



- ⇒ Markets Take a Breather
- ⇒ Volatility Likely to Continue
- ⇒ Vaccines Arriving

Markets took a brief breather this week as investors paused the relentless optimism that's motivated markets ever since the presidential election. All eyes, however, were on the GameSpot showdown between retail Redditors and short selling hedge funds.

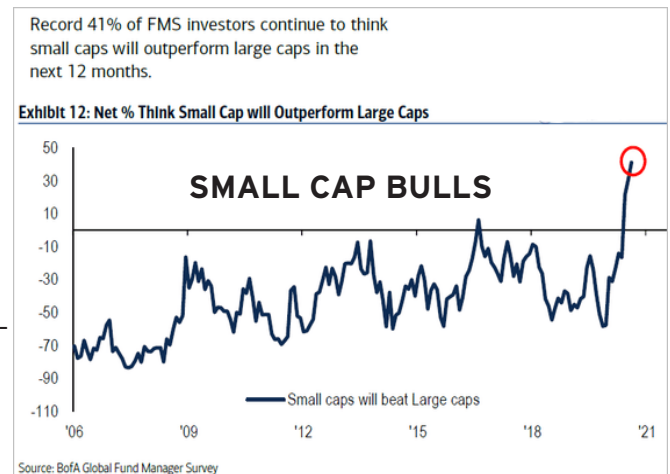
MARKETS RECAP

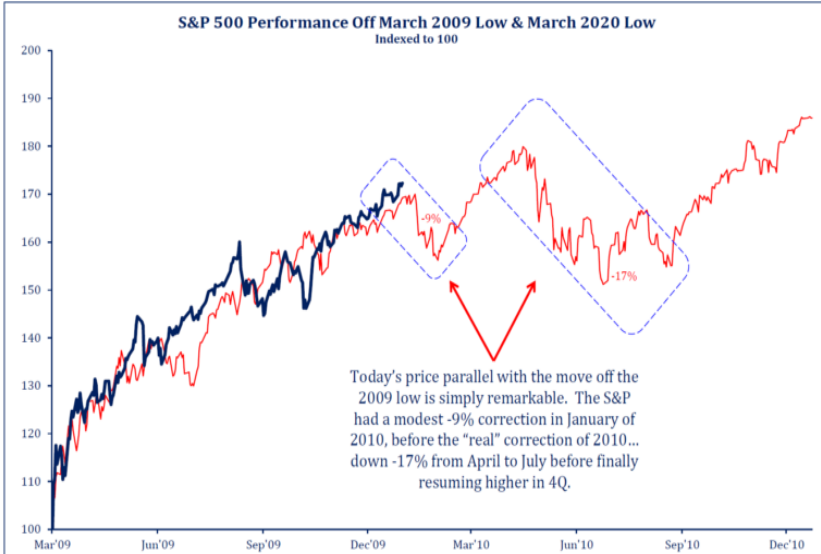
1. On Wednesday markets suffered their worst day since last October.
 - The likeliest reason for this week's minor pullback is that the market has been relentlessly optimistic since the election in November
 - Sometimes the market only falls because it has climbed so high.
 - The S&P 500 hit another new All-Time High on Monday—investors considered these heights, the new COVID variants, vaccine delivery interruptions, and data showing a slower recovery in December and tapped the brakes.
 - Wednesday's close was only a little over **-2.5%** away from Monday's all-time high.
 - Stock indexes falling below their yearly starting price is the Rule rather than the Exception:
 - Consider that, since 1980, the S&P 500 has experienced a drop below its yearly starting price for 37 out of the past 40 years.
 - In other words, it has only ever experienced positive performance from its yearly starting price 3 times since 1980.
 - After all, the average intra-year drop (peak-to-trough) is **-14.3%**
2. Volatility is up (VIX is at around 28; recall that it's been elevated, above 20, since last February) and we shouldn't be surprised if it hangs around for the next few weeks.
3. The past two weeks investors have started to rethink the "Reflation Trade". Since January 14th:
 - Communications Sector (FB, GOOG, Netflix): 3%
 - Technology Sector: 0.2%

