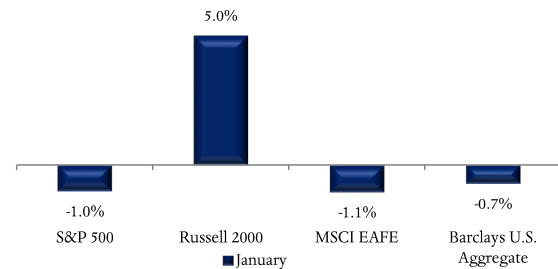




## MARKETS

After a strong and active start to the year, which pushed US stock indexes to record highs, equities succumbed to profit-taking towards month-end. Initially, the global roll out of vaccinations, and the promise of further fiscal and monetary stimulus, outweighed short-term concerns about virus-driven restrictions and potential vaccine shortages. Prospects for a speedier economic recovery increased after the Democratic sweep of Georgia's Senate run-off elections, thanks to expectations of increased stimulus. Then, in a rarely seen technical equity market phenomenon, a cohort of small, heavily shorted, stocks rallied strongly driven by coordinated buying from a mass of retail investors, largely through leveraged purchases employing call options. This led to broad-based short squeezes (where short-sellers were forced to rapidly buy back borrowed shares), and a knock-on reduction in equity risk-appetite. Overall in January, US large capitalization equity indexes declined fractionally (S&P 500 -1.0%), while small-cap stocks exhibited solid outperformance (Russell 2000 +5.0%). Overseas investors also treaded cautiously, as seen by the MSCI EAFE index which retraced -1.1%. The Euro Stoxx 600 index declined -0.7%, with performance more closely linked to the trajectory of the pandemic, due to the higher cyclicity in underlying businesses. Also denting sentiment was political turbulence in Italy that led to the resignation of Prime Minister Conte. Asian stocks bucked the trend, rising modestly in Shanghai (+0.3%) and Tokyo (+0.8%). Emerging market equities performed solidly, ending January up +3.0%, aided by strong Asian regional economic growth.

Increased expectations of government spending put upward pressure on long-dated US Treasury yields during the first half of January, but as risk-assets sold off, bonds regained some of their losses. The 10-year US Treasury note ended the month with a yield of 1.06%,



up from 0.92% at year-end. In this context, the Bloomberg Barclays US Aggregate index declined -0.7%. However, high-yielding junk bonds rose +0.4%.

Commodity prices continued to surge in January, on hopes of a return to economic normality in 2021, led by energy +10% (as Saudi Arabia unexpectedly announced a unilateral cut in output), while non-energy rose +4%. WTI crude oil increased +7.6%, and gold fell -2.7%. Commodity equities managed a small +0.4% gain.

## GEOPOLITICS

January was a unique month in US politics. The first week of the year was dominated by the contentious Georgia Senate runoff elections, which resulted in Democratic control and, in turn, the majority in Congress as a whole. Soon after, Congress ratified President-elect Biden's electoral college victory, an effort that a pro-Trump mob sought to thwart by storming the US Capitol building. Upon entering office, President Biden proposed a pandemic relief package with \$1.9 trillion, which was subsequently ratified. He also signed over forty executive actions, involving health care, the environment, social and racial justice, the economy, Covid-19, census, and immigration. President Biden also moved to build out his administration with a focus on experience as well as diversity, details of which can be found at: <https://n.pr/3tnSfXy>

On the coronavirus front, global daily new cases exhibited a downward trend, though still remained at elevated absolute levels. New and more infectious virus strains

first discovered in the UK, South Africa and Brazil have exacerbated the challenge for policymakers. Vaccine production and distribution initially fell behind schedule, but are now gaining traction. The UK has provided the first dose to 14.4% of its population; in the US this figure is 8.2%, with the EU trailing at 2.3%. There was also positive news from the Novavax and Johnson & Johnson vaccine trials, particularly in relation to preventing severe cases and hospitalizations.

### UNITED STATES

Recent data shows a mixed picture of the US economy. January's purchasing managers' indices continued to point to expanding economic activity, with both the manufacturing and services index reading a strong 58.7. Housing remains another area of strength, with construction starts rising in December at the fastest pace since 2006. As a result, property values increased +9.1% year-over-year, the largest rise since 2014.

The pandemic continues to pressure employment. December was the first month since April that the US economy shed workers and last month there were a mere 49,000 new jobs added. The unemployment rate dropped to 6.3% from 6.7% reflecting the Labor Department's annual update to population estimates. There are still 9.9 million fewer employed than last February. While consumer confidence has stabilized it is unsurprisingly still significantly below year-ago levels, but poised to rise as the country reopens.

