MARKET UPDATE

DEVINDER BENNING

JANUARY 7TH, 2021

A Recap of January 7th, 2021

Markets

Fixed Income

- US government bond prices have dropped (therefore yields up) to the lowest point since the start of the coronavirus crisis as Democrats take control of the Senate after Georgia's run-off elections.
- This gives the party control of both houses of Congress in what has been called a "blue wave".
- It clears the way for a larger fiscal stimulus package, including infrastructure spending, that could fuel economic growth and inflation.
- Control of the Senate would allow president-elect Joe Biden to push a bigger financial stimulus through Congress than the $900 Billion programme already passed in December. Bond prices have fallen (yields up) on the news.
- The US 10-year bond yield fell below 1% for the first time in March when the coronavirus pandemic induced a rush to safety by investors and has largely stayed there since in anticipation of long-running drab growth.
- An increase stimulus package raises inflation expectations. One measure of inflation expectations over the next decade has risen accordingly. The 10-year breakeven rate, which is derived from prices of US inflation-protected securities, breached 2% this week, last reached in 2018.
- As US bond yields rise, so do global bond yields!

Equities

- US equities rallied on the Democrat Senate win news as markets start pricing in better corporate earnings due to the expected boost from further fiscal measures. It has increased the market appetite for risk.
- The markets are looking through the dramatic political events in Washington. The assumption is that democratic processes are holding up and that a transition of power to Joe Biden is going to take place.
- Stok markets have been given this quite impressive 'cocktail' of good news about coronavirus vaccines, the idea that there will be more fiscal stimulus and continued support from central banks.

Foreign Exchange

- The US Dollar, as measured against a basket of currencies, remains at its lowest level since April 2018, having been suppressed by ultra-loose monetary policy since the coronavirus crisis began. The US Dollar also has a 'safe-haven' asset status as investors flock to the currency (the reserve currency of the world) in times of trouble.
- But investors are looking beyond Covid-19 troubles and selling US Dollars.

Gold

- In another sign investors were looking beyond the threat of a peaceful transfer of power in Washington, the price of gold – a commonly used safe haven asset – fell to $1,914 a troy ounce.

Moving Forward

5 things that could go wrong in 2021:

1) Investors are unanimously 'bullish' with a view that coronavirus vaccines will get rolled out and the pandemic will be beaten later in the year so returning to global economic growth. When everyone thinks the same thing, there's often trouble ahead!

2) Loose talk – central bankers saved the day in 2020 pumping trillions of Dollars into the financial system. If they were to pull back on that support that would be hard for the markets to swallow.

3) Inflation has been the market's 'bogeyman' for years. It has been non-existent since the 2008 Financial Crisis. Could inflation finally make a return after the mammoth fiscal and monetary loosening we have seen?

4) Politics and US 'Big Tech' stocks – Such stocks really dragged the markets up from their lows of March last year. The new administration in the US is more likely to impose taxation and regulation. Any damage to 'Big Tech' which comprises such a large part of US equity markets is worth watching.

5) Then the US Dollar which has been weakening for months. Could the Dollar slide accelerate? This naturally causes other currencies to strengthen so making their exports more expensive. This could be a politically and economically explosive situation.

- But for now – the equity 'bulls' are in charge!

DEVINDER BENNING
MSc – FINANCIAL ANALYSIS & FUND MANAGEMENT
dev.benning@yahoo.com