Meanwhile:

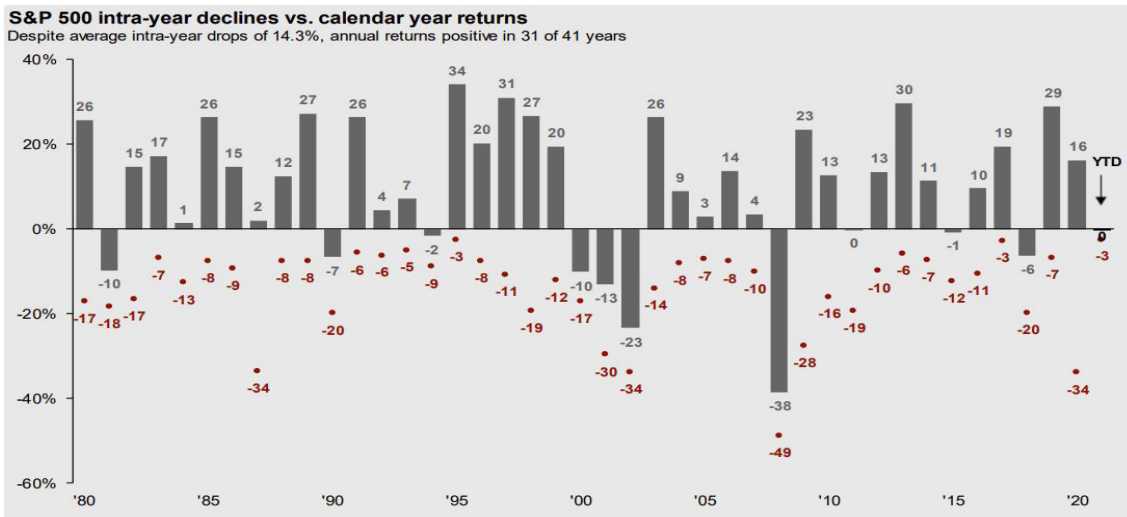
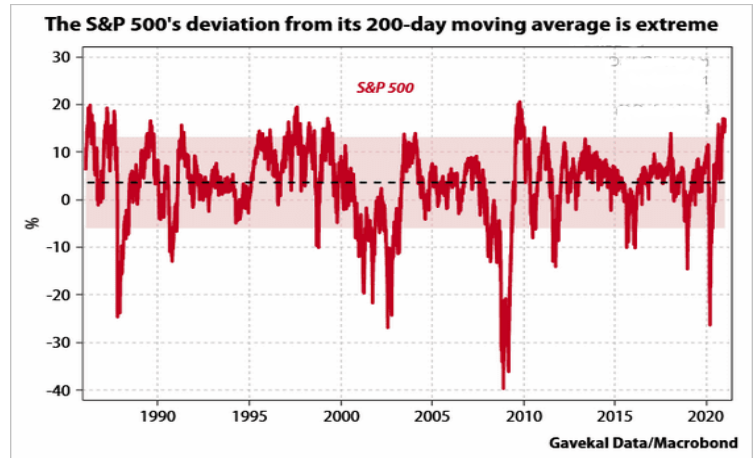
 - Energy: **-11.5%**
 - Materials: **-7.7%**
 - Financials: **-8%**
4. Though they were down today, Small Caps are still the dominant asset class so far this year.
 - The Russell 2000 is up about 5.5% YTD.

Optimism about small caps is off the charts, as you can see on the table nearby.



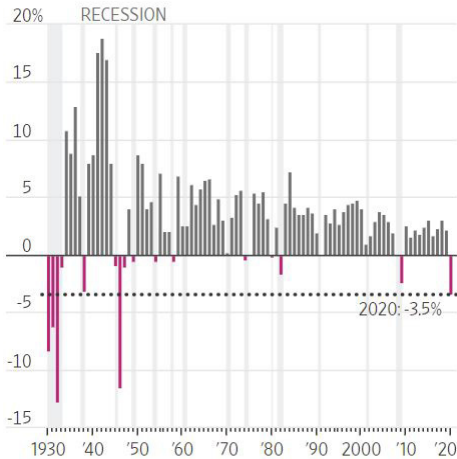


- S&P 500 trajectory looking a lot like recovery after the Great Financial Crisis bottom.
- If history is any guide—granted, a big if—we may be in store for a period of volatility and a correction.
- (below left) VIX spike yesterday, remains elevated.
- (below right) SPX deviation from 200-day MA historically high.



