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THE ECONOMY AT A GLANCE

ECONOMIC HIGHLIGHTS

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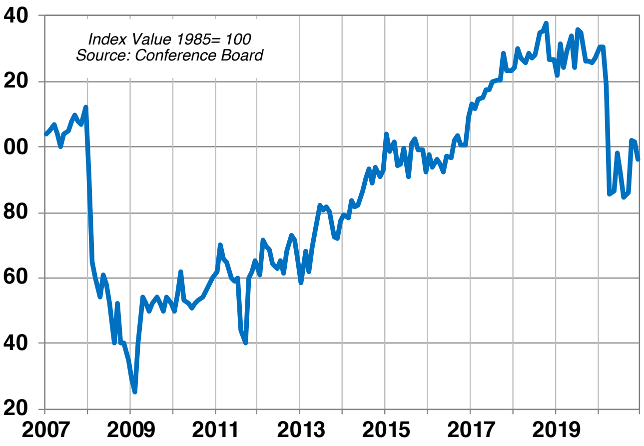
CONSUMER CONFIDENCE BOUNCES AROUND

Back in 2007, the Consumer Confidence index peaked at 112 in November, before falling to a low of 25 in February 2009 (as the bear market was bottoming). The index did not reclaim prior highs for another eight years. This time around, the index fell "only" to 96 in November from 130 in February. The slope and speed of the recovery this time will depend on several factors: the distribution of COVID-19 vaccines, a second fiscal stimulus plan, and behavioral changes among consumers on the other side of the pandemic. From an investment standpoint, we have found that the bottom of the consumer confidence cycle (when everybody has given up on a recovery) is a good time to buy stocks. In other words, consumer confidence is often a contrarian indicator.

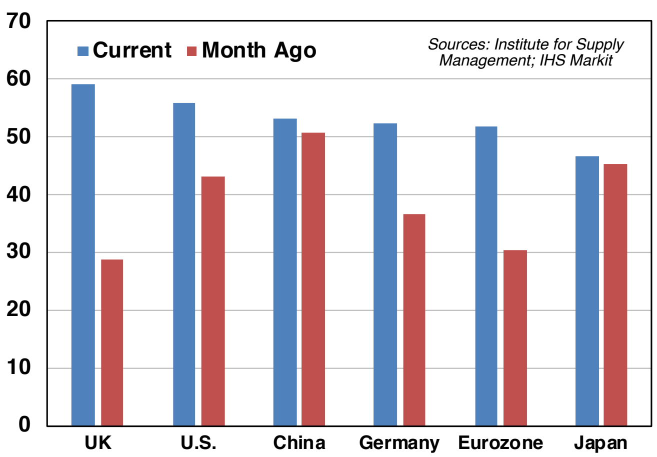
CONSUMER CONFIDENCE



MANUFACTURING FALTERING IN U.K., EUROZONE

The UK reported a November manufacturing PMI reading of 47.4 (below the level of 50 that indicates economic expansion.) Though that's quite a recovery from 8.2 in April, it's still down from 52.1 in October and 59 in August. The Eurozone recorded a 45.1 PMI in November, up from 13.6 in April but also down from October and August. Nations that have heavier exposure to industrial activity, such as Germany and the U.S., have reported more consistent PMI readings, as has China. Indeed, China has led the global recovery. In February, China's PMI reading was 40.3 -- but as of August, it had risen to 53.1. Meanwhile, Japan is one of the few major industrialized nations that has not yet seen a manufacturing sector recovery.

