Weekly Market Summary

October 30th, 2020

A Terrible Week in Review ... Someone Needs to Start Calling Again, and Fast!
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Latest Update on Coronavirus: Confirmed cases last at 45.45 million, with the death toll from the pandemic at 1,187,650. The UK's drug regulator is said to have started accelerated reviews of Covid-19 vaccines under development from Pfizer Inc. and AstraZeneca Plc, whilst Moderna says it is preparing global launch of Covid vaccines with a tiered pricing proposal. German overall cases now exceed 500,000, whereas US new cases topped 89,000 yesterday, setting a daily record as the outbreak intensifies. Anthony Fauci, the government's top infectious disease doctor, predicted it could take until the end of 2021 at least for US social life to return to normal even with an effective vaccine

In last Friday's weekly market update, we clearly suggested that financial markets had gotten far more complex/tricky lately - with irrational asset movements/gyrations being justified by frivolous explanations. In that context, we referred to:

- Regular phone calls between US Secretary of the Treasury Steven Mnuchin and the Speaker of the US House of Representatives Nancy Pelosi, in relation to a large fresh fiscal stimulus package, being the major supporting factor for the relentless rally in US & global equity markets

- Two telephone conversations between Saudi Arabia's Crown Prince Mohamed Bin Salman and Russia's President Putin, as well frequent discussions and intimidations from their top energy ministers, being the main reason for a persistent bid in oil prices.

- A US Federal Reserve, continuously on high alert and standing by to prevent any alarming increase in rates - no matter how much debt the Treasury has to sell amid the "raging" pandemic - to justify why long-term US yields would stay capped around current levels.

We also ended our weekly note by reminding our readers that there was a time, not long ago, when economic performance and assets' price movements were solely defined by strength/weakness in weekly/monthly economic data releases (indicators such as GDP, Payroll, CPI, Retail Sales, Housing Starts, Durable Goods). Well, I guess not anymore!

Starting with this week's economic releases, investors' focus remained mostly on Thursday's preliminary reading for US third quarter gross domestic product (GDP). Following an awful 31.4% contraction in the 2Q 2020 (mostly a result of strict lockdowns at that time), the US economy staged a dramatic recovery in Q3 - clawing back roughly two thirds of output lost during the first half of 2020. Official figures published yesterday showed the world's biggest economy grew by a record 7.4% between July and September, buoyed by strong demand for cars, clothing and footwear, while sales of services were led by healthcare, food, accommodation and transport (News services usually report annual GDP growth, which showed a staggering +33.1% Q/Q annualized increase). The figures were hailed by President Trump as the "*biggest and best in the history of our country*", as he sought to rally his supporters ahead of next week's presidential election. "*Next year will be FANTASTCI!!!," the US president tweeted. "However, Sleepy Joe Biden and his proposed record setting tax increase, would kill it all*." Other important data out included September Durable Goods Orders (+1.9% month-on-month, well ahead of the median market estimate for +0.5%), September New Home Sales (annualized 959,000 units, weaker than the market's estimate for 1,025,000 units), October Conference Board's Consumer Confidence (100.9 versus 102.0, weaker-than-forecast), Weekly Initial Jobless Claims (751,000, better than the anticipated 770,000 unemployed) and September Pending Home Sales (-2.2% month-on-month, well below the projected 2.7% increase).

And yet, despite an improved overall economic outlook (some could argue that this data is outdated), markets witnessed a steep selloff in stock and oil prices whilst fixed-income yields remained confined in a narrow range (although they did trade down to the low end of the range, as a result of flight-to-quality trades, out of equities into "*risk-free*" government bonds! "*risk what?"* 😊). Market volatility on the other hand, as measured by the VIX & MOVE indices (for stocks and bonds respectively), continued surging higher, sparking a pick-up in option volumes (with the put skews for both oil and equities growing markedly more bearish).

This sudden change in market sentiment/direction can be easily attributed to the below four major factors:

1- *Lockdowns & Curfews Spreading Fast Globally*: Equity and oil prices have slid throughout the week, the longest streak of losses since April, as market players worry the last few months' rally may have gone too far. Both assets are under pressure as growing lockdowns and restrictions across Europe risk halting the nascent economic recovery, reviving fears of similar adverse price actions witnessed in the second quarter of this year. French President Emmanuel Macron and German Chancellor Angela Merkel have already ordered their countries back into lockdown on Wednesday, as a "massive" second wave of coronavirus infections threatens to overwhelm Europe before the winter. In the US, a new wave of infections has been setting records with less than a week to go until Election Day.

2- *It's Official ... US Stimulus Talks Have Reached a Deadlock*: The once-promising relationship between Nancy Pelosi and Steven Mnuchin flamed out publicly yesterday, just days before the US presidential election, as the two disavowed economic relief talks – and each other! It started when the Speaker of the House dispatched a letter to Mnuchin detailing multiple outstanding issues in their-on-again, off-again talks around a $2.0 trillion stimulus bill such as state and local aid, school funding, child-care money, tax credits for working families, unemployment insurance aid and liability protections for businesses. Mnuchin was offended that the first time he heard of the letter was in the media, when Politico's morning newsletter published it shortly after 6:00 am. By the afternoon, The US Treasury Secretary was responding in kind, tweeting out a letter to Pelosi just one minute after sending it to her office. The only question that remains now is whether the breakup between the two is final, or whether they can still come together and produce a relief bill during Congress' lame duck session straight after the election.

3- Growing Uncertainties in Relation to Upcoming US elections: Ahead of the final weekend before Election Day on Tuesday, US President Donald Trump and Democratic challenger Joe Biden plan to tour across battleground states in the Midwest. Michigan and Wisconsin are two of the three historically Democratic industrial states, along with Pennsylvania, that narrowly voted for Trump in 2016, delivering him an upset victory. Minnesota, which has not voted for a Republican presidential candidate since 1972, is one of the few Democratic states that Trump is trying to flip this year. The pandemic, as well as an extraordinary level of enthusiasm amongst voters this year, has prompted Americans to vote early in unprecedented numbers (in excess of 80 million votes already cast either by mail or in person, well over half the total number of votes for the entire 2016 election!) The deluge of mail-in ballots makes it likely that the winner of several states, including major battleground such as Pennsylvania and Wisconsin, will not be clear on Tuesday night, as election officials expect the vote-tallying to take days. As a result, many investors are taking profit or simply exiting markets ahead of the final election outcome amid fears that the results may also end up be disputed, fueling further market volatility and uncertainty.

4- *Herd Mentality Trading*: We have extensively covered misleading market herd behavior in previous write-ups. That refers to those investors that start buying/selling markets at extremes, absurdly overvaluing/undervaluing prices of financial assets and later precipitating the price reversal once they had realized the glaring disconnection between the economic reality and the valuation of those financial assets in question. That is in line with the socio-psychological phenomenon of someone "*predicting*" or expecting something, and later this "*prediction*" or expectation comes true simply because one believes it will, and the resulting investors' herd behaviors align to fulfil those beliefs.

With a second wave of lockdowns now firmly in place, governments either unable or unwilling to repeat the huge fiscal relief packages that cushioned the blow last time around and no central bank wanting to admit that it is really close to running out of firepower, there is definitely a lot more at stake in getting things right over the coming days and weeks. One can only hope that next week's US elections come and go quickly. Otherwise, if the election is close, the aftermath is likely to spawn controversies, lawsuits and bring much higher market volatility as weeks of uncertainty send various markets into a tailspin!

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