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Weekly Commentary

Issue **No. 46** | **NOVEMVER 9, 2020**

Macro View

By Hubert Marleau

A Two-Lane Road with No Left or Right Turns

Submitted November 7, 2020

What Happened In the Week Ended November 6, 2020:

A massive comeback took place in the stock market last week along with significant declines in government bond yields. The slapped down yield curve lowered the exchange value of the U.S. dollar, pulling gold and copper prices higher. Thus, the reflation trade is not dead.

The prospects of stability and bipartisanship in the Oval Office and protective guardrails in the Senate, cheered investors forcing traders and speculators to flatten their large short positions they had overwhelmingly accumulated during the previous week. Although the U.S. stocks' four-day winning streak paused on Friday, the S&P 500 registered a weekly gain of 7.3%—posting its best performance for any presidential election week since the 1932 election.

The performance of the market confirmed that investors were happy with the trajectory of the vote count showing that Joe Biden was inching toward the presidency with the republican party likely to hold the Senate. The two Senate runoffs in Georgia on January 5 are not expected to flip the Senate to the Democrats.

A Democratic White House paired with a split Congress will likely 1) Slow down the political process on several hot issues like antitrust legislation, progressive redistribution of income, health care, green transport and re-regulations of businesses, 2) Protect Trump's pro-business policies, 3) Prevent aggressive corporate tax changes, 4) Bloc higher capital gain taxes, and 5) Favour a rapprochement with allies on climate change (Paris Accord), health care (WHO) and global trade (WTO).

Meanwhile economic prints continued to top expectations as the money supply keeps on increasing with no apparent financial stress on the banking system. Accordingly, the Atlanta Fed's High Frequency Model currently predicts that GDP growth will increase at the annual rate of 3.5% in Q/4.

Macro View cont.

By Hubert Marleau

I admit that a $2.0 trillion "Blue Wave" fiscal stimulus would have guaranteed a very fast rate of GDP growth for 2021. However, it remains that a watered down $750 billion relief program is sufficient to bridge the gap between the present level of economic activity and what it ought to be and the time it will take to immunize the population from the coronavirus. As a matter of fact, there is enough monetary power in the banking system and sufficient pent up demand in the household sector to potentially absorb the unused physical capacity of the economy. The thing is that the economy is not falling apart. On the contrary, it's bouncing back. GDP growth of 5.0% in 2021 is feasible.

In this respect, top-down estimates produced by analysts show that 2021 S&P 500 per share earnings of $1.75 are obtainable. Given that 10-year bond yields are around 0.75%, it implies an equity-risk premium of +4.00%. It's an excess rate of return over safe Treasury bonds that is sufficient to drive stocks prices higher in 2021. A seasoned investor looks forward and therefore is much more concerned with the direction of the economy than its state.

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