Economic Update

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This weekly update provides a snapshot of changes in the economy and markets and their implications for investors.

Growth

3Q20 real GDP was revised slightly higher to 33.4% q/q seasonally adjusted annual rate. Despite a solid bounce back, economic output is still about 3.5% below its 4Q19 level. Strong October readings suggest considerable momentum entering 4Q20, possibly resulting in better than 5% real GDP growth. However, the surging pandemic could mean slower growth at the end of the quarter and into 1Q21. Retail sales fell -1.1% m/m in December, with broad declines in most categories. Industrial production rose 1.6% m/m, although it was driven by a rebound in utilities due to heating demand.

Jobs

Nonfarm payrolls decreased by 140,000 in December, the first decline since April 2020. Job losses were concentrated in leisure and hospitality, although manufacturing and construction partially offset this, reflecting the stronger recovery in goods over services. The unemployment rate remained at 6.7%. Wages grew 0.8% m/m for all workers and for production and non-supervisory workers, up 5.1% and 5.2% y/y, respectively, partly a compositional effect reflecting the loss of lower-wage jobs. Although the labor market is likely to struggle this winter due to the pandemic, the broader distribution of vaccines should lead to a sharp rebound in employment in late 2021.

Profits

The 4Q20 earnings season kicked off with 22 companies having reported (4.6% of market cap). Our current estimate for 4Q20 earnings is $37.31 with EPS declining 4.8% y/y. Thus far, 95% of companies have beaten on EPS estimates, and 73% have beaten on revenue estimates. Further economic recovery, positive vaccine developments and a weaker dollar (-6% y/y) should help 4Q earnings, but lower oil prices (-30% y/y) will be a headwind. Earnings should continue to grow in technology, health care, consumer staples and utilities, while financials, energy and consumer discretionary are expected to contract.

Inflation

Headline CPI rose 0.4% m/m and core CPI rose 0.1% m/m in December, rising 1.3% and 1.6% y/y, respectively. More than 60% of the overall increase was driven by an 8.4% increase in gasoline. November headline and core PCE were both essentially flat, rising 1.1% and 1.4% y/y, respectively. Lower energy prices and slack in the economy continue to keep inflation pressures muted.

Rates

The FOMC maintained the federal funds target rate in a range of 0.00%-0.25%. The committee will also maintain its current pace of asset purchases of at least $80bn in Treasuries and $40bn in agency mortgage-backed securities per month until the committee feels “substantial further progress” has been made toward its inflation and employment goals. In its quarterly economic projections, its forecasts for growth, inflation and employment were all revised higher. While the “dot plot” of future rate projections implies no rate changes through 2023, a solid economic recovery in 2H21 and 2022 could result in tapering asset purchases well before rates are adjusted.

Risks

- The U.S. recession and recovery could be at a slower pace than markets are anticipating.
- Political headlines could foment market volatility.
- Inflation could spike in the medium term.

Investment Themes

- Quality with a dash of cyclicality should be a focus for U.S. equity investors.
- Fixed income investors should move up in quality, and look to core bonds for portfolio ballast.
- Long-term growth prospects and cheap absolute and relative valuations support international equities.

■ Denotes updated information

Data are as of January 18, 2021

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