The Big Read Global Economy

The ‘everything rally’: vaccines prompt wave of market exuberance

The prospect of a rebound in the global economy has fuelled optimism despite the economic damage from the pandemic

Robin Wigglesworth in Oslo 4 HOURS AGO

The markets have become too hot to handle. So intense is the frenzied stock-buying that even many of Wall Street’s biggest brokerages and wealth managers are struggling to keep up.

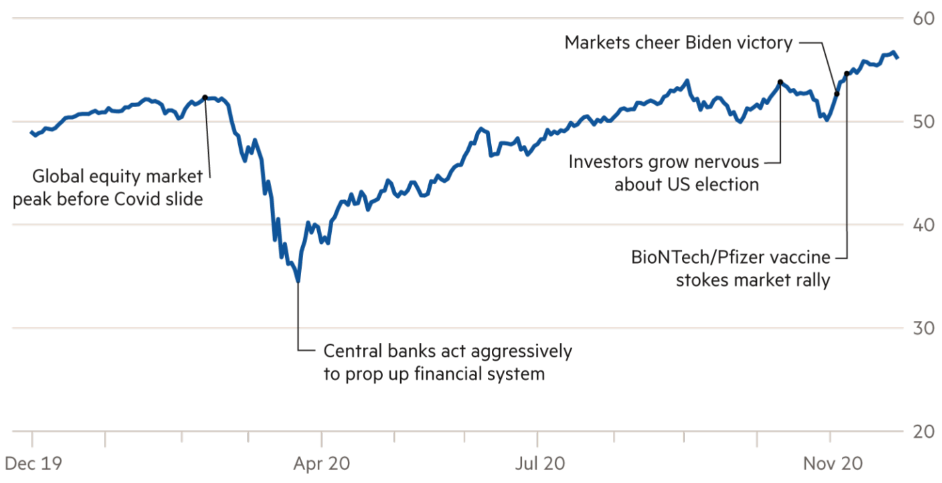
Almost every major US brokerage firm — from old stalwarts like Charles Schwab and Merrill Lynch to new platforms such as Robinhood — suffered at least one outage in November, according to Downdetector, a website that tracks online service problems, as a torrent of trading overwhelmed their websites.

Thomas Peterffy, the billionaire founder of Interactive Brokers, who first started trading on the now-defunct American Stock Exchange in the 1970s, says the current environment is unlike anything he has ever seen before — but understandable. “Money is now so easy, why not borrow what you can and put it into stocks? That’s what our customers are doing, and they’re making helluva lot of money,” he says.

Retail investors led the dramatic equity market recovery from the Covid-19 shock, flooding internet message boards to share memes, boast of wins and lament losses. But now they are increasingly joined by the investment industry’s heavyweights, which are helping reinforce and broaden out the most remarkable bull run in financial history.

Stock markets roar back as central bank stimulus banishes virus fears

Market capitalisation (MSCI All-Country World index, $tn)



Source: Refinitiv
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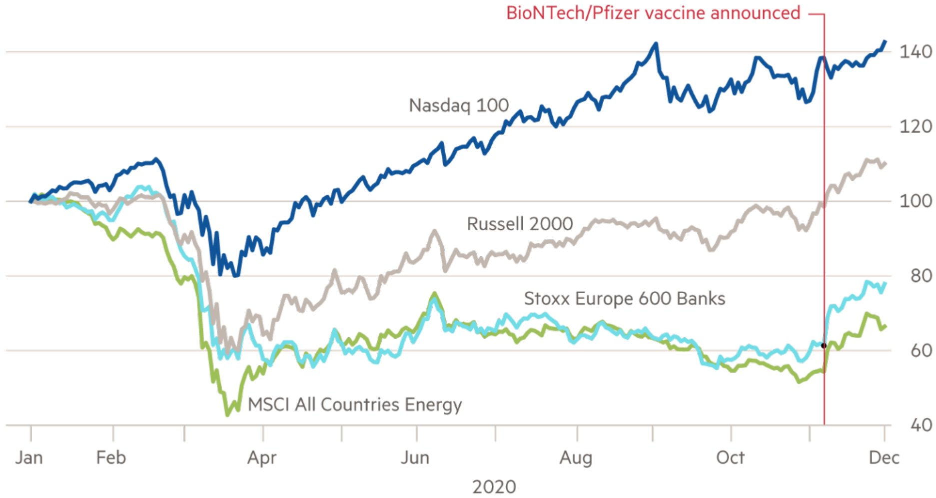
The MSCI All-Country World index climbed another 12.2 per cent in November — its best month on record — to touch new all-time highs. The gauge has added $30tn in market capitalisation since the March lows.

