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2021 Outlook Theme #1: Diverging then Converging Headlines

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2020 was an unprecedented year, as the global Covid-19 pandemic roiled global economies. We have never seen an economic cycle like this one, nor have we seen a market cycle like this one. Both the speed of the downturn and the fact that it was the result of an exogenous event made this market cycle truly different, and this needs to be kept in mind when considering 2021.

So what does this mean? Looking to 2021, we can still use the same tools and analysis, despite the unusual nature of 2020. However, like ANY market cycle, the unique nature of the cycle needs to be taken into account. That requires looking at the expected trends for 2021. When looking at the economy, we see two parallel timelines of vaccine progress and the Covid-19 virus trends.

Overall, both the vaccine and virus timelines have proceeded on largely predicted paths, laid out by experts as early as June 2020. Vaccines have moved with the pace of studies, accelerated by regulatory expediency and steps such as “at risk production” that put them on track for first doses in late 2020. On the other hand, the second wave of the virus in the winter has also been long expected, both based on behavior of other viruses that flourish at that time of year, as well as the specific characteristics of Covid-19 and its highly transmissible nature in indoor environments, which people use more when the weather gets worse and become more acute at the holidays.

Similar understandings can be used to sketch out a timeline for 2021, in a process we refer to as *Diverging, then Converging Headlines*. The vaccine and virus data first are on deviating paths, then both moving towards a favorable outcome in the second half of 2021.

Q1’21 will see the vaccine timeline continue to progress in a positive direction, while the virus news remains negative. This will likely be the most challenging period, with the virus trend at its worst and the vaccine trend most likely to produce stories of delays and other start up mishaps.

During Q2’21, the virus data should begin to turn and, hopefully, put both the vaccine and virus timelines on a converging course. The vaccine will become more broadly available. This availability, plus adjusted behaviors and policies in response to the second wave, should bring the virus trends under control, and cause them to converge towards the good vaccine timeline.

The markets will be locked onto this convergence, expected in late Q2'21, as opposed to the potential deceleration in economic data in late Q4'20 and into Q1'21. As long as neither trend shifts significantly enough to take the markets focus off that end of Q2'21 target, the Q1 headlines will be seen as merely noise. However, should a serious issue arise, such as one of the remaining vaccines see a multi-month delay, then the market would have to shift its focal point and adjust. Since markets are forward looking, as 2021 progresses their focus will shift to the second half and where economic activity will go once the trends begin to converge.

The information contained herein is based upon sources believed to be true and accurate. Sources include: *Factset Research Systems Inc.,* Bureau of Economic Analysis, Bureau of Labor Statistics, Congressional Budget Office, Board of Governors of Federal Reserve System, Fred: Federal Reserve Bank of St. Louis Economic Research, U.S. Department of the Treasury

- The Standard & Poor's 500 is a market capitalization weighted index of 500 widely held domestic stocks often used as a proxy for the U.S. stock market. The Standard & Poor's 400 is a market capitalization weighted index of 400 mid cap domestic stocks. The Standard & Poor's 600 is a market capitalization weighted index of 600 small cap domestic stocks.
- The NASDAQ Composite Index measures the performance of all issues listed in the NASDAQ stock market, except for rights, warrants, units, and convertible debentures.
- The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of 21 emerging markets. The MSCI All Country World Index is a free float adjusted market capitalization index designed to measure the performance of large and mid and cap stocks in 23 developed markets and 24 emerging markets. With over 2,800 constituents it represents over 85% of the global equity market.
- The Barlcays Aggregate Index represents the total return performance (price change and income) of the US bond market, including Government, Agency, Mortgage and Corporate debt.
- The BofA Merrill Lynch Investment Grade and High Yield Indices are compiled by Bank of America / Merrill Lynch from the TRACE bond pricing service and intended to represent the total return performance (price change and income) of investment grade and high yield bonds.
- The S&P/LSTA U.S. Leveraged Loan 100 is designed to reflect the largest facilities in the leveraged loan market. It mirrors the market-weighted performance of the largest institutional leveraged loans based upon market weightings, spreads and interest payments.
- The S&P Municipal Bond Index is a broad, comprehensive, market value-weighted index. The S&P Municipal Bond Index constituents undergo a monthly review and rebalancing, in order to ensure that the Index remains current, while avoiding excessive turnover. The Index is rules based, although the Index Committee reserves the right to exercise discretion, when necessary.
- The BofA Merrill Lynch US Emerging Markets External Sovereign Index tracks the performance of US dollar emerging markets sovereign debt publicly issued in the US and eurobond markets.
- The HFRI Fund of Funds index is compiled by the Hedge Funds Research Institute and is intended to represent the total return performance of the entire hedge fund universe.