4th Quarter 2020 Market Commentary

Employment

The Bureau of Labor Statistics (BLS) December employment report showed that Non-Farm payrolls plunged by 140,000 arresting seven consecutive months of job growth. This is the weakest report of the recovery so far considering the spike in the number of COVID-19 related cases in the November – December time range. Payrolls have expanded by 12.3 million since the February-March meltdown, but that still leaves 10 million either in temporary jobs or on the sidelines.

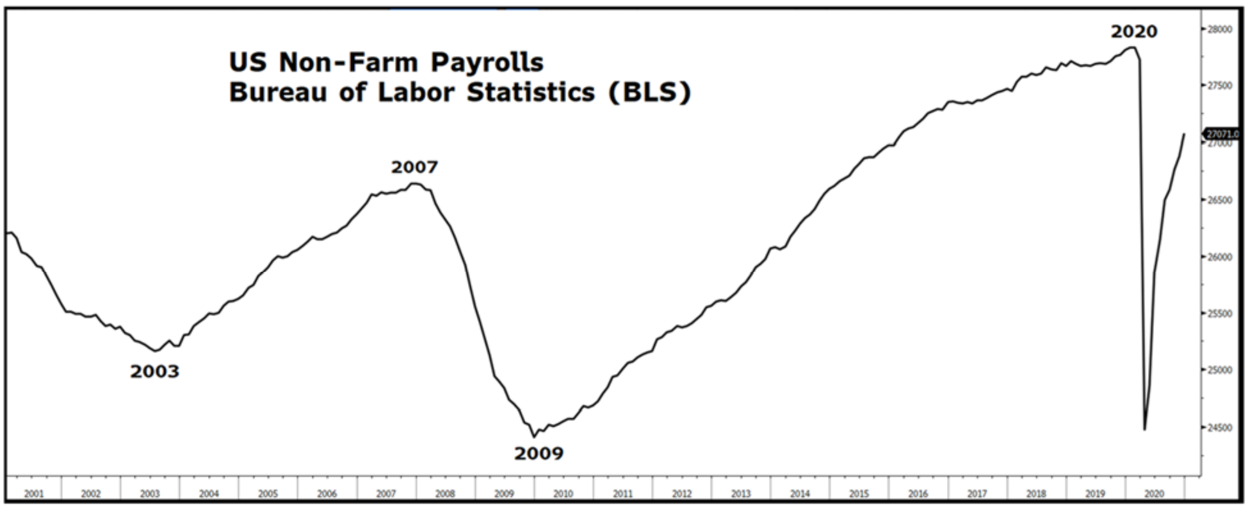

Chart Source: Bloomberg Anywhere

Although the unemployment rate for December was unchanged from November, coming in at 6.7%, the labor participation rate did not improve remaining at 61.5% - the lowest reading since the 1970s. In numerical terms, the labor force has contracted by over 4 million since the pandemic began, an alarming number to say the least. The latest round of fiscal stimulus is certainly welcomed, but it is likely only the beginning of what is needed if the employment backdrop fails to show significant improvement in the coming months.

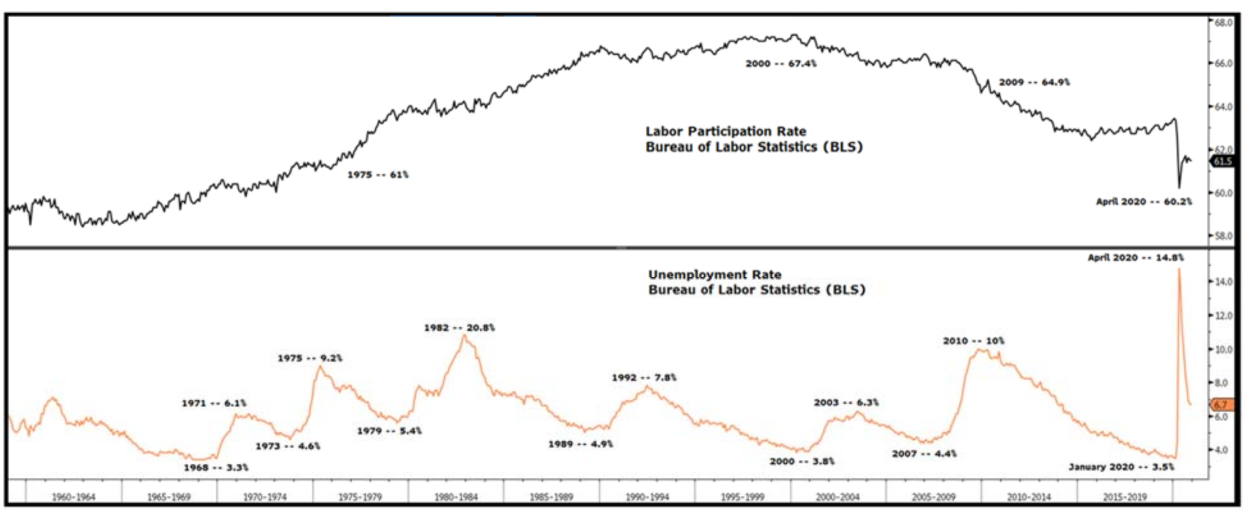

Chart Source: Bloomberg Anywhere

Underlying the weakening numbers, the Labor Department continues to classify many workers as "employed but absent from work" instead of unemployed. If these workers were to be added back into the ranks of the unemployed, then the unemployment rate would have come in at 8% - considerably higher than the reported 6.7%. The Labor Department's broader underemployment rate (U6), which includes workers in part-time positions that would prefer full-time jobs and those too discouraged to search for a job, is 11.7%.