Moreover, this stage of the rally has been mainly powered by corners of the market largely left behind during the pandemic, such as energy stocks, airlines, hotel groups, European banks, smaller US companies and emerging markets. Indeed, it has become what some analysts have termed an “everything rally”, with junk bonds, copper, oil and even bitcoin climbing sharply. The only major markets to have taken a hit are classic havens, such as US Treasuries and gold.

The backdrop to such a frenzy seems improbable. The second coronavirus wave is unravelling some of the tentative economic recovery from the brutal March shock. All told, the global economy is likely to shrink 4.4 per cent this year, according to the IMF — a decline not seen since the Great Depression.

Vaccine news upends this year’s stock market trends

Indices rebased



Source: Refinitiv

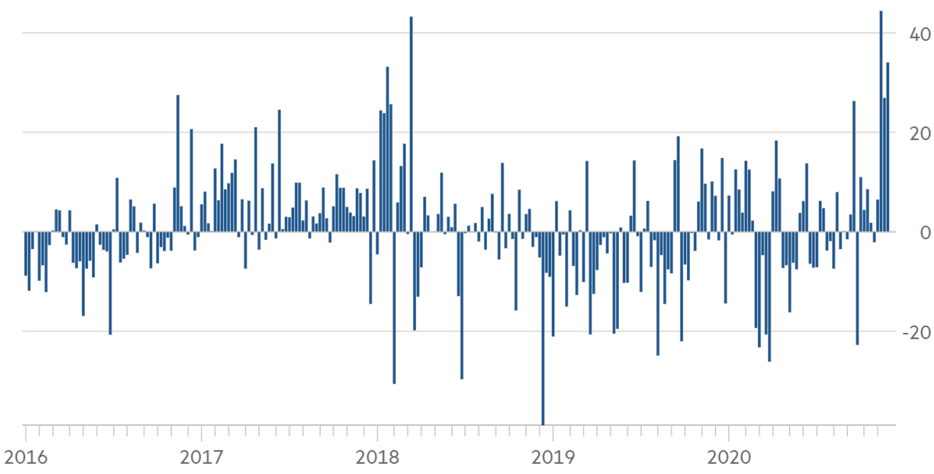
However, the emergence of several credible, effective coronavirus vaccines has triggered a burst of optimism that the global economy is poised for a powerful rebound in 2021, as the pandemic recedes but the extraordinarily aggressive stimulus measures continue to send money sloshing around the financial system.

“The game-changer was the vaccine,” says Peter Oppenheimer, chief global equity strategist at Goldman Sachs. “Hope is one thing, actually seeing the evidence (of a vaccine) is quite another. And the evidence was much better than most people were expecting. We’re still optimistic that you’ll see quite good returns in equity markets next year.”

However, some investors and analysts remain uneasy about the current ebullience. Yes, effective vaccines could eventually suppress Covid-19, but for now it continues to linger and the monstrous damage it has already inflicted will take a long time to heal.

Equity funds enjoy strongest three-week inflows on record

Inflows ($bn)



Source: EPFR
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Noting signs of uncritical optimism among fund managers, Bank of America's chief investment strategist Michael Hartnett recommends that investors ratchet back their exposure to stocks in the coming weeks and months, arguing markets are now approaching a "full bull" stage and are vulnerable to a setback.

Jeremy Grantham, the famed contrarian founder of the investment group GMO, thinks even this is optimistic. He reckons markets have smashed past the "full bull" stage and are in a late-bubble "melt-up" phase that rivals the two biggest bubbles of the past century.

"There is as much craziness now as there was in late 1999 or 1929," he argues. "It is bewildering, impressive and for financial historians like me, exciting. This is the real thing . . . It looked like we were in a bubble mode this summer, but the real craziness has come out in the last few months."

ump's impending exit from the White House is seen as a positive by markets © New York Times/Bloomberg

Joe Biden promises stability as president while a split Congress should blunt the Democratic party's left © Mark Makela/Ge

Magic wands

The early stage of the rally was powered by mammoth fiscal and monetary stimulus packages from central banks and governments around the world, totalling trillions of dollars. The impact of ultra-easy monetary policy including very low interest rates — and the prospect of it continuing for years to come — remains the dominant driver, analysts say.

