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# Stocks hit record highs, but risks may be rising

*Stocks surged ahead during the holiday-shortened trading week as investor optimism over vaccine prospects continued to climb. The S&P 500 index rose 2.3% and several market indexes hit new highs, with the Dow Jones rising above 30,000 mark for the first time. Continuing the trend that has been in place for some time, value outperformed growth last week. The energy, financials and consumer discretionary sectors all performed particularly well, with defensive areas of the market lagging and REITs the only area of the market to move lower.*

## HIGHLIGHTS

- **Investor sentiment continues to climb on increasing evidence that a widely available vaccine should materialize in the first half of next year.**
- **While we are optimistic toward equity markets over the next 12 months, we think investors are looking past near-term economic risks. As the pandemic continues to rage, we expect economic data could soften.**
- **This could mean stocks are vulnerable to additional volatility and a near-term consolidation.**



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## 10 observations and themes

### **1) The coronavirus pandemic continues to cause a humanitarian crisis, but there are some signs of stabilization in new cases.**

While the raw number of new cases is distressingly high, Europe is starting to see the number of daily new cases trending lower, and some hard-hit areas of the U.S. such as the Midwest may be plateauing.

### **2) Manufacturing data continue to be strong, showing the U.S. economy is still recovering from the recession.**

November's flash PMI Manufacturing Index rose to a stronger-than-expected 56.7, with the service and composite indexes also showing strength.

### **3) Consumer confidence, however, may be starting to wane, which could start to weigh on spending.**

The Conference Board's Consumer Confidence Index fell to a lower-than-expected 96.1 this month as individuals react to the surge in the pandemic and deteriorating household income.

### **4) Weakening confidence, combined with rising unemployment claims, suggest near-term economic risks.**

Initial unemployment claims rose to 778,000 last week, marking the second consecutive week of increases. Worryingly, the rise in claims is being driven by areas that are seeing virus surges, which may lead to limits on economic activity.

### **5) There are still hopes for a modest fiscal stimulus plan before the end of 2020.**

President-Elect Joe Biden is pushing Democratic congressional leaders to compromise with Republicans to pass something as soon as possible.

### **6) Janet Yellen's nominations to be the next Treasury Secretary is likely a positive for financial markets.**

Secretary Yellen would likely focus more of her attention on fostering the burgeoning economic recovery rather than on financial regulatory issues.

### **7) U.S./China relations are likely to remain adversarial (if more predictable) in a Biden Administration.**

We don't expect President Biden will undo President Trump's tariffs, but he is less likely to impose new ones. He will also likely continue to push China on the issue of intellectual property rights, but is also more likely to coordinate with allies in an attempt to isolate China.

### **8) Inflationary pressures could start to rise, but not in the immediate term.**

The massive amounts of monetary and fiscal policy we have seen this year will ultimately be inflationary in nature, but the economic restrictions currently in place are producing a deflationary environment. Inflationary expectations have returned to pre-coronavirus levels, but we are still some time away from seeing higher inflation.

### **9) A positive for markets: The current stock market rally is the broadest since 2013, which is a good sign for equities.**

Presently, 92% of the S&P 500 is above its 200-day moving average, and the number of new 52-week highs continues to grow especially among smaller capitalization stocks.

### **10) A negative for markets: Sentiment and some technicals are pointing to overbought conditions.**

Bullish sentiment is rising to possibly extreme levels, and put/call ratios have fallen to multi-year lows. This could indicate stocks are due for a pullback.

## Volatility may remain elevated before a vaccine is widely available

Investors remain highly bullish and are looking past growing prospects of near-term economic weakness as the pandemic continues to surge. In the United States, manufacturing data are continuing to hold up, but rising unemployment claims and signals that consumer confidence may be slipping are worrisome. Europe, meanwhile has returned to a broader set of economic lockdowns that are hurting growth. And global trade levels remain depressed, although they have improved since the spring. The bottom line is that the global economy is not on a consistent upward path, and it appears a long way away from turning into a globally synchronized economic expansion.

Ultimately, more fiscal-policy support is needed to create a bridge between today's uncertain economic conditions and when vaccines are widely available enough to allow economic conditions to return to something approaching normal. The good news is that it appears this may occur before the middle of next year.

This leaves stocks in an uncertain position. The broadening of the current bull market is a good sign, and it is possible the recent rally could continue on additional good news on the vaccine front. But at the same time, investor sentiment is rising quickly and expectations are high, which could make markets vulnerable to near-term disappointments.

As such, we would urge caution toward stocks in the near term and advise against chasing returns. We feel positive about the market outlook over the next 12 months, but think volatility will remain high for the time being and wouldn't be surprised to see a pullback in the near-term.

### 2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	2.3%	14.5%
Dow Jones Industrial Avg	2.3%	7.0%
NASDAQ Composite	3.0%	37.2%
Russell 2000 Index	3.9%	12.5%
MSCI EAFE	2.2%	4.8%
MSCI EM	1.8%	12.9%
Bloomberg Barclays US Agg Bond Index	0.0%	7.3%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.7%

Source: Morningstar Direct, Bloomberg and FactSet as of 27 Nov 2020. All index returns are shown in U.S. dollars. Past performance is no guarantee of future results.

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#### Endnotes

#### Sources

All market data from Bloomberg, Morningstar and FactSet  
Manufacturing data from the Institute for Supply Management  
Employment data from the Department of Labor

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