Fiscal Policy Change

Another troubling sign in the labor force is the growing number of workers who have been unemployed for six months. This number reached 3.96 million in December up from 920,000 in April. This term level is approaching the peak reached following the "great housing bust" in 2009 before finally turning down in 2011. As we know, this was the catalyst that led to the first round of 0% interest rates, rapidly expanding Central Banks balance sheets and ballooning government deficits.

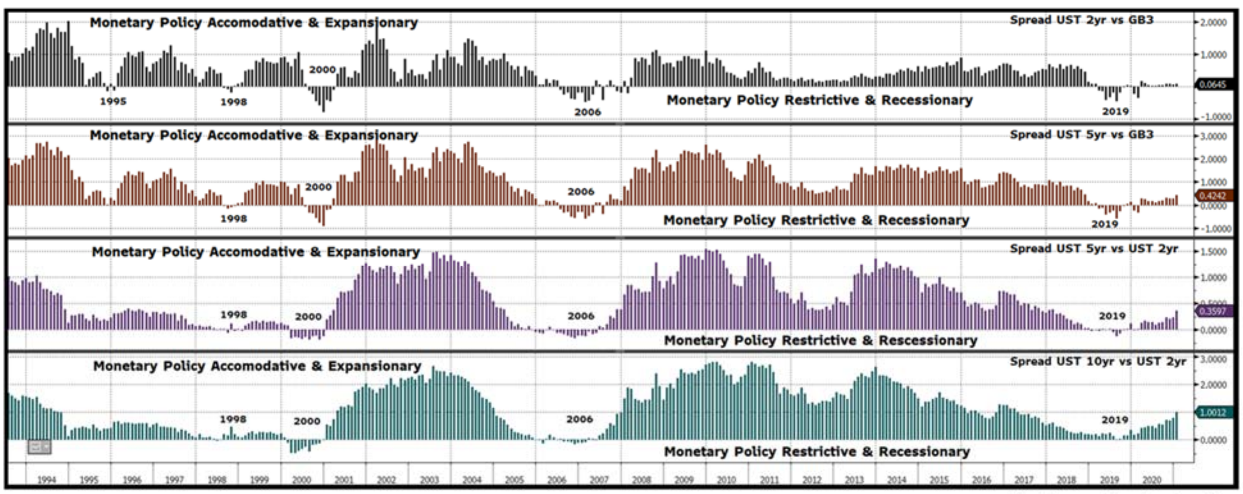

Chart Source: Bloomberg Anywhere

The catalyst for a repeat this time around has been the pandemic and it is playing out in a similar fashion, requiring a strong fiscal and monetary response by policy makers. The issue at hand; however, is that even with the historic intervention in the capital markets by the monetary authorities coupled with a strong fiscal response, it may not have been enough to stem the tide. If the "lockdowns" continue to accelerate in response to the virus with the labor backdrop noted above, the first half of 2021 is going to be choppy to say the least.

The longer workers remain on the sidelines and disconnected from the workforce, the more likely they will become permanently unemployed. The already historically low Labor Participation Rate is likely to go even lower - exerting substantial stress on consumption and the economy. The good news part of the story is that the vaccine is rolling out and could be a game changer by June according to the Center for Disease Control and Prevention (CDC).

Global Growth Accelerating

In a recent report released by China's Federation of Logistics and Purchasing, their Purchasing Managers Index (PMI) remains in expansion territory and exports have risen 21% year over year. In the United States, both the Manufacturing and Services indices, as produced by the Institute for Supply Management (ISM), are currently above trend and expanding as well. The National Association of Home Builders Market Index is also above trend and expanding with residential home construction expenditures up 16.2% year-over-year.

The U.S. Census Bureau's most recent release for retail sales came in up +4.1% year-over-year and the retail trade numbers were up +9.5%. The retail trade numbers roll up into Gross Domestic Product (GDP) suggesting that the economy is continuing to accelerate from the March economic trough. The Atlanta Federal Reserve Bank is essentially confirming these trends as their GDPNow forecasting model known as "nowcast" shows that GDP for Q4 2020 is tracking at an 8.7% annualized rate quarter-over-quarter.

Macro Overview

From our lens, as we have noted above, global growth remains below its long-term trend, but nevertheless is accelerating. The high frequency data, which has softened somewhat over the last month, remains constructive suggesting that the economy is on solid footing and should accelerate into 2021.

The pandemic is problematic for sure and, if the "lockdown" protocols continue at their present pace, will be a significant headwind to our forecast. With that said, the monetary backdrop is accommodative and the narrative from Central Bankers does not suggest that a shift is in the wind. If anything, quite the opposite, as the Federal Reserve has noted several times over the last many months that they are willing to let inflation move above their targeted 2% threshold until full employment has been attained.

Our current cycle work suggests that the global economy will not reach its peak rate of change before 2022 at which point; we expect that growth will slow, as is typical in any economic cycle. We expect interest rates at the long end of the curve to inch higher in lockstep with increased inflationary expectations as the economy improves, but the Fed Funds Rate will likely be well anchored until late summer. As noted above, given the weak labor market conditions it seems reasonable to assume that we have not yet seen the last of additional fiscal stimulus. If President Biden remains true to his word, more is indeed on the way.