M.M.WARBURG & CO

BANK

ECONOMIC SITUATION AND STRATEGY

January 8, 2021

Storming capitol and virus mutation: Not ideal start in new year

Using the word "historic" to classify events is always a little problematic. Moments are often described as historic but then do not find their way into the history books. Wednesday's events in Washington, D.C., may well qualify, not only because rioters broke into the capitol, but especially because the sitting US president had urged them on in scarcely veiled terms to stage some kind of coup d'état. Let this sink in. Trump actually called on Vice President Mike Pence, who was presiding over the joint session of Congress that would officially confirm Joe Biden's election as US president, not to recognize the vote of the Electoral College. Then, he addressed these words to a "Save America" rally at the White House: "After this, we're going to walk down (*to the Capitol*) and I'll be there with you ... you'll never take back our country with weakness. You have to show strength, and you have to be strong." But even before this, Trump's behavior had raised many questions. At the latest, the recording of his telephone call to the state of Georgia's top election official should have made it clear that Trump (sounding almost deranged in the call) is willing to overstep any limits of common decency or constitutional constraints. One does not need much expertise in law to see that this behavior is an attempt, albeit amateurish, to subvert the country's democratic foundation. A new impeachment process may be undertaken in the coming days, and this episode may even end with Trump in prison. The courts will have to decide that, and we will not get carried away with speculation here. In our view, the more interesting question is what relevance these developments have for the capital markets.

At first glance, it could be argued that they have limited relevance. After all, US companies will continue to make money even if legal action is taken against Trump, and the days of his presidency are numbered in any case. However, this way of looking at it may be a little too simple. For, any country that gets into such a situation in the first place must have a serious problem. Obviously, the people are worrisomely divided and living in their separate "silos." Those are not good conditions for an economy's long-term prosperity. History provides few examples of societies whose ability to function was severely limited, but which were nevertheless economically successful in the long term. The good news is that the United States will be governed in a few days by a president who should be able to have a balancing influence and to bridge over the division at least to a certain extent. The two Senate seats won by Democrats in Georgia may also help stabilize the situation, since this will make gridlock between the two major parties accompanied by endless election campaigning much less likely. However, one should not assume the Democrats will be able to push through everything they want. With their gain of the two Georgia seats, the distribution of Senate seats now stands at exactly 50 for the Democrats and 50 for the Republicans. In this situation, the vice-president of the United States, Democrat Kamala Harris, will have the deciding vote. Not all legislation can be passed with such a marginal majority, however. It is possible to determine which legislative bills will get priority for passage and which will be blocked. Moreover, though slight, such a majority will accelerate approval of presidential appointments to the cabinet and various posts in federal agencies and the judiciary. Most laws, however, require 60 votes in the US Senate in order to pass. At most, the Democrats' simple majority be expected to suffice to pass legislation in matters of taxation. It will not be a complete walkover, and even the healthcare reform sought by many Democrats will probably have no great chance of success in this context.

However, even if the siege of the capitol and upcoming change of government should not significantly influence the broad stock indexes in the near term, some things are likely to change behind the scenes. The Democrats will probably feel motivated in this uncertain situation not to reduce government spending, but rather to increase it further. Consequently, inflation, or at least expectations of inflation, will presumably rise, while the US dollar could suffer. That would argue in favor of cyclical stocks, and less for technology stocks. Moreover, the time in which large-cap companies have substantially outperformed small caps might end, especially in the United States. From the standpoint of euro investors, who have achieved good performance in large US stocks by heavily overweighting technology, it might be time to take action. We advise keeping a close eye on this development. However, it likewise appears too early to bid growth stocks farewell, since interest rates in the United States will remain historically low in the coming years and thus structurally benefit companies promising higher earnings growth over relatively long periods.

As if these problems were not enough, another black swan has gradually ventured into the spotlight in recent days and weeks. We are referring to the coronavirus mutation observed so far mainly in Great Britain. This virus, somewhat cryptically designated as the B.1.1.7 variant, is suspected of being significantly more contagious than the original virus. Quite independently, a genetically similar mutation has emerged in South Africa that also seems to cause higher infection rates. We may conclude from this that the virus is able to mutate comparatively quickly, which poses a great challenge to the vaccination strategy. For, this finding makes it even more important that large parts of the population get vaccinated before the virus mutates to such an extent that a new vaccination wave would become necessary – with a new and correspondingly adapted vaccine. The problem is familiar from the influenza virus, but the logistical challenge of having to vaccinate a large part of the population in a few months does not exist in that case.

Epidemiological studies from Great Britain now suggest that the mutated virus' R number (average number of people to whom one infected person will transmit the virus) might be about 0.5 points higher. That does not sound like much, but concretely it means that one person could infect more than one other person even under lockdown conditions. That is not good news and poses the prospect of new problems if this variant should spread on a larger scale to the rest of the world. The numbers currently coming from Great Britain demonstrate that the danger is real. No statistical expertise is needed to see that things are going somewhat differently there than in most other countries. If one uses, for example, Apple mobility data to understand how severely a lockdown actually affects people, there is no doubt that public life has been more extensively impeded in recent weeks in Great Britain than, for example, in Germany.