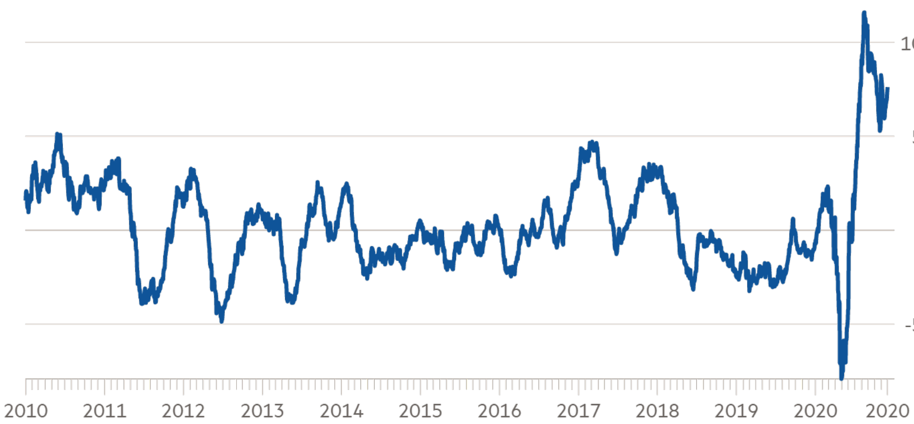
But November’s shift from optimism to near-euphoria has been triggered by an alignment of several stars. First, Joe Biden won the US presidency but Democrats failed to gain control of the Senate. For many investors that was close to the perfect result, ejecting the erratic, norm-shattering Donald Trump but stymieing the more radical parts of the Democratic agenda — such as heavy corporate tax increases.

While another big dose of fiscal stimulus may be trickier to pass, this will mean that the Federal Reserve is more likely to keep its foot on the monetary pedal. “Gridlock is Goldilocks,” was the pithy title of one Wall Street analyst’s note on the subject. That President Donald Trump’s refusal to accept the result has failed to trigger any significant unrest has added to investors’ relief.

Then, BioNTech-Pfizer, Moderna and Oxford university-AstraZeneca announced that they had developed coronavirus vaccines that were in most cases more effective than expected. This provided an enormous jolt to global markets, which could contemplate a gradual economic normalisation next year, with pent-up demand and super-easy monetary policy fuelling a huge growth spurt.

Global economy rebounds from shock of Covid-19

Citi Economic Surprise Index* (global)



*The CESI compares economic data against economists' expectations, rising when data exceeds consensus estimates and falling when data are below estimates
Source: Refinitiv
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Reports of corporate profits rebounding have reinforced the optimism. And to cap it off, last week it emerged that Mr Biden would name former Federal Reserve chair Janet Yellen as his Treasury secretary. That raises the prospect of co-ordinated and aggressive fiscal-monetary policymaking to combat the economic damage wreaked by Covid-19, further delighting investors.

Ed Yardeni of Yardeni Research referred to Ms Yellen as the “Fairy Godmother of the Bull Market” when she was chair of the central bank in 2014-18, due to her dovish views, and reckons her re-emergence as an influential policymaker is another positive sign for equities. “Now as Biden’s Treasury secretary, she will continue to wave her magic wand,” he argues.

The combination of factors has been electrifying. Fund managers have not been as hopeful that economic growth and corporate profits will improve since 2002, according to a widely-followed Bank of America survey. Their cash reserves have dropped by 1.8 percentage points in the past seven months — the fastest slump on record — to nearly 4 per cent. The survey showed that fund managers’ optimism on stocks has jumped to the highest since early 2018, when markets were basking in the glow of Mr Trump’s corporate tax cuts.

onders, of Charles Schwab, says frothiness has moved out into pretty much every measure of market sentiment © g

Prospective Treasury secretary Janet Yellen is expected to push for more stimulus from Federal Reserve chair Jerome Pow Bloomberg

Investors are also pumping more money into fund managers. Equity funds have globally hauled in nearly $90bn since the beginning of November, after the strongest three-week stretch of inflows on record. Goldman Sachs estimates that “short” positioning on US stocks — bets on them falling — is the lowest since at least 2004.

