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THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – OCTOBER 2020

U.S. Markets and Economy

The stock market gave up its early-month gains as worries about a hotly contested election, with the potential for civil unrest, consumed Wall Street. Stocks were also held back by the appearance of the much-feared second wave of the pandemic, both here and abroad. By the end of October, infections had soared to new records in the U.S., while stocks slumped to end the month, down by 6% on the Dow Jones Industrials Average and down 3.5% on the S&P 500 index. The Nasdaq declined almost 3%, led lower by the tech giants, even though earnings at Apple and Amazon were strong.

While the stock market was fixated on the election and the coronavirus pandemic, the economy continued to recover from its dramatic decline in the second quarter. Employment growth continued at a solid pace for the month (in data released at the beginning of November), driving unemployment down to 6.9%. Although this is still far above the pre-pandemic low of 3.4%, approximately half of all jobs lost earlier in the year have now been regained.

The Federal Reserve has also done its part to restart the economy, pushing short-term interest rates to zero and purchasing more than $3 trillion in Treasury, state, and local bonds as well as many other assets. One of the results of the Fed's aggressive actions is that the yield on the U.S. 10-year Treasury bond remains below 0.9%, and mortgage rates in the U.S. continue to fall. These low rates help stimulate borrowing and spending and have been particularly helpful for the housing sector, which has recovered strongly; the latest September data shows sharply rising permits, starts, and completions. In fact, new housing starts were well *above* those for September 2019, before the pandemic. While the Fed has promised repeatedly to keep rates low until the economy has fully recovered, their ability to offset any new economic weakness is limited by the zero lower bound (ZLB) problem: the Fed has stated that it will not push interest rates below zero, although Treasury yields, from three-month bills to three-year notes, are barely above zero now.

World Markets and Economy

European stocks fell in October, pulled down by declines in the U.S. and worsening conditions in Britain, where stocks fell almost 6% for the month. The British are hurtling toward a no-deal Brexit, while a recent surge in coronavirus infections has led to new shutdowns of the economy. British growth may indeed turn negative for the fourth quarter. The Bank of England may try to prop up the economy by setting short-term rates below zero, breaking their ZLB for the first time, and has already asked member banks to report on their readiness for negative interest rates. The rest of Europe has coped with negative rates set by the European Central Bank (ECB) for many months now. The blue-chip Eurofirst 300 index fell more than 5% for the month as a burst of second-wave infections and shutdowns spread throughout Europe, with France close to a total lockdown.

Japanese stocks fell only 1% in October. There, the coronavirus remains well under control, but weak export markets in Europe and the U.S. will constrain growth. At the same time, prices are again falling in Japan. A return to deflation is an unwelcome development, especially with the Bank of Japan unable to push interest rates even further into negative territory.

Chinese stocks gained in October, and China's economy continues to power ahead while the coronavirus remains almost nonexistent. The looming storm cloud for the Chinese remains the U.S.-China trade relationship. As the U.S.-China cold war continues, a future administration may even rejoin the new version of the Trans-Pacific Partnership (TPP), a trade agreement that freezes out China and reduces barriers to trade between the U.S. and other Asian countries.

Outlook

The global economic recovery is threatened by a new set of lockdowns in response to the second wave of the pandemic. If many in-person businesses are again forced to close, or even if consumers stay home for safety, economic growth could again come to a halt. While fiscal policy could again come to the rescue, a lame-duck government may be unable to agree on a new federal spending package before the end of the year, when remaining fiscal stimulus is scheduled to expire.

The real shot in the arm for the U.S. and world economy would be a safe and effective vaccine. While progress continues, with more than 100 candidates in trials from Phase I to Phase III (the final phase before approval), the world may have to wait several more months before a "success" is announced and the processes of data review by the government, large-scale manufacturing, and wide distribution can begin. Even assuming most Americans line up for their shots, it will probably be mid-2021 or later before the coronavirus can be brought under control.

U.S. stocks may continue to be volatile for the rest of the year as election recounts and court challenges add to political and economic uncertainty and the coronavirus continues to spread. Long-term investors will have to "tough out" these times, much as they did in 2000 when the Bush-Gore election was undecided until the Supreme Court stopped the recount in Florida more than a month after the election. At the time, the Dow Jones was at 10,800. In spite of subsequent recessions, terrorism, bubbles bursting, and a pandemic, the Dow Jones is now at 28,000.

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