Based on the experience gathered from lockdowns in recent months, we might therefore have expected occurrence of infection to stabilize in the meantime. Unfortunately, that has not happened. There are only a few countries in the world that exhibit more dynamic occurrence of infection than Great Britain. That could be an indication that this virus variant is not to be taken lightly. If this concern is confirmed, it might become necessary to extend the lockdowns and to vaccinate 80% of the population rather than 70%. That does not change our basically positive scenario, but could make the going a bit rougher. The first days of the new year show that 2021 promises to become as suspenseful as the past year.

Market Data Overview

Stock marktes	As of 08.01.2021 11:40	Change versus 01.01.2021 -1 week	07.12.2020 -1 month	07.10.2020 -3 months	07.01.2020 -1 year	31.12.2020 YTD
Dow Jones	31041	1,4%	3,2%	9,7%	8,6%	1,4%
S&P 500	3804	1,3%	3,0%	11,2%	17,5%	1,3%
Nasdaq	13067	1,4%	4,4%	15,0%	44,1%	1,4%
DAX	14068	2,5%	6,0%	8,8%	6,4%	2,5%
MDAX	31406	2,0%	6,6%	13,7%	11,0%	2,0%
TecDAX	3291	2,4%	5,4%	6,1%	8,4%	2,4%
EuroStoxx 50	3641	2,5%	3,2%	12,6%	-3,1%	2,5%
Stoxx 50	3188	2,6%	3,2%	9,5%	-6,8%	2,6%
SMI (Swiss Market Index)	10815	1,0%	4,2%	6,2%	1,2%	1,0%
Nikkei 225	28139	2,5%	6,0%	20,1%	19,4%	2,5%
Brasilien BOVESPA	122386	2,8%	7,7%	28,1%	4,9%	2,8%
Russland RTS	1459	5,1%	6,5%	27,5%	-7,0%	5,1%
Indien BSE 30	48783	1,9%	7,4%	22,3%	19,4%	2,2%
China Shanghai Composite	3570	2,8%	4,5%	10,9%	15,0%	2,8%
MSCI Welt (in €)	2734	1,9%	2,8%	9,1%	5,7%	1,9%
MSCI Emerging Markets (in €)	1322	2,6%	4,5%	14,8%	8,2%	2,7%
Bond markets						
Bund-Future	177,25	-39	184	312	513	-39
Bobl-Future	135,18	0	-35	10	99	0
Schatz-Future	112,29	1	-7	2	31	1
3 Monats Euribor	-0,55	3	0	-5	-17	-1
3M Euribor Future, Dec 2017	-0,56	0	-2	-5	-16	0
3 Monats $ Libor	0,23	0	0	0	-164	0
Fed Funds Future, Dec 2017	0,08	0	-1	0	-126	0
10 year US Treasuries	1,08	17	15	30	-74	17
10 year Bunds	-0,53	5	6	-4	-25	5
10 year JGB	0,04	2	2	2	6	2
10 year Swiss Government	-0,50	0	-2	-1	8	0
US Treas 10Y Performance	705,47	-1,5%	-1,3%	-2,4%	10,0%	-1,5%
Bund 10Y Performance	682,70	-0,3%	-0,4%	0,4%	2,8%	-0,3%
REX Performance Index	499,60	0,1%	-0,1%	0,2%	1,0%	0,1%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,04	2	5	-12	-19	2
IBOXX BBB, €	0,52	-4	-3	-37	-33	-4
ML US High Yield	4,95	-3	-19	-94	-104	-3
Convertible Bonds, Exane 25	8379	0,0%	2,6%	6,5%	8,9%	0,6%
Commodities						
MG Base Metal Index	368,02	3,8%	4,0%	19,9%	22,9%	3,8%
Crude oil Brent	54,81	5,6%	12,1%	30,2%	-19,6%	5,6%
Gold	1890,00	-0,4%	1,3%	0,3%	20,4%	-0,4%
Silver	27,12	2,8%	9,9%	14,4%	48,0%	2,8%
Aluminium	2028,25	2,8%	1,7%	15,1%	13,6%	2,8%
Copper	8167,00	5,4%	6,1%	22,5%	33,3%	5,4%
Iron ore	169,31	8,6%	17,3%	38,9%	80,6%	8,6%
Freight rates Baltic Dry Index	1448	6,0%	24,6%	-29,2%	83,1%	6,0%
Currencies						
EUR/ USD	1,2238	-0,3%	0,9%	4,0%	9,5%	-0,3%
EUR/ GBP	0,9005	0,6%	-1,2%	-1,2%	6,0%	0,6%
EUR/ JPY	127,10	0,5%	0,6%	1,9%	4,9%	0,5%
EUR/ CHF	1,0838	0,3%	0,3%	0,5%	-0,1%	0,3%
USD/ CNY	6,4622	-1,0%	-1,1%	-4,9%	-7,0%	-1,0%
USD/ JPY	103,82	0,6%	-0,2%	-2,0%	-4,3%	0,5%
USD/ GBP	0,74	0,6%	-2,0%	-5,1%	-3,4%	0,6%

Source: Refinitiv Datastream

Carsten Klude
+49 40 3282-2572
cklude@mmwarburg.com

Dr. Rebekka Haller
+49 40 3282-2452
rhaller@mmwarburg.com

Martin Hasse
+49 40 3282-2411
mhasse@mmwarburg.com

Dr. Christian Jasperneite
+49 40 3282-2439
cjasperneite@mmwarburg.com