MARINE BANK
Wealth Management & Trust

OUTLOOKS

February 2021

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ECONOMIC OUTLOOK

Summary

As we close the chapter on the first month of 2021, the economic data to start the year has been fairly mixed. We began the year with an overall loss of jobs (nonfarm payrolls, -140k) for the first time in eight months and followed that with a substantial uptick in weekly initial jobless claims. In fact, it was the first time since August that we witnessed back-to-back weeks of jobless claims exceeding 900k. Additionally, retail sales were less than estimates (-0.7%), while also being revised lower for the month prior. On the other hand, we saw housing continue to surge (both existing and new home sales), personal income (0.6%) and personal spending (-0.2%) come in better than expected and PMI data remains elevated. The juxtaposition in the data highlights some of the perplexities of the economy during a global pandemic.

Determining the path of the economy remains as difficult as ever with exogenous factors leading the way. Unfortunately, many of the questions that applied in prior months still remain today. How fast can we get the country vaccinated? When will society return to some degree of normalcy? What will the next round of fiscal stimulus look like?

While we don't claim to know the answers to these questions, we do know that 2021 has the **potential** for significant GDP growth. We have a new administration in Washington and a Democratic-majority Congress. There have been talks of massive fiscal stimulus—not just limited to the $1,400 checks being sent to individuals but also including other programs such as large-scale infrastructure improvement. Using budget reconciliation, the Democrats will be able to pass further stimulus with only a simple majority, meaning a party-line vote could pass a bill even with no Republican support.

The historic amount of stimulus already provided during the course of this pandemic has increased aggregate household income during a recession, something that rarely happens. The savings rate remains historically elevated as people wait for a clearer vision of their future and it will almost certainly spike higher as further government transfer payments take place. If we see some social normalization by mid-year, as many suspect, much of that elevated savings will likely be converted into spending, providing a clear path for above-trend GDP growth in 2021.

Positives

ISM Services and Manufacturing PMI's remain elevated (both at 58.7)

Pending home sales year-over-year are up 22.8%

As of early February, initial jobless claims have decreased for three consecutive weeks

Negatives

Initial 4Q20 GDP was 4.0%, indicating 2020 GDP contracted by 2.5%

Consumer confidence remains near its lows of 2020 (89.3)

Retail sales ex-auto month-over-month declined by -1.4% (vs. -0.2% expected)

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EQUITY OUTLOOK

Summary

The equity rally paused in January following the outsized performance of broad markets in the fourth quarter of 2020. The S&P 500 declined 1% in the opening month of 2021. At first glance, the market action seemed void of any meaningful catalyst and looked primarily to be a consolidation given the magnitude of gains in recent weeks.

Equity markets broadly declined by similar degree regardless of style, size or region. The Russell 1000 Growth and Russell 1000 Value indexes lost 0.7% and 0.9% respectively. The Russell Midcap Index fell 0.3% and the developed international MSCI EAFE Index matched the S&P 500's 1.0% decline. The only two major equity asset classes that stood out as outperformers were the small-cap Russell 2000 which climbed 5.0% and the MSCI Emerging Market Index which rose 3.0%, both indexes continuing significant momentum from the final quarter of 2020.

In recent days, there has been much debate regarding whether the late January decline in markets is simply a healthy consolidation of recent gains or the result of an overvalued bubble. We are inclined to believe the former. Equity markets are being fueled by accommodative monetary policy, the potential for additional stimulus and low interest rates from fixed income alternatives. In addition, as we sit well over half way through fourth quarter earnings season, the results have largely been impressive and better than analysts have expected. Stock valuations may look somewhat historically overstretched but it appears to be justified based on the current backdrop of favorable conditions.

Concerns such as sluggish unemployment and mutated strains of COVID-19 will naturally cause volatility as we move through 2021. Given the many tailwinds, though, we view any dislocation in the market as a buying opportunity for long-term investors.

Positives

- Accommodative Federal Reserve and global central bank policy
- The daily number of individuals getting vaccinated is starting to outpace the number of new cases
- Lack of return competition from other major asset classes

Negatives

- Stock valuations, by some traditional measures, look relatively stretched
- British and South African strains of COVID-19 could cause a setback

Unknowns

- Can the Biden administration create any semblance of unity in Washington

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FIXED INCOME OUTLOOK

Summary

After a politically tumultuous first week of January, longer maturity interest rates moved higher on the belief that the "blue wave" will usher in grandiose spending plans that will increase the deficit and require additional financing from the bond market. Along with the renewed economic optimism from the additional stimulus plan, many forecasters revealed their expectation that this is finally the year that inflation is going to move sharply higher along with interest rates. It seems to be a typical theme every January for which we believe there is little merit.

The 10-year Treasury note pierced the 1% level for the first time since March and ended January higher by 15 basis points (bps) to 1.07%. The 30-year bond increased 18 bps to 1.65%. The yield curve steepened for the month as the 2-year note actually declined 1 bps to 0.11%. Even though returns from the Treasury market were surprisingly strong for the entire year of 2020, they were negative for the final six-month period. That trend continued in January as they had a return of -0.96%. Intermediate-maturity Treasury notes (1 year to 10 year) had a return of -0.24% for January.

It is not surprising to us that longer yields have increased given the higher prospects of a larger economic stimulus package. We have believed that slightly above 1% was a likely target in the near term. But we will also reiterate that with short rates firmly anchored by the Fed's zero-bound overnight rate policy, a move dramatically higher in yields is unlikely. Calls for 2% to 3% yields on the 10-year Treasury note are unwarranted.

Coming into the New Year, credit spreads have tightened for eight of the past nine months (with September being the exception where they increased by 7 bps). During January, they changed very little on average and ended the month 1 bps wider at 96 bps for the average investment-grade credit across the full spectrum of the yield curve. Because the universe of investment-grade corporate bonds has a longer average maturity (and duration) than that of the Treasury market, their January returns were worse at -1.28% and -0.38% for the intermediate maturity subset. With a generally improving economy and a reduction on new issuance, we expect credit spreads to remain near current levels or even tighten more. Although the path may be uneven, we still favor corporate credit to deliver higher returns over Treasury bonds for the year.

.Positives

- Over $17 trillion in negative-yielding debt around the world
- Given the strength of the stock market, large funds are rebalancing into bonds

Negatives

- Large stimulus package will require incremental Treasury-market borrowing
- Economic rebound should lead to higher inflation, albeit temporary

Unknowns

- Timing of vaccine rollout and full reopening of the economy
- Foreign demand for U.S. debt

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