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Market Commentary
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Major Event

Trade Pacts

The major development of November was the inking of the Regional Comprehensive Economic Partnership (RCEP) by China and 14 other Asian and Pacific nations.

The pact was first proposed in 2011 by the ten ASEAN countries as a regularization of trade between its members and China. The final RCEP has expanded to include Australia, New Zealand, Japan and South Korea. This pact largely recreates the geography of Tojo's Co-prosperity Sphere. As such, the US has had the concern that the RCEP could lay the foundations of Chinese economic hegemony in the Western Pacific and Asia. As an alternative the Obama administration had negotiated the TransPacific Partnership (TPP) in 2016 as a means to maintain American economic influence in the region. That pact had secured the adherence of 7 signatories of the RCEP as well as 4 countries in the western hemisphere not part of the RCEP. However, President Trump torpedoed the TPP as one of his first acts on assuming office. Despite the longer term risks,, the Asian nations have moved ahead with the RCEP which they hope will boost their near- to mid-term prosperity.

Approximately two thirds of the world economy is now organized into three great pacts:

Pact	Number Countries	Population (M)	Combined GDP (T$)	GDP Largest Member as % Whole
European Community	27	447	15.6	22%
RCEP	15	2,200	26.2	53%
USMCA	3	490	24.4	88%

Source: World Bank

These three pacts are more different than alike. The EC is a true multilateral pact with no dominant member and embracing both economic and political governance. The RCEP is the largest of the three pacts in terms of population and economy, but it is a purely economic pact with no political unity. The USMCA (the recent re-branding of NAFTA) is entirely dominated by the US. For the US the long-term risks in the EC and the RCEP are that their countries will converge into political/military rivals to the US and that their dominant currency will challenge the Dollar's role as the world's reserve currency. While possible, such trends appear to be playing out on the time scale of generations rather than decades. While the US can afford to be sanguine, the situation of Russia is not so relaxed. It is nowbordered by two great pacts which far outclass its population of 147 million and GDP of $4.4 trillion.

What does its long-term future look like – going it alone, joining either the EC or RCEP or fracturing along the line of the Urals? For the moment it will surely carry on alone or possibly try to organize Inner Asia as a counterbalance to China. Longer term, Russia has always looked to Europe, and joining a China dominated grouping would be a national humiliation. But Russia's current leadership would find the EC's political program a distinct challenge, whereas the RCEP does not present such issues. For the EC, the logic of a rapprochement with Russia is clear. Doing so would make the EC more co-equal with the other two regions in terms of GDP, and Russia's resource economy is largely complementary to the EC's manufacturing economy. Finally, an economic arrangement should relax a lot of the political tensions along the frontier between the EC and Russia.

The Pandemic

The second major event was announcement of three working vaccines for COVID. Both Pfizer and Moderna have announced vaccines with efficacy of about 95% and good safety profiles. This is a considerable achievement for the American pharmaceutical industry as it has developed an entirely new vaccine technology and then applied it to the problem of Covid. The Oxford/AstraZeneca team took a technologically more established route to vaccine development and had an early head start, but they took about two weeks longer to deliver their results. It was trialed under two dosing regimes [Regimens?] with reported effectiveness of 68% and 90% respectively. While slightly less efficacious that the other two vaccines, it has certain practical advantages. Its cost is about $4.50 per patient as compared to $40 for the more advanced vaccines. Also, it can be stored in ordinary refrigerators and shipped through the existing cold chain rather than requiring storage at the temperature of dry ice and requiring special distribution methods. The Chinese teams took the most conservative route to vaccine development and were the first to begin mass deployment. Their vaccine also appears to be effective. Finally, the Russians announced a vaccine about two months ago, but its documentation is currently more incomplete that the others. We expect mass vaccinations in the US and Europe to begin by the turn of the year and to have reduced mortality rates by spring. It will take until early June, however, to get the virus sufficiently under control that economic life can return to normal.

In Covid research there have been two major findings announced. A study of Marine recruits established that approximately 80% of Covid infections are largely asymptomatic in the young. As a result, the young are natural spreaders of the disease to more vulnerable populations. A possible implication is that reopening schools and colleges most likely seeded the current surge of infections in the general population. Only periodic whole population testing can effectively deal with the risk of asymptomatic carriers in the young. The second finding was a continuing accumulation of evidence that masks and good ventilation can usefully slow the spread of the epidemic.

