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In this week's recap: Mixed news elicits a mixed reaction from the markets; incoming Biden Administration outlines stimulus plan.

Weekly Economic Update

Presented by Edward Papier, CIMA® CFF, January 18, 2021

THE WEEK ON WALL STREET

Markets drifted lower last week as uninspired investors digested mixed news on the economic front.

The Dow Jones Industrial Average lost 0.91% while the Standard & Poor's 500 slid 1.48%. The Nasdaq Composite index stumbled 1.54% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, slipped 0.26%.[1,2,3]

STOCKS DRIFT LOWER

Stocks traded without much conviction last week, pushed lower, in part, by a broad retreat in technology. Rising interest rates also dampened enthusiasm, feeding concerns over their effect on current stock valuations.

Markets seemed deaf to a stream of news, moving little on the House impeachment vote, encouraging news on the vaccine front, reassurances from Fed Chair Powell, or a jump in jobless claims. Energy and financials continued their recent advance, while smaller capitalization stocks rose on expectations of becoming beneficiaries of any stimulus bill.[4,5]

Stocks turned lower to close the week, following the unveiling of president-elect Biden's stimulus plan and a weaker-than-expected retail sales number.[6]

NEW STIMULUS PROPOSAL

Biden revealed his long-anticipated stimulus proposal last week, announcing a $1.9 trillion spending plan to provide further help to an unsteady economy.

Along with monetary easing, fiscal stimulus has been one of the major drivers of the stock market recovery, which is why investors have anxiously awaited his plan.

His proposal seeks to help individuals, including direct payments for qualifying Americans and enhanced unemployment aid. The proposal would also include help for small businesses with a new grant program in addition to the Paycheck Protection Program, and would bolster state finances by funding frontline workers, vaccine distribution, reopening schools, and vital services.

The market reaction was muted. Investors will be watching the extent to which Congress amends Biden's proposal and the speed at which it's picked up by the legislature.

THE WEEK AHEAD: KEY ECONOMIC DATA

Thursday: Housing Starts. Jobless Claims.

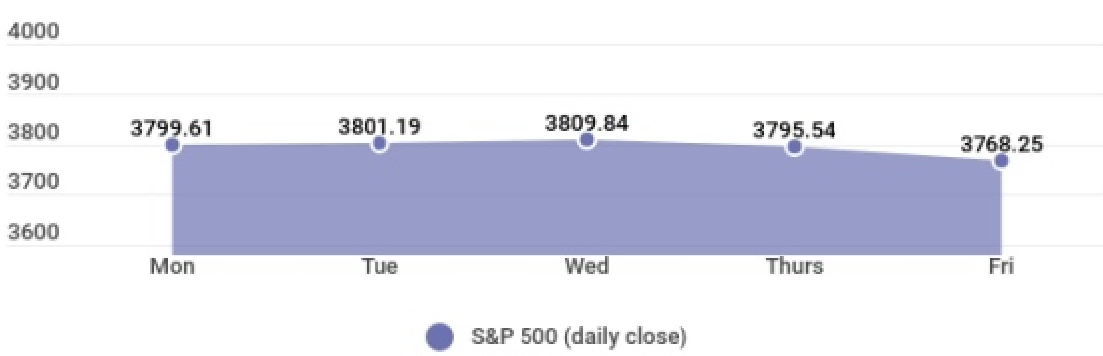
Friday: Existing Home Sales. PMI (Purchasing Managers' Index) Composite Flash.

QUOTE OF THE WEEK

"We can only be said to be alive in those moments when our hearts are conscious of our treasures."

THORNTON WILDER

Market Index	Close	Week	Y-T-D
DJIA	30,814.26	-0.91%	+0.68%
NASDAQ	12,998.50	-1.54%	+0.86%
MSCI-EAFE	2,209.37	-0.26%	+2.88%
S&P 500	3,768.25	-1.48%	+0.32%



	Treasury	Close	Week	Y-T-D
	10-Year Note	1.10%	-0.03%	+0.17%

Sources: The Wall Street Journal, January 15, 2021; Treasury.gov, January 15, 2021
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, January 8, to Friday, January 15, close. Weekly performance for the MSCI-EAFE is measured from Friday, January 8, open to the Thursday, January 14, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

Last year, the S&P 500 Index was up 18%, growth stocks 33%, the NASDAQ 44%, and an equally weighted portfolio of FAAAM—Facebook, Apple, Amazon, Alphabet (Google), Microsoft—and Netflix was up 55%. Value stocks gained 1.4%.