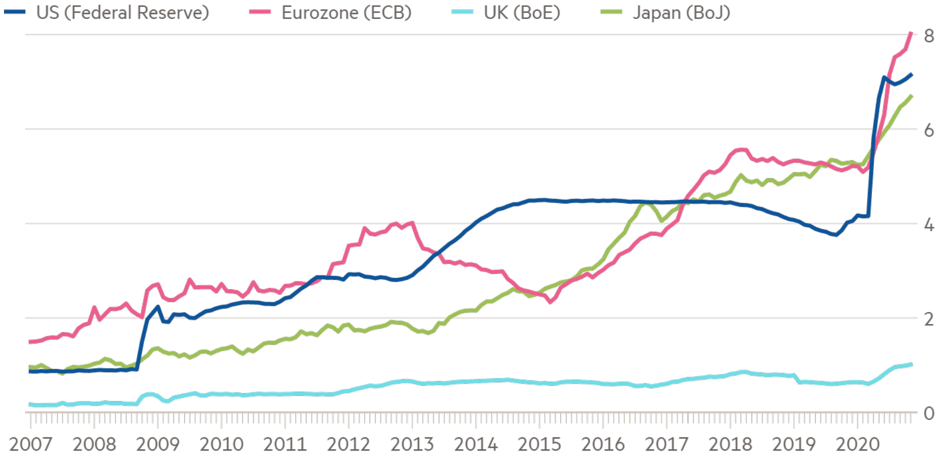
“The vaccines have cemented the view that even if we’re still in a tunnel, there is light at the end of it,” says Liz Ann Sonders, chief investment strategist at Charles Schwab. “The froth in sentiment had been concentrated in day traders, but since the Pfizer news we have seen that frothiness has moved out into pretty much every measure of sentiment.”

Aside from propelling many major equity market indices to record highs, the November newsflow has triggered a seismic investor “rotation” away from stocks that were seen as Covid-era winners and into beaten-up industries that are more closely tied to the health of the global economy. What was once a one-engine rally — with Big Tech providing virtually all of the vim — has seen markets fire on almost every cylinder in November.

European bank shares and global energy stocks had lost about half their value by the March nadir, and have since largely languished. But in November they soared 30 per cent and 35 per cent respectively. Airline stocks jumped more than 30 per cent. The Russell 2000 index of small US companies climbed more than 18 per cent, almost twice the gain of its “big brothers”, the S&P 500 and the Nasdaq 100 indices. Emerging market stocks rose more than 9 per cent in November, the biggest monthly gain in nearly four years. Junk bonds have almost clawed back all their 2020 losses.

Central banks unleash unprecedented measures to combat pandemic damage

Central bank assets ($tn)



Source: Refinitiv
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Consensus fears

Nonetheless, there is a danger that stimulus-soaked, vaccine-happy markets may be becoming oblivious to both the immediate economic dangers that continue to linger, and the enormous longer-term damage the pandemic has already caused. Even Morgan Stanley, one of the more bullish of Wall Street's investment banks, concedes there is a danger of a "near-term 'air pocket' for markets", given the froth.

Lori Heinel, chief investment officer at State Street Global Advisors, admits that the fact her longstanding optimism is now commonplace gives her pause. "That's the one thing that keeps me up at night, that we're incredibly in-consensus," she says. "It makes me nervous when we're all saying the same thing."

Although the development of effective vaccines is unquestionably positive, some economists point out that it will take up to a year to produce and distribute enough of the vaccines to inoculate most of the world. In the meantime, the second coronavirus wave is threatening to unravel the summer's economic recovery.

Good news on Covid-19 vaccines has inspired a dramatic market rally © Robyn Beck/AFP/Getty

