Great-West Investments Capital Markets Perspective

Week in Review: January 4th – 10th

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
Dow Industrials	Lg. Cap Eq.	31,098.00	2.36%	2.36%
S&P 500®	Lg. Cap Eq.	3,824.68	2.53%	2.53%
NASDAQ Comp.	US Equity	13,202.00	2.79%	2.79%
Russell 2000®	Sm. Cap Eq.	2,091.66	5.71%	5.71%
Stoxx 50	Europe Eq.	3,645.05	2.06%	2.06%

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FTSE 100	UK Equity	6,873.26	6.39%	6.39%
Nikkei 225	Japan Equity	28,139.03	2.53%	2.53%
EEM:US	Emkt. Equity	$54.71	6.40%	6.40%
EFA:US	Non-US Equity	$75.73	3.74%	3.74%
UST 10y (yield)	US Treasury	1.13%	0.22%	0.22%
B/Barc AGG	Fixed Inc.	2,369.46	-0.85%	-0.85%

If you had hoped that the turning of the calendar to 2021 would somehow allow the political divide cleaving our country in two to magically begin repairing itself, you were sorely disappointed by developments in Washington this week.

With disgruntled citizens storming – and in some cases, looting – the very seat of our government, Wednesday's breech of the US capitol delivered images far more reminiscent of third world Banana Republics trying to shed a tin-pot despot than of a modern and healthy democracy venting its disappointment with the outcome of an election. **It's impossible to overstate how tragic and sad Wednesday's events were, both in human terms over the lives lost and in what it says about the state of our Republic.**

But **our purpose here is not to opine on politics, but instead to measure and describe the impacts such events have on capital markets. And Wednesday's developments produced…almost nothing**. The barricades surrounding the capitol building were breeched at around 1 p.m. ET, with several hours still left in the trading day. **While US equities did in fact decline when protestors broke through, the S&P 500 Index never retraced even *half* of the gains earned earlier in the day**. The remainder of the week produced additional gains for equities as well, pushing all major market indices we follow for this report more than 2% higher on the week. **Perhaps even more telling, US treasuries declined and the US dollar remained mostly flat on the day;** that's significant, because extreme events often cause money to pour into these two asset classes in a flight to safety that is often quite sudden and powerful.

Frankly, I'm at a bit of a loss to explain why markets were so seemingly ambivalent to Wednesday's developments. I suppose **you could argue that Wednesday afternoon's events weren't truly a surprise** – some political commentators had suggested this kind of violence to coincide with the formal counting of the electoral votes was a possibility weeks ago. **Mental fatigue may also have played a role** – after dealing with a pandemic, social unrest all summer and an unusually contentious election in the fall, investors may simply have become steeled against even the most potentially galvanizing of events.

Another, perhaps more hopeful interpretation is that investors were simply displaying their faith in the institutions that comprise our government to withstand Wednesday's breech and whatever political implications may follow. After all, when you consider that markets, the economy and our government have all endured through the almost unbelievable list of stresses that 2020 placed on our society, investors may have been in more of a mood to take even something like Wednesday's violence more or less in stride.

A final, perhaps somewhat more pragmatic explanation leans on the idea that **the violence in the Capitol might ironically represent a catalyst for unity and compromise** – a view supported to some extent by the bi-partisan nature of criticism that has followed. Such unity could prove particularly important now that **the runoff elections in Georgia have delivered both of the state's Senate seats to Democrats[1], giving control of the White House and both chambers of Congress to a single party** (something that is sometimes viewed as market-negative because it can accelerate regulatory and legislative action at the Federal level**.) At a minimum, Wednesday's events – particularly the run-off results from Georgia – seem to have convinced markets the chances of a very robust stimulus in the near-term are now better than they were before**.

Whatever the case, **markets successfully dealt with a few other body blows last week, including a very disappointing payrolls report on Friday**. The US economy shed 140,000 jobs in December[2], compared to expectations for a modest increase. To some extent, **Friday's payroll disappointment was well-telegraphed** by a series of disappointing weekly claims numbers during December, as well as a wide miss by ADP payrolls on Wednesday,[3] perhaps dampening any tendency by markets to sell-off on the news. And rounding the list of downbeat jobs data last week, **outplacement firm Challenger announced that 2020 saw a record-high 2.3 million layoffs, roughly half of which were directly related to COVID-19**. (Interestingly, that leaves more than a million job cuts that were *not* related to the pandemic, a figure that seems to suggest the economy was already weakening and would have dipped into recession even without the virus.)