Think about that for a second: Six stocks in the S&P 500 Index gained 55% and accounted for 14% of the 18% index return. That means the S&P 494 stocks gained just 4%. Warren Buffett's Berkshire Hathaway, you wonder? Just 2.3%.

Recall a time when cab drivers, while waiting for their next fare, traded stocks on their hand-held "Quotrek" devices. It sure feels like 1999. An advisor told me last week that value-oriented managers just don't get it. Sadly, that sounds all too familiar.

Take a look at some quick stats for 2020:

S&P 50018.40%
S&P 6 (FAAAM plus Netflix)49.32%
S&P 494: 4.05%
Growth Stocks:32.79%
Value Stocks: 1.54%

Our starting conditions today are challenging and, we could argue, unlike any we've experienced in our investment lifetimes. The macro issues are as follows:

- Interest rates are near zero and negative in some parts of the world. Central banks cannot help economies the way they did in years past. The consequences: Recessions will likely hit harder, become more frequent, and last longer.
- The level of debt has never been bigger. MMT and restructuring has begun. Nobody has gotten away with the kind of money printing that's happening now without some kind of trouble.
- May see U.S. debt topping $40 trillion (doubling from here).
- Valuations have never been higher. Market cap relative to GDP (Buffett's favorite), market cap relative to domestic income, sales to earnings… etc., etc.
- Forward return probabilities are lower than they were in 1999. The decade that followed lost about 1% per year. It took nearly 15 years, 2000 to 2015, for tech to get back to breakeven (inflation adjusted).
- The quality of debt has never been worse—especially in the European Union, as member countries are handcuffed by a flawed monetary structure. Many US corporations are in equally rough shape.
- We're seeing a near-record level of zombie companies: they compose 15% of corporations in the U.S., and an estimated 20% of corporations globally. They're fueled by a zero-percent interest rate policy and investors' desperate search for yield. This will end badly with default levels spiking in the next crisis.
- We've got record margin debt. The system is uber leveraged. Leverage is risk.
- The aging demographics in the western countries, Japan, and China are not favorable conditions for growth.
- The gap between the haves and have-nots is widening. Mix slow growth, low wage growth, and higher costs of goods into the equation and people aren't going to know what him them.
- A rising superpower, China, is challenging a declining superpower, the United States.
- Bottom line: The current boom is the third great bubble of the past quarter century. We are heading down the same path as the dot.com bubble of the late '90s and the real estate bubble that burst in 2008.

Watch what they do, not what they say… As Munger said, the "Frenzy is so great, and the systems of management, the reward systems, are so foolish." That's a large part of the reason why valuations have reached such extremes. It is perhaps the greatest debt-to-equity swap of all time. Capitalism gone wild. It will reset.

Timing? Impossible to know. It could peak next month. It could arrive in late 2021, or sometime in 2022. We do expect the next bear market will exceed average bear market declines. Average is in the negative mid-30 percent range. The next is likely similarly to the tech and real estate bubble declines: think -50% range.[7]

Sounds depressing, but there are opportunities. It's depressing only if you don't navigate it well. The bubble is in passive investment management. Hint: Amadeus likes option spreads to protect long positions, commodities, good old-fashioned trading strategies and of course the many non-correlated alternatives: Private debt, private equity and real estate on a primary and secondary basis, promissory notes, equipment and aircraft leasing, direct and co-investments, venture investing, energy, multi-alternative, co-GP interests, litigation finance, mineral royalties, and other special situations.

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Know someone who could use information like this?

Please feel free to send us their contact information via phone or email. (Don't worry – we'll request their permission before adding them to our mailing list.)

CITATIONS:

1. The Wall Street Journal, January 15, 2021
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4. CNBC.com, January 14, 2021
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