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WEEKLY MARKET RECAP

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Summary for the week ending on Friday, 18 December

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ECONOMIC AND POLITICAL BACKDROP

The US

After weeks of stalled negotiations, signs of progress emerged in congressional attempts to craft a new stimulus bill. A bipartisan group of lawmakers convened last Monday to discuss a new USD 908 billion package. The group was unable to come to an agreement, but reports later surfaced that the two sides had agreed to temporarily put aside two of the thorniest issues: Democratic demands for further aid to states and localities and Republican demands for a litigation shield for businesses and other institutions. On Tuesday, stocks seemed to get a lift after Senate Majority Leader Mitch McConnell vowed that Congress would remain in session until a deal was reached.

By the end of the week, the outlines of a roughly USD 900 billion package appeared to emerge, including roughly USD 600 direct payments to individuals and supplementary federal unemployment assistance of USD 300 per week. Stocks pulled back on Friday, however, on reports that Republicans were demanding a provision barring the incoming Treasury secretary from providing the Federal Reserve with more emergency lending funds in 2021.

The rollout of the Pfizer-BioNTech coronavirus vaccine last Monday also seemed to bolster sentiment. On Thursday, a US Food and Drug Administration (FDA) advisory panel gave its approval to Moderna's similar mRNA vaccine, which would nearly double the expected number of total doses available by the end of the year. Current coronavirus trends remained daunting, however, with the US setting records for daily deaths. The heavily populated southern part of California emerged as the new epicentre of the crisis, despite strict lockdown measures.

The toll the virus is taking on economic activity also became clearer during the week. On Wednesday, the Commerce Department reported that retail sales contracted 1.1% in November, roughly triple the expected decline and the worst showing since April. Weekly jobless claims, reported Thursday, reached 885,000, well above expectations and the highest level since early September. Continuing claims fell back to a new pandemic low, however. A pickup in auto and parts manufacturing helped industrial production grow 0.4% in November, a bit more than expected, but October's strong gain was revised lower from 1.1% to 0.9%. Housing data generally remained solid.

Europe

French President Emmanuel Macron self-isolated after displaying symptoms of COVID-19. Macron had attended a series of high-level events in the past week, including a summit of EU leaders. After his announcement, the prime ministers of Spain and Portugal, who met with him at a dinner, quarantined themselves as a precaution.

Germany tightened lockdown restrictions to tame a strong resurgence in coronavirus infections and offered more support to affected businesses. Dutch Prime Minister Mark Rutte announced a second, strict lockdown that included the closure of

schools and shops for at least five weeks. Prime Minister Giuseppe Conte said severe restrictions might be imposed over Christmas to prevent a third wave of infections in Italy, where there is no nationwide lockdown. European Commission President Ursula von der Leyen said the EU would begin vaccinating against COVID-19 on 27 December, although some member states have announced different start dates.

The European Central Bank (ECB) lifted a ban on European banks paying dividends but capped pay-outs and share repurchases at a combined 15% of an institution's 2019 and 2020 profits or 0.2% of a lender's key capital ratio, whichever is lower.

The Swiss National Bank (SNB) kept its key policy rate unchanged at -0.75%. Norges, Norway's central bank, left its main rate at 0% but signalled that an expected improvement in the economy next year could support a rate increase in mid-2022.

The UK

The UK imposed its toughest tier-4 regime – England's highest level of coronavirus restrictions – on London, South East and east of England amid a sharp rise in infections. Millions of people across the UK have seen their festive plans severely restricted or scrapped.

Negotiations on a post-Brexit trade deal are in a "serious situation," UK Prime Minister Boris Johnson said after a call with von der Leyen late Thursday. He said again that a no-deal scenario was "very likely" unless the EU's position changed "substantially." Von der Leyen said in a statement that both sides welcomed "substantial progress on many issues" but added it would be "very challenging" to bridge the "big differences, in particular on fisheries." The EU Parliament set a Sunday deadline for the talks, allowing time to ratify legislation before 31 December, when the transition period ends. The UK Parliament is on standby for an emergency sitting before Christmas to consider the approval of a deal.

The Bank of England (BoE) lifted a ban on banks' pay-outs, urging banks to limit their dividends to 25% of their cumulative profits in 2019 and 2020 or 0.2% of the value of their riskiest assets, whichever is highest.

The BoE held interest rates at 0.1% and kept the target for its asset purchase programme unchanged, as expected. Policymakers reiterated they did not intend to tighten monetary policy until there was evidence that "significant progress" was being made in achieving the 2% inflation target.

Japan

The Japanese government lowered its GDP growth forecast for the 2020 fiscal year (ending March 2021) to a 5% contraction from its July forecast for a 4.5% contraction. The changes reflect the winter resurgence of infections and the reimplementation of restrictions on travel and other business closures. Conversely, the government concurrently upwardly revised its fiscal 2021 GDP growth forecast to around 4%, from its earlier 3.4% growth forecast, due to the benefits from its stimulus efforts. According to a Reuters poll of economists, six out of 40 respondents expect Japan's economic growth to return to pre-pandemic levels in fiscal 2021, 15 expect this to happen in fiscal 2022 and 19 said this would take place in fiscal 2023 or later.

