VACCINATED AND IMMUNIZED?

This was the year that many of us became "more expert" (but not, for almost all of us, experts) on how medical vaccines are developed, tested, and approved for widespread use. Potentially – and expectantly – 2021 will be the year in which we learn appreciably more about how quickly and broadly vaccines can get distributed globally and how well they may immunize the world's population against COVID-19. This was also the year that – at the risk of stretching the medical analogy too far – capital markets seemed to have taken a vaccine of sorts early on that successfully immunized investors against what easily could have been among the worst years for risk assets (i.e., stocks and corporate bonds) since calendar year 2008. Rather than build downward momentum after a sell-off that pushed equity prices down -31% through late-March, most markets clawed their way back to breakeven levels by mid-summer and pushed ahead to all-time highs in the fall.

The US Federal Reserve and other global central banks deserve credit for developing a vaccine for capital markets in the form of monetary policies that delivered massive amounts of market liquidity and stability in a record short amount of time. The result (so far): these monetary policies (as well as a dose of bipartisanship that quickly produced fiscal policies that provided financial support to individuals and businesses) successfully immunized most investors' portfolios against the economic, medical, and social ravages of COVID-19.

The key November datapoints relevant to global capital markets and investors in 2020 included:

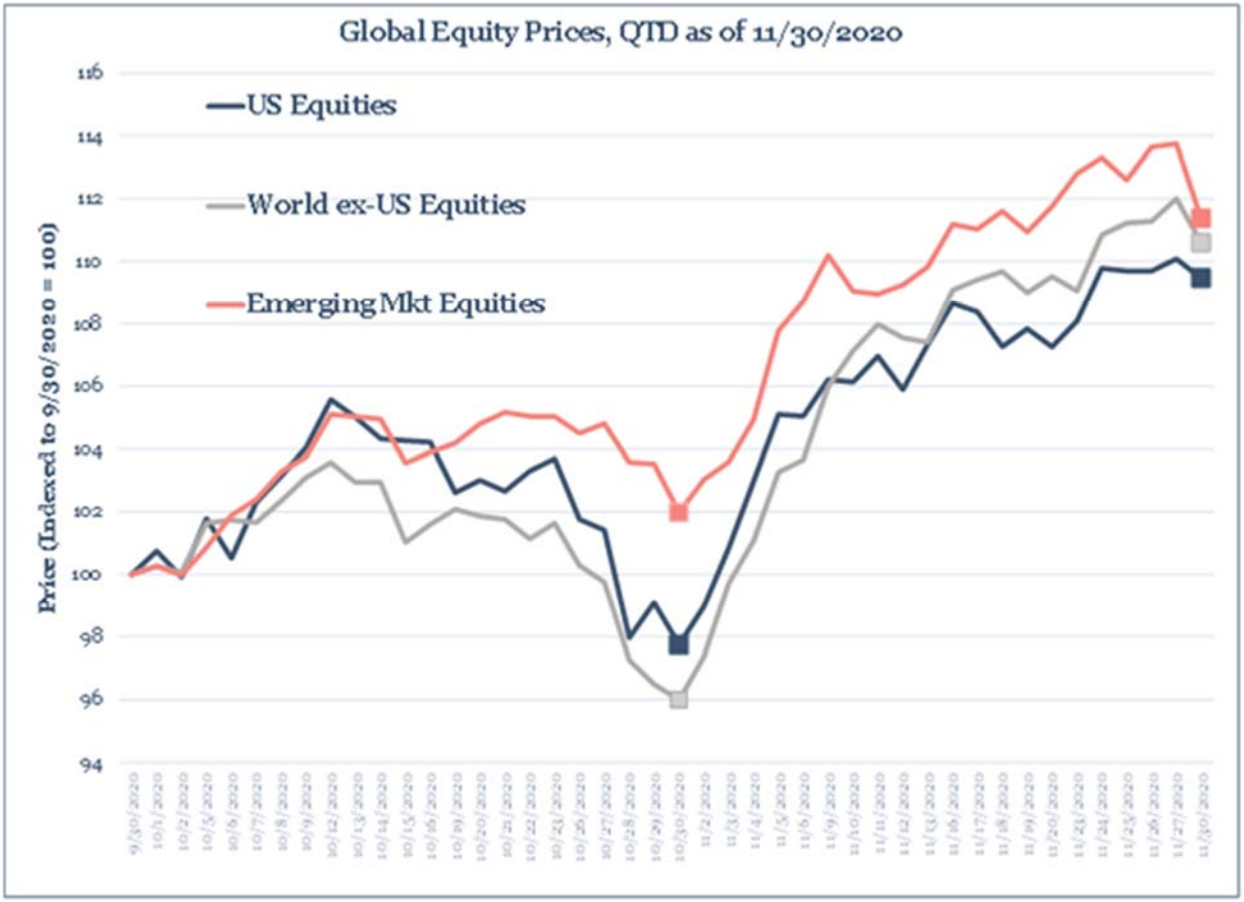
- The US Bureau of Economic Analysis released its second estimate of Third Quarter 2020 GDP, which was unchanged (+33.1% annualized rate of growth) versus its prior estimate. Recent consensus estimates for the current quarter (+4.0% rate of growth) are unchanged versus last month amid signs of surging COVID-19 infections. Projected growth averaging +3.0% annualized across each of 2021's calendar quarters would, if achieved, restore the size of the overall US economy to December 2019 levels by December 2021.

