smart, but not broadly understood). Her thesis point was that Wall Street tends to underestimate how creative Americans are at "gaming" the system, for lack of a better word. I've been waiting over a decade for this to be relevant again.

Her view, which I think might be relevant in analyzing data in the coming months, was that **Wall Street completely misunderstood how the 'average' American viewed credit in 2008.**

Wall Street had a specific pecking order for credit delinquencies back before the crisis:

1st Defaults – **Store Branded Credit Cards** – easiest to get, least important

2nd Defaults – **Major Credit Cards** (Visa, Mastercard, AmEx, Discover)

3rd Defaults – **Auto loans** (people need their cars)

Last to Default – **Mortgages**

I'm not sure where **student loans** would fit in the waterfall since they cannot be defaulted on, but that is an interesting question going forward.

Basically, every credit officer in the land had models looking for 'early warning' signs that defaults in mortgages were going to increase. But there was little evidence of that as people were paying their most basic card – the store issued credit card – while seeing a slight increase in mortgage defaults.

What Wall Street missed, but the proverbial person on the street did not miss, was that they didn't need their homes, but they would need food, clothes, and gas.

In a world where evictions seemed unlikely, or there were plenty of other places to go, paying your mortgage was less important. Under water, or soon to be under water on your house, why pay? So mortgage delinquencies skyrocketed before the usual signals kicked in, catching many off guard and causing massive losses. **The 'masses' beat the Wall Street quants** (I use a derogatory reference of 'masses' on purpose but it is meant to be a sarcastic dig at those who missed the trend, rather than those who figured it out).

Watch the 'Masses' Outsmart Wall Street - Again

The job situation is without a doubt, extremely bad. There have been historic amounts of job losses.

At the same time, there are now some strong incentives, once again, to game the system. This time it isn't in the mortgage market, but in the job market.

Let's just lay out a few basic facts:

- The unemployment benefit has been doubled or tripled for many compared to before the CARES Act. In a world where most states paid between $300 and $500, the $600 from the Federal government changes the calculus greatly. Instead of being covered around $10 per hour (on a 40 hour week) the breakeven is much closer to $25 per hour. If you add in the belief that the job losses will be temporary, then it changes the incentive to want to work versus getting a few months of unemployment benefits.
- The CARES Act also established the Pandemic Emergency Unemployment Compensation (PEUC)

program, which extends unemployment benefits for an extra 13 weeks, and the Pandemic Unemployment Assistance (PUA) program, which expands unemployment insurance eligibility to self-employed workers, freelancers, independent contractors, and part-time workers impacted by the coronavirus. That is a long list of people who traditionally did not qualify.

That is what is paid to former employees directly. Designed to offset that is the PPP, which is designed to help employers keep employees, but there seem to be some 'loopholes' in that as well.

- Most of the tests are based on costs, not specific employees. If you spend X on employees, you need to spend a certain portion of X, but not necessarily on the same employees.
- Debt forgiveness also seems to be based on the number of employees, but not necessarily the same employees as you had at the time of the loan.

If I think about this cynically, here is an 'extreme' scenario, that while morally corrupt, is logical:

- A company with 10 employees lays all 10 off. They collect similar or better wages than working. Employees are happy.
- Company hires some family and friends who weren't working and pays them out of PPP money. Family and friends are happy, especially if there isn't real work to do because the store/restaurant/whatever is still shutdown.
- As things 'reopen' you promise some of the workers who actually know what they are doing, to pay them a bonus later, or find some other way to work "off the books".
- As the CARES Act benefits end, you start hiring back the workers who know what they are doing, putting them back on the books and letting go of the 'space holders' – who, in some cases, ironically, might qualify for regular unemployment insurance.

Sounds evil, but in a world where many have expressed shock at which large companies have asked for or received money, why is it unrealistic? There is a lot of stress and anger out there, creating the willingness to possibly behave in ways that people otherwise wouldn't behave.

Bottom Line – Unprecedented Means Unprecedented

Jobs data is going to be very difficult to use as a barometer of economic health. I expect jobs to lag, because common sense tells us that people will figure out how to extract value from the system. Not everyone will, but enough will (especially if you feel that you've been hurt by rules imposed on you by a government entity in the first place).

I'm not saying it is right, or condoning that behavior, but it seems naïve to completely ignore it.

There is a lot of use of the word "unprecedented" lately, but all too often, in my opinion, without the correct application. If job losses are unprecedented, and benefits and support are unprecedented, why keep trying to plug them into existing models?

Yes, I am still bullish after Dr. Fauci and Powell. While recent price action is concerning, I haven't triggered any of my Reasons to Turn Bearish. Today's piece isn't directly tied to the reopening, but there might be some lessons there too, but that's for tomorrow's T-Report.

Be Safe and Fight On!

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