The Japanese government is planning a record JPY 107 trillion budget for fiscal year 2021. The proposed budget addresses coronavirus response initiatives, social welfare and additional military spending. The spending plan is in addition to three extra budgets to combat the economic drag on the economy from the global pandemic. The third extra budget and the fiscal 2021 budgets will be presented to the Cabinet together as a 15-month budget. Debt-servicing costs are forecast to total approximately JPY 24 trillion in fiscal 2021, an all-time high. The Bank of Japan made no changes to its monetary policy stance at the December meeting, stating its liquidity-boosting measures would continue through September 2021 or longer as conditions warranted.

Tokyo reported more than 800 new infections on Thursday, and a nationwide daily total climbed to 3,200, a record high. The increase in new cases caused Tokyo's government to raise its medical alert level to 4, its highest, for the first time since the inception of the four-stage scale in July. Coronavirus patients in the region's hospitals have increased to approximately

2,000 and are occupying more than 60% of Tokyo's 3,000-bed capacity. Severe cases, requiring ICU care, have already filled one-third of its 200 ICU beds, and hospitals are struggling to find qualified staff.

In response to the nationwide increase in new cases, Prime Minister Yoshihide Suga suspended the government's domestic tourism programme subsidies through the New Year holidays. The Japanese government has contracted with Pfizer for 120 million vaccine doses, enough for approximately 60 million people, half of its population.

China

On Friday, the US Commerce Department said it was adding Semiconductor Manufacturing International Corp. (SMIC) to its so-called Entity List, which deprives targeted companies from accessing US technology ranging from software to circuitry. The addition of SMIC to the export blacklist came after the US found "evidence of activities between SMIC and entities of concern in the Chinese military industrial complex," according to the Commerce Department's statement.

The US's move against SMIC, which is central to Beijing's drive to build a self-sufficient chip industry, marked the latest in a string of Trump administration-directed actions targeting Chinese tech companies. Deteriorating Sino-US relations have dampened investor sentiment this year as both sides clashed on issues, including trade, Hong Kong protests and managing the coronavirus outbreak.

Even so, demand for Chinese assets has stayed resilient amid ample evidence that the economy is firmly recovering after being among the first countries to contain the pandemic. On Tuesday, official data revealed that November industrial output, fixed asset investment and retail sales grew strongly from year-ago levels. The November data raised expectations that China's fourth-quarter economic growth would accelerate from the third quarter, when GDP grew 4.9% from a year earlier. Despite signs of growing economic momentum, the yield on China's sovereign 10-year bond ended nearly unchanged for the week until Friday morning.

EQUITY MARKETS

Last week, MSCI All Country World Index (ACWI) returned 1.6% (15.6% YTD).

In the US, the S&P 500 returned 1.3% (16.9% YTD). The major indexes reached record highs as expectations grew for the passage of another federal coronavirus relief package. Information technology stocks outperformed within the S&P 500, helped by gains in Apple and Microsoft. Energy stocks lagged despite oil prices touching nine-month highs on strong demand from India and China. Small caps outperformed large caps and growth outperformed value, with Russell 2000 returning 3.1% (19.6% YTD), Russell 1000 Growth 3.0% (37.3% YTD) and Russell 1000 Value 0.2% (1.5% YTD).

Trading volumes were muted through much of the week in advance of the rebalancing of the S&P 500, which electric carmaker Tesla was set to join the following Monday. USD 110 billion in shares were expected to change hands on Friday, as mutual funds and exchange traded funds (ETFs) that attempt to mirror the returns of the S&P 500 adjusted their portfolios. Several large ETFs that target other benchmarks also rebalanced.

In Europe, the Euro Stoxx 50 rose 1.7% (-2.8% YTD) on optimism surrounding coronavirus vaccinations, better-than-expected readings from purchasing managers' indexes in key eurozone economies and signs of progress in US congressional negotiations for another round of fiscal stimulus. In local currency terms: Germany's DAX rose 3.9% (2.9% YTD), France's CAC 40 ticked up 0.4% (-5.4% YTD) and Italy's FTSE MIB added 1.3% (-4.5% YTD). Switzerland's SMI returned 1.3% (1.5% YTD). The euro appreciated against the US dollar, ending the week at 1.23 USD per EUR, up from 1.21 at the end of the previous week.

In the UK, the FTSE 100 returned -0.1% (-10.5% YTD) as the British pound strengthened to 1.35 USD per GBP from 1.32 on earlier optimism over a trade accord with the EU. UK FTSE 100 stocks tend to fall when the pound rises because many companies in the index are multinationals that generate significant overseas revenues. The FTSE 250 returned 2.5% (-6.3% YTD).

