



November 30th, 2020

## It's only as Good as it Seems

- **Markets keep faith in the prospect of a vaccine, and ongoing support from policymakers.**
- **With equities in a euphoric mood it is worth keeping in mind some of the risks**
- **Latest Fed minutes and Yellen at the Treasury argues for anchored long-term rates**
- **Low mortgage rates bring vibrancy in the housing market and likely further performance from US housebuilders.**
- **OPEC meets with a risk that production rises in the new year. The equity oil sector is at risk.**

**The markets look to continue to ignore the poor near term news on COVID19 cases and see only the rebound in economic activity in 2021.** While we await a fiscal package, the stock market is getting sufficient support from the Federal Reserve. The easy bet for investors is that the Fed will remain accommodative well into 2021 and likely beyond. The presumptive appointment of Janet Yellen as Treasury secretary only adds weight to the view that monetary policy may take the weight of the burden of keeping the U.S. economy going.

**Near term, data has shown the U.S. economy to have gone into the second wave of COVID with some economic strength in contrast with the eurozone where data has been weak.**

U.S. industrial surveys and investment spending were ahead of expectations at the start of November. By contrast, in the eurozone, industrial confidence was already falling. That said the downturn in the eurozone to date has been far shallower than seen in March/April.

In Asia, governments have reimposed lockdowns in some parts, but to date, the setback in economic data has been modest. In Japan, despite record-high infections, the mobility of the population has remained on an upward trajectory. China's economy ability to contain the effects of the COVID crisis was evident in a report showing that October industrial profits grew by 28.2% year-on-year. Aggregate earnings for the year are up a much more modest 0.7% yoy due to the hit to profits earlier in the year.

The S&P500 is up at a new high although 'only' 3.7% higher than where the index was in August. However, that does represent a stonking 11% rise from the late October low of 11.3%. So, for one minute, it is worth considering what could go wrong in the coming months.

1. The second wave of COVID9 lingers for far longer and does more damage than is currently discounted. To be honest, so far it seems that governments don't have the willingness to close-down their economies anywhere close to the degree seen in March April, even though hospitalisations are reaching the levels of April.
2. The authorities distribute far more slowly than expected/discounted. There are clear logistical challenges of distributed and administered, particularly if it has to be kept at such low temperatures.
3. President Trump starts to have successes in his attempts to call into question the election. Key dates are December 14th when electors from all 50 states will meet to place their official votes. On January 6th Congress will count the vote. The U.S. code allows Congress to object to electoral votes.....so we won't know **until January 6th**.

While the markets may be complacent about some of the risks, investors have plenty of comfort in the thought that whatever is thrown at the markets, policymakers will ride to the rescue. Last week's Fed minutes showed that they continue to believe that they will have to provide further policy help for the U.S. economy.

#### MSCI Global Equity Total Return Index Trades at Highs



Source: Bloomberg

**The latest Federal Reserve minutes in our view suggest that the Fed is likely to extend the maturity of their bond purchases in support of the economy.** That decision could come as early as their December meeting given there remains a strong likelihood that there will be no new U.S. fiscal package before a new President is sworn in. We expect the 10-year government bond yield to stay anchored around current levels.

The U.S. 10-year government bond yield currently trades at 84bps in a range of 76bps to 97bps over the past month. We expect the Fed to have at least half an eye on maintaining something yields close to this level. But even the fundamentals don't warrant a steeper yield curve. The U.S. unemployment rate is two to three times higher than where it was at the start of the year. These are levels seen after 2008 when inflation struggled to stay above 2.0%.

News that Janet Yellen is the likely candidate for Secretary of State for Treasury only underlines the significant links between Fed policy and the Treasury. Janet Yellen has been an advocate for a further round of substantial fiscal stimulus. If the new Biden government finds that budgetary policy gets stuck in a still Republican-dominated Senate Janet Yellen will no doubt signal to Fed Chair Powell which monetary policy levers to pull.

**The resilience of the U.S. consumer was seen in the 'Black Friday' sales data a new record with consumers spending \$9.0 billion, an increase of 21.6% year over year** (online sales hit \$7.4 billion on Black Friday in 2019), according to Adobe Analytics data. It was the second-largest online spending day in U.S. history, coming in behind Cyber Monday 2019.

**One more enduring U.S. consumer demand is for homes.** The last few quarters have been notable for the strength in the U.S. housing market. The extremely low mortgage rates and ongoing good demand supported by demographics are keeping the housing market vibrant. The census bureau reported that new home sales in October were well ahead of expectations at +41.5% year-on-year. Mortgage applications for single-family homes are up 19% on a year ago with mortgage re-financing up 79% (another reason for the Fed to keep long rates low). The 30-year mortgage rate is at a 30-year low.

**The US homebuilders index has performed largely in line with the S&P500 since the start of the year but has rallied 150% from its March low. We suspect there is more performance to come.** The inventory of existing homes is down nearly 20% from a year ago and is now at a lowly 2.5 month's supply, the lowest in recent history. Strong demand and slow supply are doing what it would naturally do and is forcing house prices higher. The FHFA reported last week that its house price index was up 9.1% in September the strongest in 14 years.

**There will be much attention on the OPEC meeting this week give the volatility of views ahead of the meeting.** The cohesiveness of OPEC+ (OPEC plus non-OPEC countries such as Russia) is key to whether production cuts can remain in place to support the oil price. Libya and Nigeria have argued for increase allocations. Indeed, even within mainstream OPEC the UAE has seemed at odds with Saudi Arabia. The lack of a consensus at informal talks on Sunday leaves a risk of no new deal to limit production and hence the default is hat 1.9 million barrels of oil a day will be back on the market at the start of 2021.

## MSCI Global Oil sector relative MSCI World rebounds, but for how long?



Source: Bloomberg, MSCI

**All said the equity oil sector may see some profit taking in the near term.** The sector has got excited about the recent rise in the oil price to \$45, but quite frankly the oil price had a four handle back in June. Hopes for a vaccine do help, but the world still faces several sources of oil that remain potentially on tap ready to keep oil at around current levels including Libya, Iran, Nigeria. However, analysts expect the U.S. oil industry to be less of a threat to stable oil prices in the coming twelve months. Indeed, conventional wisdom is that U.S. oil production could remain at the current 11m b/d level even by the end of next year well below the peak of 13m b/d in February. U.S. fracking is well below previous levels. The number of fracking crews in the Permian basin is just 63 compared to 146 at the peak.

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