The Democrat-controlled congress will usher higher than previously forecast US economic growth in the coming year, thanks to the Biden administration's \$1.9 trillion "American Rescue Plan" which augments the bi-partisan \$900 billion stimulus that was agreed to late last year. The likely macroeconomic impact is astounding, amounting to 10% of US GDP, including a potent effect on consumption thanks to direct transfers to consumers (\$1,400 checks will be mailed to eligible citizens). The Democratic majority in the Senate also increases President Biden's opportunity to implement climate change policy, linked with broader fiscal

### January 2021 Economic Statistics

	Jan-21	Dec-19	Dec-18
Federal Funds Target Rate	0 - 0.25%	1.50-1.75%	2.25-2.50%
Consumer Confidence Index	89.3	126.5	128.1
Manufacturing PMI Index	58.7%	47.2%	54.1%
Unemployment Rate	6.3%	3.5%	3.9%
JPY / USD	104.68	108.61	109.56
USD / EUR	1.2136	1.1210	1.1469
Gold / oz.	\$1,846.09	\$1,517.01	\$1,282.73
Oil (WTI) / bbl	\$52.20	\$61.06	\$45.41

measures to support growth, technological innovations and fast-track the transition to renewable energy.

### EUROPE

Sentiment and growth in the eurozone took a turn for the worse in January, on the back of fresh pandemic related lockdowns and social distancing measures, compounded by a slow vaccine rollout. The European Commission's consumer confidence survey fell by 1.7 points compared to December. Data showed the German economy grew by a lackluster 0.1% during the fourth quarter of 2020, while French GDP shrank 1.3%. The eurozone composite PMI for the region declined to 47.8 and continues to signal contraction. As a consequence, a double-dip recession has become more likely, extending the timeframe for economic recovery.

An escalation of the political crisis in Italy ended with the resignation of Prime Minister Conte. Mario Draghi, former head of the European Central Bank has been tapped to form a new unity government.

In the UK, after a resilient fourth quarter, growth dynamics deteriorated in January as the tight lockdown took its toll on economic sentiment. The composite PMI fell sharply from 50.4 to 41.2 last month.

### ASIA

Supported by a recovery in demand in both domestic and external markets, Chinese Real GDP rose by an impressive 6.5% year-over-year in the fourth quarter. China will likely be the only large economy to achieve positive GDP growth in 2020, impressive on an absolute basis, and especially since it was achieved without

additional stimulus. With domestic activity recovering, the hard-hit service sector was able to catch-up with the industrial sector which bounced back first. The most recent Caixin China Services PMI reading of 56.3, has now surpassed the 53.0 reading of the manufacturing index, suggesting that the major growth driver has shifted to demand from consumers and private enterprises. Trade normalization and strong demand for health care equipment and work-from-home technology has also supported local growth. Notably, Chinese manufacturers have been able to gain market share as international competitors have been hampered by lockdowns and supply chain disruptions. As a result, Chinese industrial production increased by 7.3%, and exports rose 18.1%, year-over-year, leading to a record monthly trade surplus. The obvious risk on the horizon is if China's recent trade success leads to scrutiny from the new Biden administration.

## OUTLOOK

January's events reinforce that governments and central banks are fully committed to support global economies with massive fiscal stimulus and very easy financing conditions. These include two back-to-back stimulus plans in the US, ongoing ultra-low interest rates, and supportive comments from the G4 central banks. In all, investors have good reason to remain optimistic. Further, with regard to the pandemic, our analysis leads us to believe that vaccinations should provide long-lasting protection against Covid-19, including the recently discovered mutations, though boosters may eventually be needed to tackling the latter.

We remain optimistic with regard to equities. An environment of moderately higher government bond yields and improving near-term growth prospects should provide support for US stocks, especially those of quality and value, perhaps favoring the small capitalization segment which has underperformed for an extended period. We also remain positive on Europe as it should benefit from the economic recovery with the market dominated by value and 'growth-sensitive' sectors. The strong rebound in China should also be supportive for global equities. Moreover, we believe stock selection will play a more

important role this year than in the recent past, arguing in favor of active portfolio management.

Perhaps of some concern is the growing retail speculation in equity markets. Over 10 million new trading accounts were opened last year, many of which have utilized significant leverage, including derivatives. Margin debt has risen to a record high of \$778 billion (up \$50+ billion in each of November and December). Such speculation is typically a warning sign, however, the Fed Chairman Powell currently isn't even "thinking about thinking about" raising interest rates or curtailing liquidity.

The Federal Reserve's money printing efforts (\$120 billion per month) have increased the size of the central bank's balance sheet to \$7.4 trillion, while helping to finance the US government's budget deficits. The US national debt is currently \$27.9 trillion, with the annual deficit estimated to be \$3 trillion. These debts are thus far manageable thanks to low interest rates (the US government currently pays 1.7% on average debt balances). Further, newly appointed Treasury Secretary Janet Yellen called for Congress to "act big" on spending in order to boost the economic recovery. She also wrote "economic policy can be a potent tool to improve society. We can and should, use to address inequality, racism and climate change." These sentiments are not limited to the US as seen by International Monetary Fund Managing Director Kristalina Georgieva who told policymakers "please spend" and added "spend as much as you can and then spend a little bit more." In the context of low interest rates and mounting debts, coupled with inflationary prospects given the expected pent-up demand as the world emerges from the pandemic, we remain cautious with regard to fixed income as the reward-to-risk ratio remains unattractive.

As we attempt to capitalize on the present financial market dynamics, we have identified several timely investment opportunities which aim to offer risk-adjusted and non-market correlated returns. Strategies include long/short credit, merger arbitrage, hedged European equity, energy / water infrastructure, distressed real estate, as well as med-tech, and edu-tech.

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.