There were rays of hope in last week's data, however, including yet another re-affirmation from the Federal Reserve that rates were likely to remain lower for longer, and that policymakers were quite in-tune with market expectations regarding future increases[4]. That insight, delivered by way of last week's Fed minutes for the December 16 meeting, could prove important because any miscommunication surrounding the Great Unwind, when it actually comes, could place markets at risk for significant volatility unless managed very carefully by the Fed.

Another example of not-quite-so-dire news was a **blow-out report from the Institute of Supply Management, which showed a broad-based economic recovery was continuing to take hold in December.** A key number in that report[5] showed that employment had inched back into expansionary territory, one of the last indicators to make that jump. Markit Economic's **Purchasing Managers' Indices[6] were somewhat more mixed, however, with both the services- and manufacturing indices for the US taking an unexpected leg down** even as they remained comfortably in expansion mode.

Notably, though, things were **not nearly as upbeat in the Eurozone, where composite PMIs dropped back below the 50-yard line as a result of surging COVID cases and renewed lockdown initiatives**[7]. Also concerning were details in both reports suggesting that cost pressures have continued to build for businesses in both the US and Europe, which could present firms with an ugly choice in 2021 and beyond: raise selling prices and risk a cooling-off of demand, or keep prices stable and risk an earnings-destroying margin pinch in future quarters. Either would represent an unenviable choice for businesses if input price pressures continue to rise.

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[1] https://results.enr.clarityelections.com/GA/107556/web.264614/#/summary.
[2] https://www.bls.gov/news.release/empsit.nr0.htm
[3] https://adpemploymentreport.com/2020/December.
[4] https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20201216.pdf
[5] https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/pmi/december/
[6] https://www.markiteconomics.com/Public/Home/PressRelease/adc517110a0e4375b768010f191f9a5d
[7] https://www.markiteconomics.com/Public/Home/PressRelease/cc88b8983d4d4fb4a2d8bd0affeed7d8

What to Watch This Week: January 11th – 17th

Notable economic events (January 11th – 15th)

Monday: No scheduled economic events; potential impeachment activity

Tuesday: JOLTS

Wednesday: CPI, Fed's Beige Book

Thursday: Initial Jobless Claims, EXIM prices

Friday: PPI, Retail sales, Empire St. Mfgr., Industrial Production, UofM Consumer Sentiment

It will be a fairly light week on the economic front, with inflation-related data dominating the schedule. Politics threatens to co-opt the calendar, however, with the beginning of potential impeachment proceedings likely on Monday. Whether that would represent a legitimate effort to unseat the President or something more symbolic remains to be seen, however, and as of Monday afternoon markets seem largely unfazed.

There will be a host of inflation-related data released this week, including consumer prices (CPI) on Wednesday and producer prices (PPI) on Friday. In addition to that, the Atlanta branch of the Federal Reserve also conducts a monthly survey of inflation expectations among US businesses (due out on Tuesday,) that we typically don't spend much time discussing in these pages. However, given the consistency with which price pressure has appeared in other recent survey-based data (most notably the PMI and ISM data,) I plan to give this month's version a fairly close read and will share any insight that may appear.

Ditto for the import/export price release due on Thursday: once the US/China trade war dropped from the headlines, that release lost some of its importance. Given the current environment with prices, however, that release may have seen its status elevated ever so slightly. **More to come next week, if appropriate.**

Friday will really be the biggest day for data junkies, at least in terms of what's scheduled. In addition to **industrial production data** (which will serve as an important cross-check of recently strong – albeit decelerating – survey and operating data from manufacturers and other productive sectors of the US economy,) **we will also get the first of January's regional Fed surveys from New York State**.

Also on Friday, the **University of Michigan will release its mid-month look at consumer attitudes**. Confidence has yet to reach pre-pandemic levels, and this year's ups-and-downs have illustrated exactly how impactful political views can be on consumer confidence. That makes this week's read even more interesting given last week's events in Washington (and, perhaps to lesser extent, in Georgia.)

Top prize in terms of what is most likely to reflect the true status of the US economy, though, probably has to go to the **retail sales report, also due on Friday**. December's report could be a mixed affair, though, given that uncertainty related to the status of stimulus payments and the extension of key pandemic-related unemployment programs was still very much up in the air for more or less the entire month. In any case, the fact that the next round of stimulus checks have already begun to show up in peoples' accounts (as well as the growing expectation of yet another check in coming weeks) suggests that December's retail sales numbers will probably be somewhat thin compared to next month's. Stay tuned.

Source for index data: Bloomberg.com; GWI calculations.