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US Financial Markets – The Week in Review

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Economic and political backdrop

After weeks of stalled negotiations, signs of progress emerged in congressional attempts to craft a new stimulus bill. A bipartisan group of lawmakers convened last Monday to discuss a new USD 908 billion package. The group was unable to come to an agreement, but reports later surfaced that the two sides had agreed to temporarily put aside two of the thorniest issues: Democratic demands for further aid to states and localities and Republican demands for a litigation shield for businesses and other institutions. On Tuesday, stocks seemed to get a lift after Senate Majority Leader Mitch McConnell vowed that Congress would remain in session until a deal was reached.

By the end of the week, the outlines of a roughly USD 900 billion package appeared to emerge, including roughly USD 600 direct payments to individuals and supplementary federal unemployment assistance of USD 300 per week. Stocks pulled back on Friday, however, on reports that Republicans were demanding a provision barring the incoming Treasury secretary from providing the Federal Reserve with more emergency lending funds in 2021.

The rollout of the Pfizer-BioNTech coronavirus vaccine last Monday also seemed to bolster sentiment. On Thursday, a US Food and Drug Administration (FDA) advisory panel gave its approval to Moderna's similar mRNA vaccine, which would nearly double the expected number of total doses available by the end of the year. Current coronavirus trends remained daunting, however, with the US setting records for daily deaths. The heavily populated southern part of California emerged as the new epicentre of the crisis, despite strict lockdown measures.

The toll the virus is taking on economic activity also became clearer during the week. On Wednesday, the Commerce Department reported that retail sales contracted 1.1% in November, roughly triple the expected decline and the worst showing since April. Weekly jobless claims, reported Thursday, reached 885,000, well above expectations and the highest level since early September. Continuing claims fell back to a new pandemic low, however. A pickup in auto and parts manufacturing helped industrial production grow 0.4% in November, a bit more than expected, but October's strong gain was revised lower from 1.1% to 0.9%. Housing data generally remained solid.

Equity markets

The S&P 500 returned 1.3% (16.9% YTD). The major indexes reached record highs as expectations grew for the passage of another federal coronavirus relief package. Information technology stocks outperformed within the S&P 500, helped by gains in Apple and Microsoft. Energy stocks lagged despite oil prices touching nine-month highs on strong demand from India and China. Small caps outperformed large caps and growth outperformed value, with Russell 2000 returning 3.1% (19.6% YTD), Russell 1000 Growth 3.0% (37.3% YTD) and Russell 1000 Value 0.2% (1.5% YTD).

Trading volumes were muted through much of the week in advance of the rebalancing of the S&P 500, which electric carmaker Tesla was set to join the following Monday. USD 110 billion in shares were expected to change hands on Friday, as mutual funds and exchange traded funds (ETFs) that attempt to mirror the returns of the S&P 500 adjusted their portfolios. Several large ETFs that target other benchmarks also rebalanced.

Fixed income markets

Long-term US Treasury yields increased modestly through most of the week, as fiscal relief hopes and optimism about vaccine distribution outweighed the generally disappointing economic data. At its 15-16 December meeting, the Federal Open Market Committee (FOMC) held its policy rate steady, as expected, and elected to maintain the current composition of its bond purchases, disappointing some investors who had hoped for an increase in the Fed's buying of long-term bonds. In an adjustment from its prior statement, the FOMC said it would continue buying Treasuries and agency mortgage-backed securities at its current pace "until substantial further progress has been made toward the Committee's maximum employment and price stability goals." The statement caused yields to briefly increase, but the move was quickly reversed as Fed Chair Jerome Powell's comments to the press and the FOMC's updated Summary of Economic Projections were perceived as dovish. The 10-year Treasury yield ended the week at 0.95%, up from 0.90%.

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Low levels of primary issuance, along with a year-end buying trend, drove investment-grade corporate bond credit spreads tighter throughout the week. Trading volumes were lower than average, and expectations for issuance remain subdued through year-end. Solid equity gains supported the performance of high yield bonds, and credit spreads tightened across all quality tiers. Investors were mostly focused on the primary calendar as the below investment-grade market saw a high volume of new deals. Technical conditions were mixed, however, as high yield funds industrywide reported modest outflows.