PMI SURVEY RESULTS



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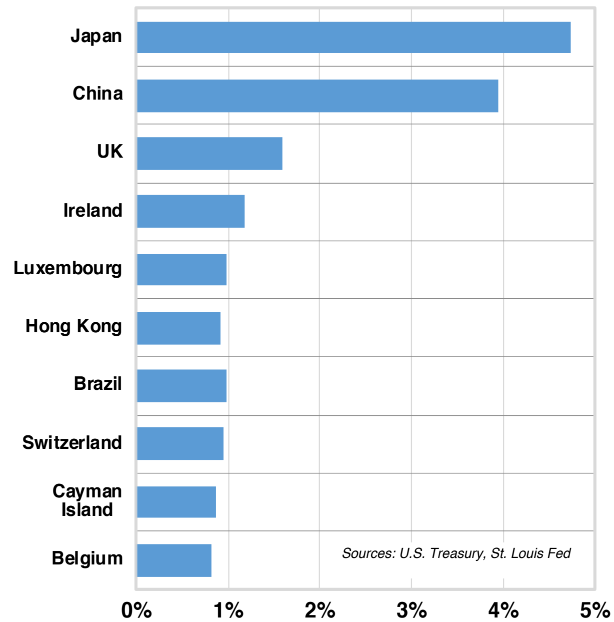
LARGEST OWNERS OF U.S. DEBT

Total public debt owed by the U.S. government was $26.9 trillion at the end of 3Q, up 16% from year-end as the government has increased spending to keep the economy afloat during the pandemic. Outside of U.S. investors, the two largest holders of U.S. public debt are Japan, which owns 5% of the debt, and China, which owns 4%. Other nations among the top 10 holders own 8% of the debt, so the top 10 holders collectively own 17%. The grand total of U.S. debt owned by foreign holders is $7 trillion, or about 26%. We suspect that these holders are unlikely to push the U.S. government hard on reducing debt or to dump their holdings into the bond markets. Local U.S. holders can rest (relatively) assured that the government's printing presses will keep pumping out money until all are paid. Japan's holders are long-term in nature and China has no reason to sell a large portion of its holdings: the increase in supply would depress the price of the balance of its holdings, and may even weaken the dollar further, setting off trade repercussions. We expect to see strong demand for U.S. fixed-income securities (and thus low interest rates) in the quarters ahead.

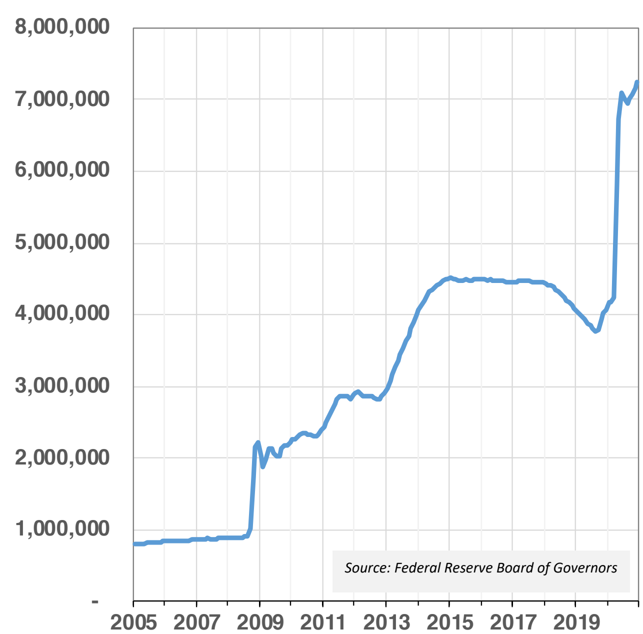
LARGEST FOREIGN U.S. DEBT HOLDERS



RATES VERY LOW FOR VERY LONG

The Federal Reserve expects to keep interest rates at the current level of 0%-0.25% until "labor market conditions have reached levels consistent with the committee's assessments of maximum employment and inflation has risen to 2% and is on track to moderately exceed 2% for some time." With the unemployment rate at 6.7% while COVID-19 cases surge, and core measures of inflation just above 1.1%, we think the Fed will keep the fed funds rate low until at least 2022. But that doesn't mean the central bank won't be busy. The Fed will continue to increase its holdings of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month. These purchases help to smooth market functioning and accommodative financial conditions, supporting the flow of credit to households and businesses. One thing we don't expect the Fed to do is to lower interest rates below zero. Although that strategy has been implemented in some countries, it is not clear to Chairman Powell that the tool works. Further, he does not think it is appropriate in the U.S. given the reliance of corporations and investors on money-market mutual funds.

