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Market Update: 18th December 2020

The US Recovery

The outlook for the US economy remains mixed in the short term as positive vaccine developments over the week offset the negative impact of unsettled US stimulus negotiations. With a number of relief packages set to expire by the year end, financial markets have focused on the FDA's approval of the Pfizer vaccine rather than the contentious stimulus packages that have been proposed over the last few months which has subsequently supported equity markets to post weak gains in December. The additional clarity provided by the finalisation of the electoral college vote has removed the possibility of a Trump administration sealing another term, and greater focus will be provided to Joe Biden's initial policy changes. This update will outline the state of the US economy, the latest political events and the key conditions of a US economic recovery.

State of the US Economy

Throughout November and into December, high frequency data has pointed towards a loss of momentum and downward pressure in the US economy. US covid-19 cases surged to an all-time high in mid-December, reaching 280,000 daily cases on the 11th December and remaining above 200,000 since. With daily deaths reaching a high point of 3,000 in December, economic forecasts are being revised down as states enforce partial shutdowns to the economy.

The manufacturing sector is expected to come through the incoming restrictions in a relatively strong position since they have not been forced to shut, and their ability to mitigate Covid-19 risks helps to maximise operations. The housing sector has fared relatively well so far through the fourth quarter, with house sales and new home construction expenditure in October reaching above their pre-pandemic levels. The services sector on the other hand is expected to be a lot less resilient to the incoming business and curfew restrictions. Alongside a slowdown in private consumption in November, GDP is expected to slow down further towards the end of the year as the pandemic causes a drag on performance.

As economic growth slows due to the worsening pandemic, labour market data has begun to reflect the impact from the economic scarring. Non-farm employment increased between 600-700,000 in September and October, however employment only increased by 245,000 in November. With employment still below its February level by close to 10 million jobs, the latest data has been relatively disappointing and non-farm data is expected to worsen in December. Moving forward, the short-term outlook will be heavily influenced by how much Covid-19 cases rise, the extent of restriction tightening/loosening and additional policy support.

US Election

On Tuesday this week, the electoral college confirmed a Joe Biden victory, leading to the incoming president receiving official recognition from a number of previously reluctant figures. Republican Senate Majority Leader Mitch McConnell is among those who recognised the president a month on from the initial election after a series of Trump legal challenges that fought to overturn the result. Despite this, and even as other Republicans followed McConnell's lead, Trump has still refused to concede defeat, owing Biden's victory to voter fraud. That being said, the electoral college vote is determinative, and an inevitable White House transition has already caused senior political figures to look forward to the next four years rather than undermine the election outcome. Although they were not named, seven senior Republican senators contacted the incoming president highlighting their desire to work alongside the Democrats, which will enhance Biden's credibility and his ability to enforce policy changes from January 2021. The latest recognition has come from overseas, too. Russian President Vladimir Putin, who was accused by US intelligence agencies of intervening in 2016 to help get Trump elected, recognised Biden's victory, suggesting that any remaining speculation around the US election outcome has been put to bed.

With Biden elected, attention will likely be directed to the remaining Senator elections, with the control of the Senate still undecided. Currently, the results stand at 48 seats to 50 seats in favour of the Republicans, with Georgia the only remaining state to elect its two Senate officials on 5th January. Although it is widely forecasted that the two remaining seats will fall into the Republicans favour, there is still an opportunity for the Democrats to be awarded the seats that would create a 50-50 Senate composition, with Vice President Kamala Harris being the tie decider. Political forecast platforms have begun to reduce the odds of the Republicans to retain their seats in Georgia, with Predictit Markets putting the odds of the Democrats winning control of the Senate at 34%, considerably higher than the 8% of investors surveyed by Strategas Research Partners to produce the same result.

Although it is difficult to accurately predict what this would mean for new policy measures, some general comments can be made in the event of a Democratic controlled House and Senate. If this scenario unfolds, the deadlocked stimulus package would be bolstered in the areas that Democrats want and would be passed with greater urgency. This would provide the much-needed stimulus relief to low-income households, helping to avoid a worsening economic downturn. Additionally, although it may not occur in the short-term, the Democrats may begin to unwind the tax cuts for wealthy Americans whilst also pursuing the antitrust cases against certain mega cap tech stocks with greater urgency. These policy measures will be pursued in some form under a Republican controlled Senate; however, it is unlikely they will be passed with the same urgency nor will they be as aligned to Democrats interests.

