

## The fifth quarter of 2020

### Weekly Market Compass: The economy may not truly turn the page until spring

Jan 19, 2021 | Kristina Hooper, Chief Global Market Strategist

It might be 2021, but it doesn't feel like a new year in many parts of the world. We haven't yet turned the page on all the difficulties of the past year, so it seems like we are stuck in 2020. Or as my colleague aptly put it, this is just December 49th, 2020.

#### Vaccinations moving slowly in many parts of the world

Let's start with COVID-19. Things aren't getting better globally in terms of controlling the virus. The US and the UK look particularly challenged. And the holiday season could have been one giant superspreader event for those who did not stay isolated. Germany has had record daily COVID-19 infections – and deaths – for the last several weeks. Even Pope Francis' personal physician died last week of the virus.

There is also less progress than expected on the distribution of vaccines in numerous countries. France has vaccinated only 0.29 per 100 people while Germany has vaccinated only 0.82 per 100 people and Canada has vaccinated 1.03 per 100 people.<sup>1</sup> Spain has vaccinated only 1.04 per 100 people, the US has vaccinated only 2.82 per 100 people while the UK has vaccinated 4.19 per 100 people.<sup>1</sup> We can all learn from Israel, which has vaccinated 22.34 per 100 people, helped by a digitized universal health care system, a widespread ad campaign and good planning, purchasing doses early on in order to cover the entire population.<sup>1</sup> That so many countries have made so little progress is concerning because medical experts estimate that 55.6% to 81.5% of the total population should be vaccinated in order to bring an end to COVID-19.<sup>2</sup>

#### Economic data shows continued pressure

Recent economic data has shown signs of the damage being wrought by the rise in COVID-19 infections. The December jobs reports for both the US and Canada were disappointing, as was last week's US initial jobless claims. We also saw weakness in US retail sales for December.

As for the eurozone economy, it also came under pressure in December. As Chris Williamson of IHS Markit explained, "The eurozone economy contracted for a second successive month in December, deteriorating at a slightly faster rate than previously thought at the end of the year due to intensifying COVID-19 infections."<sup>3</sup>

I would expect economic data to continue to show weakness in the next several months as the virus continues to spread.

#### Stimulus talk didn't help US stocks last week

Also last week, US President-elect Joe Biden released details of his \$1.9 trillion stimulus package proposal, titled "The American Rescue and Recovery Plan." But the market reaction was different than what we saw with past tranches of stimulus, with stocks selling off. Some suggested it could be that expectations of stimulus were already baked into stocks while others placed the blame on his talk of taxes. I think his discussion of raising taxes is responsible, sending US stocks lower on Friday. It also served as a reminder of all the additional spending many countries have done and the accompanying debt they have taken on to combat COVID-19, and the significant consequences.

And so I think we should expect more of the same for the next several months. I suspect the first quarter of 2021 will really just be the fifth quarter of 2020, with continued headwinds for many economies. I worry about some risks:

- **COVID-19.** I talked about slow progress with vaccinations. What's worse is the variants of the virus that have emerged. Medical experts are not sure whether current vaccines will protect against these recent variants. Doctors believe that the vaccines are effective against the far more contagious UK variant (which is projected to become the dominant strain of the virus in the US by March) - but there are no widespread studies to support that belief yet. And there is more concern that the South African variant may not be protected against by current vaccines. Even if the vaccines do protect against all these variants, I worry that these more contagious strains will cause an even bigger increase in infections, hospitalizations and deaths - and an even bigger decrease in economic activity - in the next several months before vaccines are broadly distributed. German Chancellor Angela Merkel is so worried about these COVID mutations that she has alerted lawmakers that the country should remain in lockdown until early April, explaining "If we don't manage to stop this British virus, then we will have 10 times the number of cases by Easter. We need eight to 10 more weeks of tough measures."<sup>4</sup>
- **Distribution headwinds.** Various countries are running into distribution glitches related to supply and infrastructure. Many emerging markets countries don't have enough supply of the vaccine, as wealthier countries have bought up the vaccines. Some developed countries may not have enough supply either. In the US, President-elect Joe Biden last week announced an ambitious plan to vaccinate 100 million Americans in his first 100 days in office by building out a strong federal infrastructure, utilizing the Federal Emergency Management Agency (FEMA) and the National Guard. However, US Health and Human Services Secretary Alex Azar announced last week that there is no vaccine stockpile left in the US, which could slow down those vaccine plans. I wouldn't be surprised to see more distribution hiccups in many countries in the next several months.

There is also one risk specific to markets: the potential for monetary policy to tighten more quickly than expected - or, to be more accurate, investors worrying that monetary policy will tighten more quickly than expected. This concern is centered on the Federal Reserve, given trepidation that stimulus might actually push inflation higher and force the Fed's hand.

Admittedly, there have been a few Fed officials who have made comments recently that could cause indigestion for investors on a sugar high from ultra-low rates. However, last week Fed Chair Jay Powell tried to assuage fears about tightening, saying that the Fed would be very careful in communicating about any changes in policy and that the Fed would avoid premature tightening. He explained that "(One) lesson of the global financial crisis is: be careful not to exit too early" and that central bankers shouldn't even try to discuss exiting "because the markets are already listening."<sup>5</sup>

Yes, markets are listening because there is so much worry about this topic. For the record, I continue to believe it is unlikely we see inflation spike substantially - but it remains an investor concern. I think markets could swoon on just words alone - or, to put it more accurately, just misinterpreting words.

I must stress that I believe there is a very bright light at the end of the tunnel. We just need to make it through the next few months. In other words, I believe we WILL be able to turn the page.

By this spring, I believe “Groundhog Year” will be over and headwinds will abate. I expect markets to continue to move in expectations of a robust recovery later in 2021 when vaccines are broadly distributed. That should benefit cyclical stocks, emerging market stocks (especially in Asia), and commodities that are sensitive to the economic cycle, especially energy and industrial metals. I do expect tech to continue perform well, given that many of the trends that accelerated during the pandemic may not reverse. As always, I believe investors should be prudent, which means maintaining a well-diversified portfolio to help lower overall volatility, which is a likely risk in this environment.

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### Source

<sup>1</sup>Source: Our World in Data, as of Jan. 7, 2021

<sup>2</sup>Source: The Lancet, “Estimating the COVID-19 R number: a bargain with the devil?” Oct. 22, 2020

<sup>3</sup>Source: IHS Markit, Jan. 6, 2021

<sup>4</sup>Source: The Independent, “Germany faces 10 ‘tough’ weeks if it gets UK-strain of coronavirus, Merkel warns,” Jan. 12, 2021

<sup>5</sup>Source: Bloomberg, L.P., “Powell Bats Down Bond-Taper Talk, Warning Against an Early Exit,” Jan. 14, 2021

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### Important information

Diversification does not guarantee a profit or eliminate the risk of loss.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments.

Businesses in the energy sector may be adversely affected by foreign, federal or state regulations governing energy production, distribution and sale as well as supply-and-demand for energy resources. Short-term volatility in energy prices may cause share price fluctuations.

Many products and services offered in technology-related industries are subject to rapid obsolescence, which may lower the value of the issuers.

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