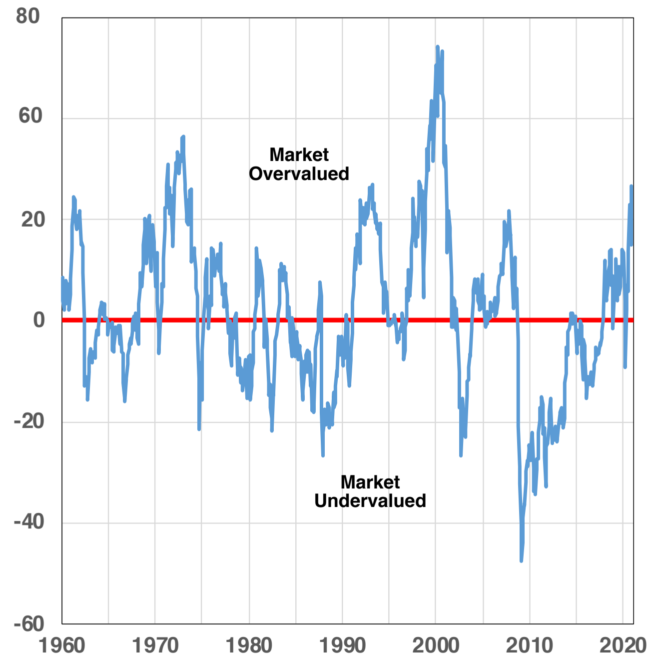
FED BALANCE SHEET (FED ASSETS, $ MIL)



STOCKS STILL ABOVE FAIR VALUE

Stock prices, as expressed by the S&P 500, are above fair value (which our model pegs at closer to 3000 due to the earnings weakness in 2020). Our valuation model for the stock market takes into account factors such as stock prices, five-year normalized earnings (three historical years, two forward-looking), GDP, inflation, and T-bond and T-bill yields. We note that stocks rarely trade right at fair value. Since 1960, on average, the index has traded at a tight 2% above fair value, but the standard deviation to the mean is 16%. As such, we normally expect the S&P 500 to trade between 14% undervalued and 18% overvalued. At current prices, the stock market is approximately 15%-20% above fair value, implying that investors are quite optimistic about equities in the coming months. While bullish for 2021, we'd feel better about the outlook for stronger stock returns if val-uations were not so stretched. Several factors could improve valuations: a pullback in stock prices, lower bond yields, or better earnings. Still, given the current fully valued level of the market, disappointments could be painful (and offer buying opportunities) given low interest rates and prospects for growing earnings next year.

S&P 500 VALUATION MODEL (0% = Fair Value)



ECONOMIC CALENDAR

Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
22-Dec	Real GDP	3Q	33.1%	33.1%	33.1%	NA
	GDP Price Index	3Q	3.6%	2.6%	3.6%	NA
	Existing Home Sales	November	6.85 Mil.	6.90 Mil.	6.64 Mil.	NA
	Consumer Confidence	December	96.1	97.5	97.5	NA
23-Dec	Personal Income	November	-0.7%	-0.2%	-0.2%	NA
	Personal Spending	November	0.5%	0.4%	0.3%	NA
	New Home Sales	November	999 K	995 K	990 K	NA
24-Dec	Durable Goods Orders	November	1.3%	1.0%	0.8%	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
4-Jan	Construction Spending	November	1.3%	NA	NA	NA
5-Jan	ISM Manufacturing	December	57.5	NA	NA	NA
6-Jan	Factory Orders	November	1.0%	NA	NA	NA
7-Jan	Trade Balance	November	-63.1 Bln.	NA	NA	NA
	ISM Non-Manufacturing	December	55.9	NA	NA	NA
8-Jan	Non-farm Payrolls	December	245 K	NA	NA	NA
	Manufacturing Payrolls	December	27 K	NA	NA	NA
	Average Weekly Hours	December	34.8	NA	NA	NA
	Average Hourly Earnings	December	0.3%	NA	NA	NA
	Unemployment Rate	December	6.7%	NA	NA	NA
	Consumer Credit	November	7.23 Bln.	NA	NA	NA