Economic Outlook

Fourth Quarter 2020

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The World Gets a Shot in the Arm

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SEI recently released its fourth-quarter Economic Outlook. A summary of the conclusions is provided below:

- COVID-19 remains a significant public health concern and continues to hamper the global economy. The successful production and delivery of vaccines will be the two most important factors that determine the pace of economic recovery in 2021.

- Economic activity in the US has continued to improve from April's low and is now 2.5% off its year-ago level[1] (implying that the economy is still operating almost 5% below capacity).

- The economic rebound was driven by three factors. First, a large portion of the US population has been able to continue working and shopping virtually. Second, manufacturing and construction experienced strong recoveries. Third, income-support programs and the emergency lending facilities were successful in preventing a downward self-reinforcing spiral in consumption and employment.

- There is fear that US business activity could be throttled by additional lockdown orders during the first quarter. However, investors are looking beyond the valley. The promise of vaccines being widely available in the US and other developed countries has encouraged a risk-on, pro-cyclical posture in financial markets.

- While we have seen some evidence of a "Great Rotation" from growth to value and cyclical investing, we believe it is too early to tell if this is the beginning of a major secular shift in equity investment themes.

- In a year when most countries have been under severe economic and financial stress, the UK has endured more pain than most. The pandemic dominated the economic backdrop, but the prospect of Brexit made matters worse. The last-minute Brexit deal provided a Christmas gift of sorts, at least in terms of removing a degree of uncertainty in the UK as the deal addressed the transfer of goods although not commerce in services.

- Barriers to trade introduce economic inefficiencies. Post-Brexit, prices will likely end up being a bit higher, GDP a bit lower and supply chains a bit more unreliable.

- The pandemic has had one good outcome for Europe. It forced Germany and other fiscal "hawks" to allow an expansion in fiscal policy. This move away from budgetary austerity should be viewed in context. Most countries have experienced a sharp rise in red ink this year, and the biggest deficits are outside the eurozone. The memory of the European periphery debt crisis is still fresh in the minds of many policymakers; they realize that pushing for fiscal austerity measures prematurely would probably be a mistake.

- On the other hand, we think that there is greater need for other countries outside the eurozone to regain control of their finances. If those countries fail to do so, Europe could be the beneficiary of investment flows that would further prop up the euro and equity valuations.

- If the world economy enjoys a durable cyclical recovery in 2021, the dollar should continue to fall. This would also bolster the rally in commodity prices. Commodities of all sorts have been rallying sharply since the spring.

- A weak US dollar is an important catalyst for emerging-markets performance. We expect that the coming year will see the relative performance of emerging equities improve, partly because the dollar should continue to weaken.

A full-length paper is available if you wish to learn more about these timely topics.

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[1] Source: US Bureau of Economic Analysis

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