Japanese stocks posted gains for the week. The Nikkei 225 returned 0.4% (14.3% YTD), the broader large-cap TOPIX 0.6% (5.9% YTD) and the TOPIX Small Index 0.2% (-0.9% YTD). The yen strengthened versus the US dollar, trading at JPY 103.3 versus USD, compared with 104.0 the week before.

Emerging markets and other markets

MSCI Emerging Markets Index returned 0.9% last week (16.4% YTD).

Chinese stocks posted a weekly gain despite recording mild losses on Friday, when the US announced it was blacklisting China's top chipmaker and more than 60 other companies for national security reasons. For the week, the large-cap CSI 300 Index returned 2.3% (24.6% YTD) and the Shanghai Composite Index 1.4% (13.9% YTD).

In Turkey, the BIST-100 Index returned 2.8% (25.1% YTD). Equity investors did not seem to react negatively to the imminent likelihood of long-threatened sanctions from a NATO ally.

Late the previous week, the US House of Representatives and the US Senate passed – with broad support that could override a possible presidential veto – the National Defence Authorisation Act for fiscal year 2021. Part of this military spending legislation requires President Trump to impose sanctions on Turkey – within 30 days after the bill becomes law – for its 2019 purchase of the S-400 missile defence system from Russia. President Erdogan and other Turkish leaders and the media condemned the sanction efforts.

Given Trump's hesitation to impose sanctions on Turkey, T. Rowe Price sovereign analyst Peter Botoucharov believes the initial sanctions, which have been technically required under the provisions of the Countering America's Adversaries Through Sanctions Act, are likely to be limited to select individuals and are unlikely to directly impact banks or corporations and their access to financing. Botoucharov notes it will be up to President-elect Joe Biden, after he takes office, to dial up sanctions further or to find some common ground for dialogue to resolve the situation.

In South Africa, the FTSE/JSE All Share Index returned 0.7% (7.8% YTD). The market was closed on Wednesday for a holiday.

In the latter part of the previous week, Health Minister Zweli Mkhize declared the country was in the "second wave" of the coronavirus and cautioned that citizens should expect a faster rate of increase in cases and a higher peak in the number of cases than earlier this year. On Monday night, President Cyril Ramaphosa addressed the nation and announced the government was introducing some additional social gathering and business restrictions, particularly in certain coronavirus "hot spots." Ramaphosa also increased the hours of an evening curfew – now 11:00pm until 4:00am – and ordered the closure of bars, restaurants and various nonessential businesses at 10:00pm so that people have time to get home before the curfew begins.

While T. Rowe Price credit analyst Roy Adkins believes these restrictions could help, he also believes that reversing the increase in cases will be a tall order. Ramaphosa says that much has been done to prepare the country to deal with the coronavirus during the first lockdown, but media reports suggest that hospital capacity in various hot spots is at its limit.

FIXED INCOME MARKETS

Last week, Bloomberg Barclays (BB) Global Aggregate Index (hedged to USD) returned -0.1% (5.3% YTD), BB Global High Yield Index (hedged to USD) 0.5% (5.2% YTD) and BB Emerging Markets Hard Currency Index 0.5% (6.1% YTD).

Long-term Treasury yields increased modestly through most of the week, as fiscal relief hopes and optimism about vaccine distribution outweighed the generally disappointing economic data. At its 15-16 December meeting, the Federal Open Market Committee (FOMC) held its policy rate steady, as expected, and elected to maintain the current composition of its bond purchases, disappointing some investors who had hoped for an increase in the Fed's buying of long-term bonds. In an adjustment from its prior statement, the FOMC said it would continue buying Treasuries and agency mortgage-backed securities at its current pace "until substantial further progress has been made toward the Committee's maximum

employment and price stability goals." The statement caused yields to briefly increase, but the move was quickly reversed as Fed Chair Jerome Powell's comments to the press and the FOMC's updated Summary of Economic Projections were perceived as dovish. The 10-year Treasury yield ended the week at 0.95%, up from 0.90%.

Encouraging developments appeared to reduce investor demand for assets perceived as havens, sending core eurozone bond yields higher and offsetting concerns about tougher coronavirus restrictions and Germany's plan for hefty debt issuance next year. Over the week, German 10-year bund yield moved up to -0.57% from -0.64%. Peripheral eurozone bond yields ended the week flat.

UK sovereign yields generally increased on growing optimism that the UK and EU could reach a trade agreement. However, dovish messaging from the BoE amid an uncertain economic outlook, as well as growing worries over tighter coronavirus restrictions, somewhat curbed the rise in gilt yields. The 10-year gilt yield ended the week at 0.25%, up from 0.17% at the end of the previous week.

Low levels of primary issuance, along with a year-end buying trend, drove investment-grade corporate bond credit spreads tighter throughout the week. Trading volumes were lower than average, and expectations for issuance remain subdued through year-end. Solid equity gains supported the performance of high yield bonds, and credit spreads tightened across all quality tiers. Investors were mostly focused on the primary calendar as the below investment-grade market saw a high volume of new deals. Technical conditions were mixed, however, as high yield funds industrywide reported modest outflows.

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