

The following is an excerpt from the Summer 2020 edition of The Linneman Letter.

Reopening the Economy

We are exiting a “can’t do” economy, where the government dictated what people were allowed to do. This is in comparison to a “won’t do” economy, where people may choose to refrain from some activities and spending for fear of COVID. The former is a government-mandated shutdown disaster. The latter is Sweden’s model which respected individual freedom and is faring far better economically. The result is that we now have a very ugly economy and equally ugly social unrest.

People were slow to realize the medical challenge posed by COVID but were even slower to understand the economic and social costs of shutdown. Many papers (and fairly little insight) will go into studying this by many young economists. But it is simple: if ISIS took over the U.S. without a fight and instantly eliminated life as we know it, how fast and how far would the economy tumble? We think you would agree that “very fast” and “at least 35%” would be your answers. Now assume that they left. Would it all immediately revert overnight? The answer is clearly no. Well, that is what the governments of the world have done.

The only sector that comes quickly back to March levels after the shutdown is hair salons! Restarting huge Vegas and Orlando hotels will be very difficult after being shut down and laying off all workers for 3 months. For example, where will they get that much Purell and toilet paper? The rest of the economy falls in between. We suspect that we bottom around 50 million

unemployed (about a 30% unemployment rate) and negative 10-20% GDP from the first week of March 2020. We will take at least 3 years to get back to February 2020 levels. All sectors will struggle, as you cannot destroy an economy and expect a quick rebound.

A Goldman Sachs report shows that bearish stock markets since 1800 averaged 38% declines, with event-driven declines of about 25%. They report that recessions last about 2 years on average, but only 8 months for event-driven declines. On the upside of the cycle, recoveries require about 52 months to make up lost ground, with event-driven recoveries taking only about 8 months.

Since the shutdown began in early March, the U.S. economic pie has notably shrunk, and unemployment

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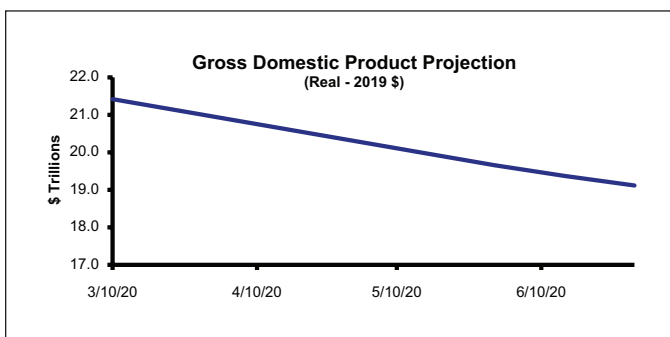


figure 1

has soared. Remember that the point of paying wages is to attract and retain employees. But with high unemployment and less business activity, notable wage

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cuts seem inevitable. City and state governments, universities, and most companies could probably cut wages across the board by 10-25% and still retain and attract their best employees. After all, where will they

go? And while a few aging Boomers would retire, and a few superstars could change firms, the vast majority of employees would take the cuts and be thankful to have a job.

In a decimated economy, almost no business wins. Ending the shutdown was not a matter of lives versus the economy, but of lives versus quality of life. We must be realistic about the economic impact on real people. We wish we could still dunk a basketball and play like LeBron James, but that has never been an option despite countless hours of practice. As we open up, we must face six realities:

- To get billions of COVID tests will take a long time.
- People are going to die from COVID (as they do from many other factors every day).
- People in poor health have a high likelihood of dying if they get COVID, so they should be urged to self-isolate.
- Thinking we can easily undo the loss of 48 million jobs is delusional; there is no reset button.
- Continued social unrest is a serious risk, especially as the Class of 2020 graduates into an economic void.
- An effective vaccine or treatment is far from a sure thing.

The fantasy of a quick recovery is the same as the fantasy of an effective vaccine by December. If the shutdown had been 2 weeks, the economy would have popped back up, but there is too much damage done for this to happen. It is key to understand that an economy can survive 1-5% declines or when 30-50% shuts down a few days (à la Christmas or a snowstorm), but not 30-40% for 3-4 months. This is not to mention the disease and fear of the disease are still there as we open.

The answer to dealing with COVID must be adaptation. We have adapted to other diseases, as well as to

the dangers of cars and terrorism. We have done this for every disease in history. In fact, one of the great adaptations is washing hands, which until the 1880s was not widely practiced even in hospitals, despite the fact that Dr. Semmelweis had demonstrated its efficacy 40 years earlier.

Faced with the current realities, we have to do what we did with our basketball aspirations: move forward the best we can. Healthcare spending is the near-term key to the recovery as routine and non-emergency services return. The opening of a sector that represents 18% of the economy will be a huge economic boost. Many emergency and COVID patients paid through Medicaid, which does not cover costs. The hospitals have bled money, as have doctors and clinics. We have paid for these services by our insurance premiums, but they were not available to us as the result of the shutdown. Getting as much as 14% of GDP back in action will not only spur improved healthcare but also invigorate the economy's recovery.