- Joblessness remained high in the US; initial unemployment claims ticked higher in late November, and the total number of unemployment claims remains near the global financial crisis' high. The unemployment rate, which peaked at 14.7% in April, is forecast to have further declined, to 6.8%, in November.

- The third quarter "earnings season" has largely wrapped up for US companies. In aggregate, companies whose shares comprise the benchmark S&P 500 Index achieved sales and earnings growth that exceeded pessimistic expectations. But, reflecting a 2020 economic reality that differs radically from that of 2019, overall quarterly earnings were nearly -9% lower year-over-year. Net of a weak final quarter, earnings for all of 2020 are projected to be 15-20% lower than in 2019.

- Global equity prices rallied sharply in November (MSCI ACWI: +12.3%) in large part due to the news that an efficacious COVID-19 vaccine may soon be available and that limited inoculations could begin before the end of 2020. Furthermore, the US Presidential election ultimately went off without a hitch despite pre-election worries and the residual noise created about the validity of the results. On balance, market participants reacted very positively to the election's outcomes, which currently seem likely to include a politically divided House and Senate and, accordingly, to preclude major changes to the US tax code in the short-run.

- International markets (+13.5%) led by the Eurozone (+20.3%) outpaced the U.S. markets (+12.2%), with prices aided in part by continued weakness (-2.8% in November; -6.5% since mid-year) of the USD versus a basket of non-US currencies. In US equity markets Value stocks (+13.5%) outperformed Growth stocks (+10.2%) in hopes of an improved economic outlook that would benefit a greater number of industries and market sectors beyond mid-2021.



- The Federal Reserve announced at month-end that it will extend four lending facilities through March 31, 2021. Although these monetary tools had been largely underutilized since their establishment in 1Q20, they continue to be viewed as a “backstop” to the capital markets. Bond investors remain focused on the timing and size of a prospective additional stimulus bill, which would provide budgetary relief to states and local municipalities.

- Akin to equity markets, fixed income credit markets experienced a boost from news of positive COVID vaccine results and dwindling uncertainty around the U.S. Presidential election. Credit spreads on investment grade and high yield bonds ended the month at below pre-COVID levels, with high yield spreads tightening a notable -97 basis points to +412 basis points. Corporate bond yields – now 1.80% (investment grade) and 4.70% (below investment grade) – are now the lowest on record. Taxable bonds returned +1.0% (Barclays US Aggregate Index) in November.

- Tax-exempt municipal bonds, which had underperformed since the start of the pandemic, made up some ground this month as market yields fell across most maturities. For the first time since early March, the ratio of long-dated (30-year) Muni to Treasury yields ratio fell below 100%, signaling a continued recovery of investors' confidence in creditworthiness of issuers in this market. Tax-exempt bonds returned +0.8% (Barclays 1-10 Year Muni Index) in November.

As we head into the year's final month – and as we anticipate that the first several months of 2021 may be the worst yet for the spread of COVID-19 in the US and globally – the near-term test for investors will be whether the roll out of actual vaccines will produce the levels of immunity and rebounding economic growth and profits already implied by capital market prices. We certainly hope that markets have correctly called the future, but as always caution investors to guard against the many unknowns that attend something as unprecedented as a global pandemic.

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