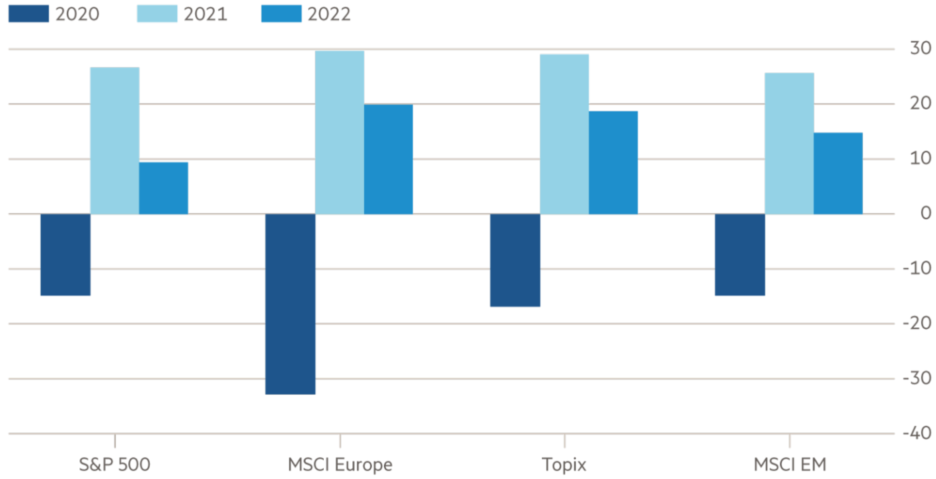
Europe’s renewed lockdowns mean that all of the region’s major economies are suffering another contraction, according to Deutsche Bank. In the US, last week’s Thanksgiving holiday could turn out to be a “super spreader event” that ultimately leads to another downturn in the first quarter of 2021, says Michael Feroli, JPMorgan’s chief US economist. The looming Christmas holiday could become an even bigger Covid spreader for many other countries.

Two remaining Georgia Senate seat elections in January could also upset markets, some analysts note. If the Democrats triumph, the party would in effect enjoy control of both executive and legislative branches. That would likely lead to a heftier stimulus package, but put corporate tax hikes and more aggressive regulatory moves back on the agenda, potentially wrongfooting markets.

Conversely, governments refusing to countenance more stimulus and ratcheting back public spending too quickly — as happened in the wake of the global financial crisis — might sap the market rally of its vim, other analysts caution. “We suspect that policymakers in general will be wary of engaging in austerity drives this time around. Nonetheless, there is a risk that they withdraw fiscal support too much too soon,” says John Higgins, an analyst at Capital Economics. “That could slow economic growth and take the wind out of stock markets’ sails.”

Corporate profits expected to rebound strongly in 2021

Morgan Stanley’s regional earnings per share forecasts, 2020-22 (%)



Source: Morgan Stanley
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Financial markets are forward-looking, and will probably be able to shrug off a tricky few months by focusing on the brighter outlook next year, investors say. The IMF has pencilled in a 5.2 per cent expansion for the global economy in 2021. But with an economic recovery already baked into stock markets, even a modest disappointment next year might upset markets.

Moreover, equity markets may be damaged if bond yields continue to climb higher — perhaps spurred by a long-forecast acceleration in inflation in 2021, says Ms Sonders. Stocks benefit hugely from low bond yields, both due to the miserliness of the prospective returns of fixed income and because they directly feed into how investors value the future earnings of a stock. Rising bond yields might make fast-growing technology stocks — which have dominated returns this year — seem particularly frothily valued.

Yet a decent year but a more volatile decade may be the inevitable consequence of measures taken by governments and central banks since March, some analysts caution.

While Goldman Sachs has some of Wall Street’s punchiest forecasts for the coming year, Mr Oppenheimer admits that the longer-term outlook is murkier, given heftier debt burdens, which he believes will over time weigh on growth, already-high stock prices and limited scope for bond yields to fall. “While the inflection point in the global economy and company profit is likely to be strong, supporting a decent period for equity markets, we’ll probably see lower returns than we saw in the last decade,” he says.

Lori Heinel, CIO at State Street Global Advisors, says the industry is ‘incredibly in-consensus’, but GMO founder Jeremy Grantham cautions that markets have smashed past the ‘full bull’ stage © Getty

Room to rise?

The bulls are undaunted. Mr Peterffy reckons that given the unfettered, central bank-financed government largesse, the stock market could — albeit with some “hiccups” along the way — double in price over the next three years, even if he suspects that inflation is inevitable, and will gobble up much of those returns in real terms. “This doesn’t look like it is going to end soon,” he says.

Mr Grantham says the euphoria is “completely understandable”, given the prospect of ultra-easy monetary policy for years to come and the “spectacularly successful” vaccines that are beginning to be approved by regulators.

But he suspects that once the vaccines actually start being administered at scale and the pandemic recedes, a lot of investors are going to wake up to the fact that the global economy is still dogged by a host of thorny problems that both predate and have been exacerbated by the virus.

“While we have this euphoria, it’s pretty hard to imagine the bubble breaking,” he says. “But you look at the data and you think this thing could go next week.”