Markets Pause to Digest Stimulus and Growth Expectations

As the year progresses, markets seem to have transitioned to a more sideways trading pattern after backing away from recent record setting highs. The pause in the upward march comes as Biden is seeking to push his COVID plan through Congress. The current legislation seemingly has something for everyone to like and dislike, and passage will almost assuredly require modification to gain approval as even Democrats are not in agreement with the plan.

While some of the stimulus helps those in need, many individuals reported using most of their money to pay down debt or to save (invest), versus spending on nonessential items. In the face of COVID and various restrictions, Americans have been saving more of their disposable income than they did during the financial crisis or during the recession of 2001. Taken together, the data suggest that the anticipated rush by consumers to spend money after the economy fully reopens may never materialize.

Notably, much of the trading volume that has picked up recently has likely resulted from people investing their government checks in the stock market. GameStop, the recently highly volatile company which has gained and lost more than 100% in a single day several times, provides an example. Another round of stimulus is likely to kick off further volatility in markets as investors buy into other positions.

While COVID drives much of the daily trading, longer-term issues

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will likely draw greater scrutiny as the COVID stimulus is absorbed. Economists predict that GDP will increase 4.9% this year measured from fourth quarter of last year, according to the business and academic economists surveyed in February. This marks an upward revision from January's forecast of 4.3%. Despite the slow rollout of COVID-19 vaccines, they cited the vaccinations and the prospect of additional fiscal relief from Washington as reasons for the adjustment.

A strong growth rate for 2021 comes after 2020's decline of 3.5%, meaning that the economy will again pass its previous highs in the second half of this year. While this may not seem terribly impressive, it is a very different picture than was expected throughout much of last year and also puts the US in a much stronger position than Europe.

The same economists were more cautious about the job's recovery. In February, employers were expected to add 4.8 million jobs this year, a downward adjustment from January's 5.0 million projection. More importantly, this is equal to just half of the 9.6 million jobs lost since February 2020. If this plays out as forecast, the mean unemployment rate would be 5.3% by year's end which compares to a 6.3% jobless rate in January. The real unemployment rate, a broader measure that includes discouraged workers and those only working part time due to a lack of other options, remains in the double-digit percentage range. These rates are fairly good, but remain significantly higher than existed pre-COVID when rates clocked in routinely below 4%.

Despite a relatively poor job market in January, which created only 49,000 jobs after shedding 227,000 in December, U.S. consumer confidence increased in February. The perception of a better job market amid declining new COVID-19 infections and expectations for additional money from the government to help the economy drove expectations. Consumers also anticipated higher inflation which fits in with economists' predictions that demand will swing back to services from goods by summer as more Americans are vaccinated and price

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pressures increase.

Two purchasing managers' surveys on manufacturing released in February pointed to continued growth as increased demand is helping U.S. factories. The Institute for Supply Management's manufacturing index nudged lower in January to 58.7 from 60.5 in December but remained firmly in growth mode as a reading above 50 indicates activity is expanding.

The purchasing managers' index (PMI) for the U.S. services sector rose to 58.9 in February, from 58.3 in January, notching the best increase in nearly six years, according to IHS Markit.

Global trade has rebounded from its COVID collapse, with China and other Asian manufacturing countries claiming more of all exports from masks to bikes, and Asian countries are expected to maintain these gains post-COVID. Global trade fell in 2020, but by just 5.3%, according to new data from the CPB Netherlands Bureau for Economic Policy Analysis, and trade returned to pre-pandemic levels by last November. The recovery took less than half of the time following the global financial crisis. Amazingly, China enjoyed a net increase in exports in 2020.

In Germany, manufacturers are thriving while service providers struggle. The PMI for the manufacturing sector rose to 60.6 in February from 57.1, recording a strong three-year high. The country's services sector declined sharply falling to 45.9 from 46.7 in February and hitting a nine-month low. Across Europe, manufacturing PMI was 54.8 for January, down slightly on December's 55.2, but still one of the highest figures recorded over the past 2½ years, according to IHS Markit. Even the UK's manufacturing PMI was strong coming in at 54.1 in January.

As the world is struggling to return to a post-COVID world, economic figures are going to become increasingly important in equity valuations. During the past year, current earnings have been largely ignored as investors have instead focused on future expected earnings in a post-COVID world. As the world is adjusting, and the future becomes the present, earnings may increase bringing valuations back down, or most likely, they move up a bit leaving valuations somewhat elevated. As investors also pull money out of the market to spend on other items in a post-COVID world, equity markets could also be adversely impacted.

Andy Maynard, head of equities at China Renaissance Securities, noted that "You don't see institutions buying on the dip," when referring to recent runups in Chinese and Hong Kong equities. This could be a temporary pause or a sign of a larger shift, or low interest rates and the fed's commitment to continue as a backstop for equity markets could provide enough of a foundation to keep equity markets trading at elevated levels. High volatility appears very likely as markets adjust to frequent changes in companies' fortunes while individuals change their investing habits as COVID ends.

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