Avantia

Monthly Newsletter

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Market Outlook

The nation has been transfixed by the deep freeze across most of the country, the power and water woes in Texas, and the prospects for more storms ahead. Quietly and seemingly in the background, the stock market is showing signs of calming. Yes, stocks still appear to be at stretched valuations and the 10-year Treasury yield made another lurch higher Friday (to the 1.35% area), but daily volatility on the S&P 500 in 2021-to-date is much calmer than in was across most of 2020.[1] The equity market has been hampered by a range of mixed, but largely uninspiring economic and corporate earnings reports. A busy economic agenda showed initial jobless claims surprisingly accelerated, housing starts fell much more than expected, and import prices were hotter than forecasted, while building permits unexpectedly jumped and regional manufacturing activity growth topped estimates.[2]

Equity Market

The week brought the last major wave of fourth-quarter earnings reports, with 82 of the S&P 500 companies scheduled to report results. Analysts now expect overall earnings for the S&P 500 to have grown slightly on a year-over-year basis, marking an exceptionally quick earnings recovery compared with past recessions—following the global financial crisis in 2008–2009, it took the S&P 500 five years to recover its earnings-per-share peak. Roughly four of five companies in the index have topped earnings estimates to date, well above typical quarters.[3]

Non-US Equity

International equities have performed well so far in 2021, despite the virus-driven economic slowdown. This may be because economic data continues to surprise on the upside and earnings estimates for the MSCI World Index have continued to climb—positive surprises that may last, as COVID-19 vaccinations are now exceeding cases.[2] Last week's eurozone GDP figures slipped back below zero in the fourth quarter to -0.7%, after growing at 12.4% in the third quarter. However, the lockdown-induced slowdown has been less economically damaging than expected during the ramp-up of the vaccine rollout, with most economic data exceeding economists' expectations. In China, output is back at pre-COVID-19 levels and the priority now is economic and social stability. We expect China to exert a stabilizing influence on global growth. [4]

Fixed Income

The bond market is signaling concern about inflation. After nearly a year of bouncing along in a 0.5%-1% range, 10-year Treasury yields have moved up swiftly in recent weeks. Rates climbed to the highest levels in almost a year as the 10-year reached 1.33%.[6]
Municipal bonds outperformed this week in the face of a steeping yield curve, aided by hopes for federal support to shore up state and local finances and solid demand as investors reinvested January coupon payments. Benchmark yields rose 2-15bps on the week, the most meaningful move since April, moving ratios higher.[6]

Inflation and the Federal Reserve

Federal Reserve Chairman Jerome Powell reiterated that inflation was not an immediate concern and that interest rates would be kept lower for longer despite the recent spike in rates.[2] The Fed's policy response to rising inflation will be the key variable for asset prices once COVID-19 has receded. We expect the Fed to stay the course, keeping accommodation at full throttle all year even if growth is robust and inflation is rising. The central bank is more worried about tightening too soon than too late—willing to risk and even encourage an inflation overshoot to support stronger growth.[4]

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