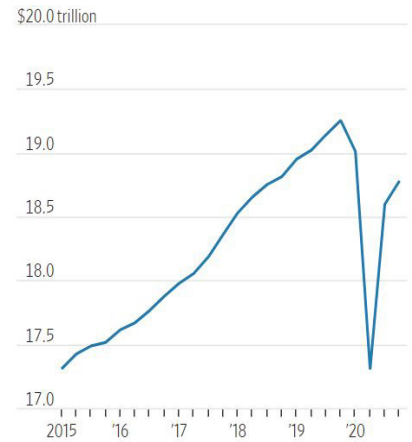
ODDS & ENDS

Yearly change in gross domestic product



- ⇒ GDP growth came in at 4% for the fourth quarter (see right).
- ⇒ Annual growth came in negative as we suffered the worst contraction since 1946.
- ⇒ The recovery so far is outpacing the Great Recession.

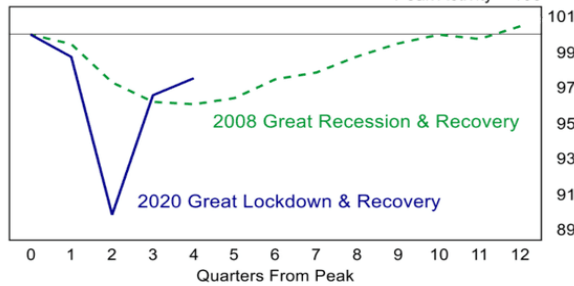
Gross domestic product, by quarter



Real GDP in Current vs Previous Cycle

Incomplete Recovery in Real GDP

Peak Activity = 100

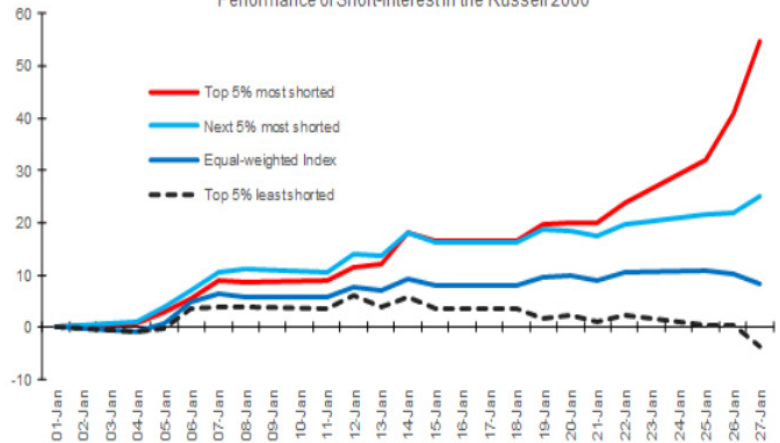


Note: Quarterly data through 2020 Q4. Seasonally adjusted at annual rates.
 Peak activity for 2008 recession defined as Q2 2008.
 Peak activity for 2020 recession defined as Q4 2019.
 Source: Mizuho Securities, BEA.

- ⇒ In addition to GameStop, Redditors are bidding up the most shorted stocks in the Russell 2000.



Performance of Short-Interest in the Russell 2000



WHAT WE'RE WATCHING

- ⇒ We're expecting more turbulence as the market digests incoming news on vaccines and their delivery.
- ⇒ J&J's single-dose is 85% effective against severe COVID cases (66% effective overall) and Novavax's double-dose shows 89% effectiveness (but less effective against South Africa variant).
- ⇒ Lots of data next week: manufacturing, services indexes, January jobs numbers.