# THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – DECEMBER 2020

**U.S. Markets and Economy**

U.S. stocks had a strong December to cap a strong year. The Dow Jones Industrial Average and S&P 500 index reached new all-time highs, while the Nasdaq Composite rose to a new all-time high (just below 13,000). Vaccine progress and the Fed's easy money continued to be the main forces behind the rally.

Both Moderna's and Pfizer's vaccines began distribution in December. More vaccines are on the way, too. The two in distribution have very high efficacy rates and few reported side effects. Although these vaccines cannot stop the latest U.S. surge in COVID-19 infections, hospitalizations, and deaths, mass inoculations in 2021 should break the back of the pandemic in the U.S., and economic growth, which has been stuttering, should pick up speed.

The Fed also restated in December its determination to keep the "pedal to the metal" for the foreseeable future. Short-term interest rates should remain around zero for many months, and with long-term rates also low (the U.S. 10-year Treasury yield is still below 1%), the economy gets a steady boost. The housing sector has been a prime beneficiary: new housing starts are up and existing home prices are rising as mortgage money is available for less than 3% for a 30-year fixed-rate loan. Low mortgage rates have also spurred a wave of refinancings, which continued in December. Lower mortgage payments mean more disposable income to be spent on consumption. Low rates also spur home remodeling, and all this increased housing activity means better demand for building supplies and construction workers.

There was also good news in December on fiscal policy, as the White House, after threatening a veto, signed off on the compromise $900 billion spending bill, which will provide many struggling households with some extra cash to help ride out the latest wave of closings and lockdowns. Wall Street was also encouraged by the centrist tilt of Biden's cabinet, which suggests there will not be dramatic swings in policy after January 20.

**World Markets and Economy**

The pandemic was truly worldwide, sparing no nation or continent. At the end of 2020, as a powerful new wave of the virus spread around the world, even Antarctica reported its first infections. One exception was China, where the virus was stopped by massive lockdowns in 2020. The Chinese economic recovery did not help Chinese stocks much in December, though, as U.S.-Chinese economic and political tensions rose steadily. These tensions may not be reduced by the Biden administration, which may have concluded that a cold war with China, centering on technology and human rights, is inevitable. Chinese stocks, as measured by the Shenzhen Composite, ended December at exactly the same level as mid-July.

Taiwan was another pandemic exception: the island nation of 24 million has recorded a *total* of 776 cases and seven deaths. Near-universal masking, distancing, testing, and contact-tracing were the keys. As a result, Taiwan's economy may have the fastest growth rate in the world for 2020; not surprisingly, Taiwan's stock market rallied to an all-time high in December.

Japan's economy should recover from a two-year recession in 2021 as its exports bounce back in tandem with the world's rebound from the virus. With this positive economic outlook, and with fiscal and monetary policy both extremely expansionary, the Nikkei stock average rose in December to its highest level in 30 years.

Europe was another story. The virus repeatedly devastated much of the continent, with most governments adopting more and more draconian policies to stem the late-year new wave of infections. The British may have suffered the most, with a new mutation apparently leading to an even more potent transmission of the virus. Under a new "fourth tier" lockdown policy, in effect for much of the country in December, all nonessential businesses must close, and people cannot meet with others indoors unless they live with them or are part of their support bubble. These policies are forecasted to cause a double-dip recession in Britain that may only be ended by wide distribution of vaccines. British stocks, however, made a small gain in December, boosted by a last-minute breakthrough in Brexit negotiations.

The picture is similar in the rest of Europe. Even the Swedes, who appeared to have a superior model for dealing with the virus, have seen an explosive growth in cases in December. The French are enduring a national lockdown that began in November. A continued surge in cases in Germany led the government to impose a full lockdown in December. The European economy's recovery will thus be delayed, in spite of extremely easy money and expansionary fiscal policy. European stocks, as measured by the STOXX Europe 600 index, gained barely 2% for the month. As in the U.S., Europeans await the widespread distribution of vaccines in 2021 (which will be key to the resumption of economic growth).

**Outlook**

The first months of 2021 will be grim ones in the battle against the coronavirus. Americans traveling and gathering for the Christmas season could drive a new and even greater wave of infections, hospitalizations, and deaths before vaccines can be widely distributed. Many hospitals are reaching, or passing, limits on beds and facilities, which will mean even less availability for severe non-COVID illnesses. The necessity for further lockdowns, combined with the absence of new fiscal initiatives, could push the U.S. economy back into recession in the first quarter. But the second and subsequent quarters should be much stronger as the mass of vaccines begins to spread immunity widely enough to break the back of virus transmission. It appears, as of December 2020, that the virus, clever as it is, cannot mutate fast enough to defeat the vaccines in the short run. The economy should then recover, fueled by pent-up demand and ultra-low interest rates. Wall Street is also looking to 2021 for a recovery in corporate earnings. Although the economy may not fully recover until the second half of 2021, earnings should begin recovering from the collapse in 2020 earlier in the year. Much of the rest of the world will also begin recovering as the virus is finally vanquished by vaccines in Europe and Asia.

*Past performance may not be indicative of future results. Different types of investments involve varying degrees of risk. Therefore, it should not be assumed that future performance of any specific investment or investment strategy, including the investments and/or investment strategies recommended and/or undertaken by Reilly Financial Advisors (RFA), or any non-investment related services will be profitable, equal any historical performance level(s), be suitable for your portfolio or individual situation, or prove successful.*