Additional Policy Support

While investors must wait for the remaining Senate elections to know if the Democrats will control both the House and the Senate, investors will be closely watching the latest stimulus bill efforts which has faced gridlock as a result of Democrat and Republican negotiations. As a result, financial markets have been increasingly reactive to stimulus package news flows in recent weeks which has been reflected in stock and bond market movements. Following several weeks in which improved expectations of a bill lifted market sentiment and stock prices – highlighted by a bipartisan proposal by a group of lawmakers in the beginning of December – the effort took a turn for the worse last week; a new proposal by the administration muddied the waters and Senate Republican leaders rejected the bipartisan bill put forward. Not surprisingly, stocks wavered throughout the week and the S&P 500 ended the period with a loss after two weeks of solid gains. The market impact would have been expected to be harsher if it were not for the positive vaccine news flows from the FDA's latest approvals, which has brought the pandemic's end date inevitably closer. That being said, most agree that additional fiscal aid will be needed to ease the transition between now and the vaccine's distribution rollout, particularly in the areas with expiring aid by the year-end.

The S&P 500 rebounded from its longest slide since September this week as Wall Street is said to be growing increasingly confident that lawmakers will pass a bill based on a $748 billion bipartisan proposal. The proposal will inject cash directly into the economy as prior benefits begin to expire at the year end, whilst helping to separate out the most contentious and partisan issues in the previous stimulus negotiations. even with additional US lockdown announcements incoming, financial markets have focused on the positive news as they price information into financial markets, with US stocks gaining as well as precious metals. As the Congress recess on Friday looms, the end of the week deadline could lead to a bill urgently passed and ratified, otherwise any hope of additional stimulus will have to wait until the turn of the new year.

Away from the fiscal stimulus proposals, the Federal Reserve and its monetary policy actions have been a key event this week. Market strategists were looking out for a possible link between future asset purchases and inflation, or even a change to the pace or composition of bond buying as some investors expected a tilt to the purchase of longer dated bond maturities. In reality, investors only received additional qualitative guidance from the Chair of the Federal Reserve, as the Central Bank committed to future asset purchases until "substantial" progress has been made in the pursuit of price stability and full employment. Taking this into account, changes to the Fed's bond buying programme are not expected, with any additional short-term policy support coming from stimulus negotiations between US politicians. Looking forward, the earliest any changes may be enacted by the Fed is on 26th January, which will subsequently allow policy makers to understand how much support households have received from the stimulus bill as it makes its next decision based on the latest economic needs.

Rising Covid-19 Cases

As US policy makers have held off from enacting additional support measures, US Covid-19 cases have continued to rise, inflicting greater economic pain and a reluctant second lockdown in many states. As it stands, the US has had a total of 17.3 million Covid cases and 311,000 deaths so far, accounting for 18.70% of worldwide deaths. With cases showing little sign of slowing down, concern has begun to grow around the US' ability to handle the worsening outlook. According to data from the Federal government, about one third of the US population lives in areas where fewer than 15% of ICU beds are available, meaning a sudden rapid increase in cases could lead to overcapacity. As a result, if the growth in cases continues at its current rate, the US could experience a sharp slowdown in consumer spending and employment growth, which will lower GDP growth expectations for December and the beginning of 2021.

Once Covid-19 cases in the US have levelled out and began to fall, there will be two key factors that determine the recovery of the US economy: the path of the virus and the policy response. The former factor will be largely dependent on the rollout of a covid-19 vaccine, the enforcement of social distance and mask wearing and additional funding for test and trace. The latter factor has been covered above and will be dependent on the outcome of negotiations from Washington and subsequently any additional monetary policy responses from the Federal Reserve.

Our View

For much of the year, US equity markets have outperformed as investors seek both safe haven assets as well as assets that offer strong growth prospects at a time when economies globally were transitioning through a recession. As we have approached the end of the year, the attractiveness of US equities has decreased somewhat as a result of their elevated valuations, whilst discounted opportunities elsewhere have provided investors with value-based opportunities. With many US states now entering renewed lockdowns/enforcing movement restrictions, we believe other regions offer stronger short-term opportunities to benefit from. Our medium- and long-term outlook will be dependent on the outcome of stimulus negotiations, the outcome of the remaining Senate elections and the growth in Covid-19 cases. The Senate election will largely influence the expected policies over the next four years whilst the growth in Covid-19 cases will determine how and when the economy can reopen. That being said, attractive opportunities in the US remain, such that we remain neutral on the region and our expectations will be dependent on the outcome of the events we have detailed within this document.