The US Elections

Finally, the United States held a general election. We took the bold stance in March that President Trump's presidency was a likely victim of the Covid epidemic and so it has proved. Both parties energized their bases and thus largely neutralized each other's core strengths. Trump largely captured the blue collar and rural vote, while Biden captured the white collar and urban vote. Biden's victory was determined by white collar suburban men. Hillary Clinton had alienated this demographic, which in 2016 threw its support to Trump. However, Trump's maladministration disappointed them, and they shifted their vote to Biden in whom they can reasonably see one of their own. Biden also established some credibility with blue collar voters. However, this credibility was entirely personal and did not extend to the Democratic party as a whole. The Democrats had indulged in a long primary season that allowed the left wing of the party enormous airtime and had followed this up by a summer flirtation with street politics. These moves cost the Democrats dearly in the Congressional and State house races and denied the party the mandate it had eagerly sought. With Congress hung, political power in America rests firmly in the hands of two men – President

Joseph Biden and Mitch McConnell, the Republican Senate leader. President Trump hopes to remain a political power, but we regard this hope as fanciful. By inauguration day the better part of a half million American's [phrasing?] will have died of Covid, and perhaps 2/3rds of them are more victims of Trump's reckless policies than of the disease itself. Not since Mussolini has the Democratic party hated a politician as much as it now loathes Trump. We expect the full power of investigations and prosecutions will be deployed towards breaking Trump's remaining political power. We expect that this program will be quietly abetted by important parts of the Republican party. Trump will be lucky to negotiate his personal survival as a quid pro quo for his complete retirement from politics. While Biden removes Trump as a factor in Republican politics, we expect McConnell will play a similar role with regard to the progressive Democrats. This group is currently unrepentant at the disappointment they handed their party and still expects to receive the fruits of Biden's victory. McConnell will do Biden the considerable favor of denying them those fruits. It is broadly expected that McConnell will obstruct Biden's entire agenda. This could happen, but there is also the possibility that the two men will discover commonalities they can agree upon. Both men know that they are at the end of their political runs, that the country faces pressing problems and that they can have considerable influence in shaping the next generation of political leadership. Shared concerns and perspectives can provide a basis for agreement – as has happened in the past. A first indicator of whether the next two years will be collaborative or obstructive will emerge as the Biden cabinet seeks Senate confirmation. Wall St has been more than satisfied with the election results, in which it sees the retention of the Trump tax cuts without the volatility caused by the man himself.

Market Review

Equities

The US stock market found much to celebrate in November. On November 4 the S&P 500 rose 1.65% as the US Presidential election occurred peacefully. On Monday November 9 it rose 7.19%, probably in response to the election count completing on Saturday with a clear victory for Joseph Biden and the Sunday announcement by Pfizer that its vaccine for Covid-19 had demonstrated a high degree of efficacy. This was followed by a similar declaration from Moderna on November 30 and the market rose an additional 1.10%. The total run up for the month was 10.17%. Against the current events of rapidly spreading infection, falling economic activity and generally rowdy behavior by defeated President Trump, the market was clearly pricing a brighter future than dwelling on a dismal present. Other equity markets shared in the advance; the US Small Cap Index (Russell 2000) rose 18.28%, the developed economy index (MSCI EAFE) rose 15.36% and the emerging economy index (MSCI EMI) rose 10.17%. In terms of sectors, particularly strong performances were turned in by energy, financials and industrials. The large cap value stocks turned in a return of 12.19%, which powerfully outdistanced growth stocks at 0.50%. It was very much a month in which the pandemic blighted sector of the market came back.

Bonds

The US bond market was considerably more muted in its response. The long Treasury ETF (TLT) sold off 0.68% for the month, while the CPI-linked Treasury ETF (TIP) advanced 0.50% for a return differential of 1.18% between the two flavors of long Treasuries. This seemingly modest shift is actually 72% of a year's interest income with long Treasuries currently yielding 1.62%. With a hung Congress and genuine economic hardship in the streets, fiscal stimulus (aka deficit spending) stretches out to the horizon. The Treasury market has enjoyed a near 40year bull market. However, it now looks as if the market top may have been reached on August 4 when TLT traded at 171.57 and yielded

1.33%. It is currently trading at 8.2% below that high and we would be surprised to see it return to the August highs.

Currency

The trade weighted dollar fell 2.6% continuing a trend that has been strongly in place since the dollar's high on March 23. The currency is now off 10.26% from that high. Gold fell 3.72% in the month and is now 12.55% below the high of $2071 per troy ounce set on August 6 – nearly coincident with the bond market high. We interpret both the drooping dollar and declining price of gold as representing a relaxation of the flight to safety engendered by the combination of the pandemic and the fear of political turmoil in the US.

Economy

The markets are clearly signaling a willingness to close the Covid chapter of the book and move on to the next chapter. We think the real economy will follow suit but at a much more measured pace. The United States's particularly poor response to Covid has done enormous damage to small businesses and to the service trades. They will continue to suffer through the spring and only begin to recover in the summer. We do expect significant animal spirits and pent-up demand to be released by the ending of the epidemic and so the second half of the year could be a robust recovery for the survivors. It would be helpful if political partisanship could be set aside and the various factions would focus on problem solving rather than problem creation. But, fortunately, recovery is unlikely to hang on an outbreak of political rationality.

Guidance

In a year without ready historical parallels and with considerable back and forth, one could have done far worse than a strategy of stay the course. Provided the course you are staying is the correct one for your strategic objectives, we would not recommend a different approach at this time.