

What to watch as 2020 comes to an end

Weekly Market Compass: I address nine issues to follow over the next few weeks

Dec 14, 2020 | Kristina Hooper, Chief Global Market Strategist

This is the last blog of the year for me. And what a year it has been – one full of loss. Loss of people, first and foremost, and also of businesses. It was just reported the other day that New York icon The 21 Club will be closing for good, the latest of many service-related businesses to sadly fall victim to the pandemic. I think we are all eagerly waiting to close the books on 2020 and looking forward to brighter days in 2021. I want to thank the many health care workers and other frontline workers (including grocery store employees, emergency responders and teachers) who have risked their lives this year in the face of the pandemic. I think I speak for all of my Invesco colleagues in saying that I am in awe of you and all you have done this year.

As we close out 2020 and look ahead to 2021, this is what I will be watching in the coming weeks:

1. Brexit

We still don't know what will happen, as the most recent deadline has been extended, UK Prime Minister Boris Johnson has warned businesses to stockpile inventory in the event of a "crash out" Brexit, and both sides said on Friday that a "no deal" separation was the most likely outcome. The stakes are very high, especially in the midst of a pandemic. I truly hope that an agreement is reached because I don't believe a "no deal" Brexit is fully priced into markets.

2. US fiscal stimulus.

It seems the potential for a fiscal stimulus package in the near term is declining by the minute. While the proposed \$900 billion package is inadequate, in my view, no stimulus at all would cause even more economic scarring, as the Federal Reserve has warned.¹ I expect more businesses to close in the coming weeks and months, and anticipate that the upcoming US jobs reports will reflect very anemic job growth. This would exacerbate the "K" shape that the recovery has been taking, exacerbating the income and wealth inequality gaps. However, I expect the economic rebound that unfolds in 2021 to be robust and more inclusive than what followed the Global Financial Crisis. So long as financial conditions remain loose, "creative destruction" can occur and new businesses can start up. However, that doesn't mean there won't be significant damage created by the lack of adequate fiscal stimulus in the short run.

3. The Federal Reserve

The Fed meets this week, on the heels of last week's European Central Bank (ECB) meeting, in which the ECB expanded its asset purchase program – but disappointed many who were hoping for more. I believe the Fed will need to reinforce its support for markets and the economy given the Treasury Department's decision to claw back the funding of a number of credit facilities. I suspect that support may come in the form of guidance about future quantitative easing purchases being increased and focused on longer-term maturities because the Fed expects economic conditions to worsen in the near term. This could lower longer-term yields, which should be supportive of the economy and markets. The Fed could also reiterate its willingness to be more tolerant of inflation and let the economy run before it raises rates. I believe this means that the US dollar may remain weak relative to other major currencies such as the euro.

4. The US Senate runoff races in Georgia

Party control of the Senate will be decided by these two races - which will in turn shape future stimulus (including infrastructure and "green" spending) and tax policy in America. While I believe it's far more likely that one or both seats will be won by Republicans, if both seats go to the Democratic candidates (which I assign a very unscientific probability of about 20% to), then expect stimulus to be larger and include state and local government aid - but taxes are likely to rise as well. This might cause short-term jitters for stocks.

5. COVID-19 infection rates

US cases continue to rise with no signs of abatement. The eurozone has had some success "bending the curve" of the current wave thus far, but winter is just beginning in the northern hemisphere. Germany just announced a serious lockdown to combat the spread of the virus, which has hit the country hard. If infections in Western developed countries rise enough, that could be very damaging to their economies, and in a worst-case scenario result in a double-dip recession.

6. Vaccine hiccups

The UK and the US have both approved use of COVID-19 vaccines, and more countries will soon follow, which is incredibly positive news. However, we need to recognize that if there is difficulty with distribution or side effects for those who have taken the vaccine, that would likely cause downward gyrations for stocks. We also want to follow the percentage of given populations willing to take the vaccine, as that will dictate how quickly we can move past COVID-19 and return to normalcy.

7. Capital expenditures

As I've said before, I expect capex spending to rise in advance of broad distribution of COVID-19 vaccines in many countries. And I expect business sentiment to rise in advance of capex spending, and so I will be following both metrics closely. I wouldn't be surprised to see sentiment improve in the next month or so despite a difficult environment in terms of infections.

8. Chinese economic data

The Chinese economy has been performing well given its ability to control the virus, and we expect it to lead the economic recovery in 2021 given this strength. We are already seeing very encouraging economic data. For example, car sales for November in China were strong, rising 11.6% over the previous year.² However, we will be following economic data closely to confirm continued strength.

9. Markets

Markets have been on a tear since March. Initial public offerings, which have been the object of great enthusiasm this year, are emblematic of this "risk on" environment. Understandably, clients keep wondering how long markets can continue to look through current problems. I believe it's normal to experience consolidation after a strong run-up, as we have seen this year. Triggers for a sell-off could include any of the factors listed above, from a substantial rise in COVID-19 infections that suppress economic activity to hiccups for vaccine distribution. I would stress that, given the monetary policy backdrop, I would expect any sell-off to be very short-term in nature as we look ahead to a strong economic recovery driven by the vaccine, which in turn should be positive for corporate earnings. I should add that a sell-off in stocks would probably be accompanied by a rise in gold, but that would be short-lived as well, in my view. I will be following all of these items closely and will update readers when my blog returns on Jan. 4. I wish you and yours a happy holiday season.

Source

¹Source: The New York Times, "Fed Officials Warned of Slowdown Without Stimulus," Oct. 12, 2020

²Source: China Association of Automobile Manufacturers

Important information

Brexit refers to the scheduled exit of the UK from the European Union.

Quantitative easing (QE) is a monetary policy used by central banks to stimulate the economy when standard monetary policy has become ineffective.

Capital spending (or capital expenditures, or capex) is the use of company funds to acquire or upgrade physical assets such as property, industrial buildings or equipment.

The opinions referenced above are those of the author as of **Dec. 14, 2020**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.