If there is good news about the shutdown depression, it is that it will defang any financial and business excesses, as well as pare back any excessive consumer behavior. However, do not bet against the U.S. economy and its dynamism. In 10 years, the economy will be humming. Things like good malls, hotels, travel, Vegas, etc. will superficially look the same, but à la air travel after 9/11, there will be many changes.

A sensible reboot would encourage (though not require) seniors to continue to isolate, get schools, universities, and governments back to work, open retail, and perhaps have a program that pays working seniors not to work. We will also use masks and lots of sanitizer in offices and shops and wash our hands (though since when is that something new?).

We now know that obesity and chronic diseases are the overwhelming majority of severe COVID cases and deaths. In fact, 99% of deaths appear to be among such people. So how do you protect yourself quickly? Improve your diet, regulate your weight, actively exercise, stop smoking and drinking excess alcohol, manage stress, and improve your social relationships. These are all proven ways to modify your DNA settings to improve health and greatly reduce morbidity factors. Start now, and if you do it faithfully and by winter, you will be much safer from the worst effects of COVID.

This is far cheaper than shutting down the economy and also cheaper than the medical outlays of find-

ing a vaccine. It will also probably be more effective, as any vaccine is unlikely to be 100% effective (think of the flu vaccine). We would cut COVID deaths by at least 50%. COVID has averaged about 10,000 deaths per week, of which only about 4,000 would have been alive a year later. If this death rate continues going forward, it would place COVID third on the list of causes for death in the U.S., but less than 35% of the deaths caused by both heart disease and cancer. Basically, 99% of COVID victims had preexisting morbidity factors. For many, these are generally controllable conditions improved through diet, exercise, and stress management. If people walk 10,000 steps a day (or the equivalent) and get their waist-to-height ratio below 0.6 over the next 6 months, they will basically be protected

from the worst ravages of COVID. No vaccine, miracle drug, societal shutdown, or even social distancing required. All it takes is an individual commitment to get healthier. For further information on taking steps to improving your health and bolstering your immunity to COVID and other maladies, we recommend this link: ClevelandClinic.org/wellness.

We encourage you to reach out and help someone in need. As bad as we all have it, there are others who are less fortunate. Find an organization that speaks to you and donate whatever you can, be it \$5 or an hour of your time. For more information on our favorite charity, Save a Mind, Give a Choice (SAM), please visit Lewa.org/impact/communities/save-mind-scholarships/.

We have never been a fan of betting against the U.S. economy, as it has repeatedly shown incredible tenacity in the face of hardship. State governments need to free the people and allow them to decide how to deal with their lives and loved ones. We will travel and see those we love again. People will win out over panic and fear.

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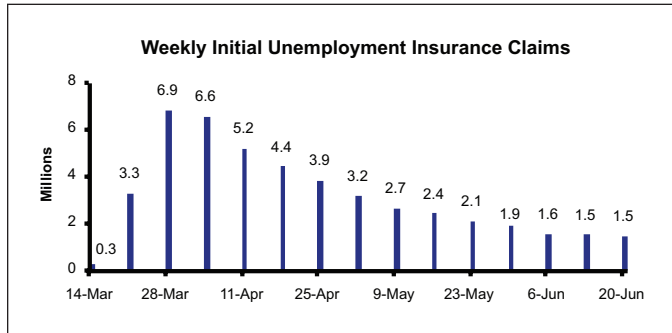


figure 2

About Dr. Peter Linneman

Dr. Linneman, who holds both Masters and Doctorate degrees in economics from the University of Chicago, is the Principal of Linneman Associates. For nearly four decades, he has provided strategic and financial advice to leading corporations. Through Linneman Associates, he provides strategic and M&A analysis, market studies, and feasibility analysis to a number of leading U.S. and international companies. In addition, he serves as an advisor to and a board member of several public and private firms.

Dr. Linneman is the author of the leading real estate finance textbook, *Real Estate Finance and Investments: Risks and Opportunities*, now in its fifth edition. His teaching and research focuses on real estate and investment strategies, mergers and acquisitions, and international markets. He has published over 100 articles during his career. He is widely recognized as one of the leading strategic thinkers in the real estate industry.

He also served as the Albert Sussman Professor of Real Estate, Finance, and Business and Public Policy at the Wharton School of Business at the University of Pennsylvania until his retirement in 2011. A member of Wharton's faculty since 1979, he served as the founding chairman of Wharton's Real Estate Department and the Director of Wharton's Zell-Lurie Real Estate Center for 13 years. He is the founding co-editor of *The Wharton Real Estate Review*.

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