

ECONOMIC & MARKET INSIGHTS

An Executive Summary for January 2021

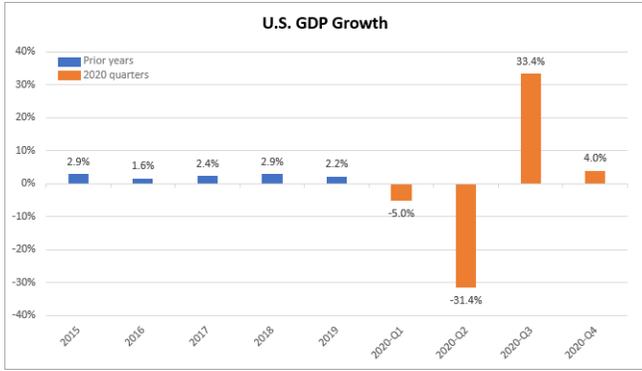
As the page turned on 2020, the new year began with hope of an economic rebound, which initially drove stock markets higher. However, a few January surprises, such as the Democratic candidates unexpectedly winning both senate seats in the Georgia runoff elections, and a surge in volatility as retail investors used online trading platforms to drive sudden price spikes in a few stocks with large short positions, contributed to uneasy market movements for the month. Additionally, the path to eradicate COVID-19 also became more uncertain as new strains were identified and outbreaks reignited in some regions.

Global economic data was mixed. The U.S. economy expanded 4% in the fourth quarter, but contracted 3.5% for the year, the largest annual decline since World War II. The Eurozone shrank by more than expected over the fourth quarter. China's 2020 GDP grew by a remarkable 2.3%. The World Bank reduced its global growth forecast for 2021 to 4.0% to reflect challenges to containing the pandemic and massive levels of sovereign debt accumulation. U.S. business activity is expanding, but the labor market may have stagnated. Non-farm payrolls took an unexpected dip in December before moderating in January. Jobless claims have trended upward, with wage growth and labor market participation well below pre-pandemic levels.

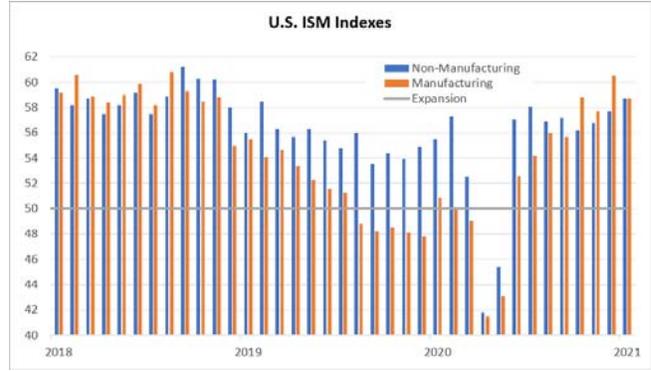
Despite a choppy month, broad stock markets experienced only modest declines. Cyclical assets such as small-caps, emerging markets equities, and commodities outperformed by a wide margin. Returns were mainly driven by country and stock factors. Stocks that were caught up in the short squeeze, such as GameStop, partially drove the rally in small cap companies. China, the largest emerging markets country, returned over 7%, while many of its peers struggled. Growing manufacturing and trade activity drove up energy and industrial metal prices. The energy sector was the best performer, after Saudi Arabia made a surprise production cut and U.S. oil inventory dropped.

Rising interest rates and narrow credit spreads weighed on taxable fixed income during the month. High yield bonds and senior bank loans with relatively attractive yields and muted interest rate sensitivity outperformed other taxable bonds. The 10-year U.S. Treasury yield breached 1.0% for the first time since the onset of the coronavirus pandemic. The U.S. Treasury yield curve hit the steepest level since 2016 as rising inflation expectations and growth prospects drove long-term yields higher. Despite elevated equity volatility, high-grade credit spreads barely moved and lower-rated spreads even declined. Although default rates have risen to over 6%, this is much lower than had been feared. The prospects for an improving economy, ample liquidity, and steady short-term rates should continue to propel demand for higher yielding debt.

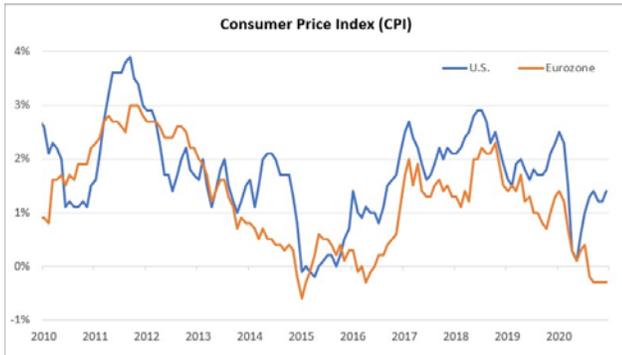
Municipal bonds eked out a positive return for the month. Healthy investor demand and limited supply balanced the impact of rising interest rates and high valuations. Like their taxable counterparts, high yield municipal bonds outperformed and are experiencing muted default rates. Although municipal bonds are expensive, with yield spreads over Treasuries far below historical averages, fears of higher tax rates and better than expected fundamentals should be a tailwind. Tax revenues for 2020 were much stronger than anticipated, with gains in personal income, property, and investment taxes offset by modestly lower sales tax revenues. President Biden's economic relief plan should also support states and municipalities.



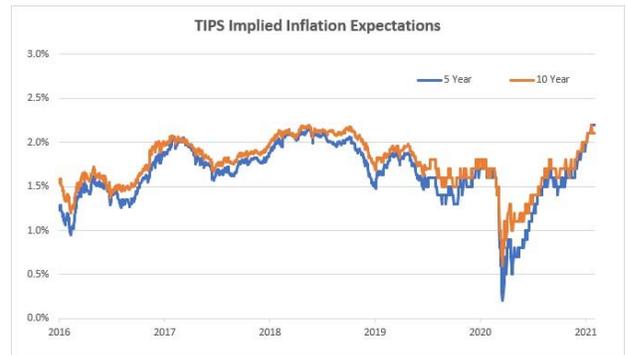
U.S. Department of Commerce



Institute for Supply Management



U.S. Bureau of Labor Statistics



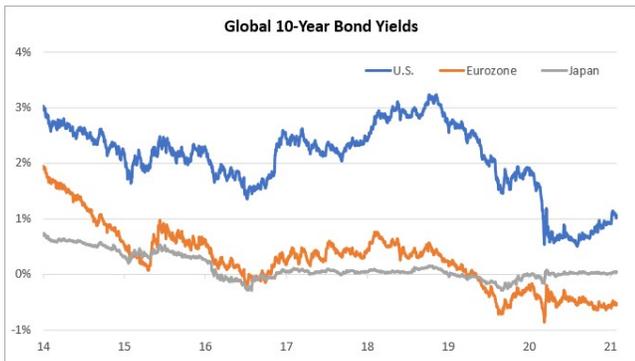
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