BALDINI
INVESTMENT STRATEGIES

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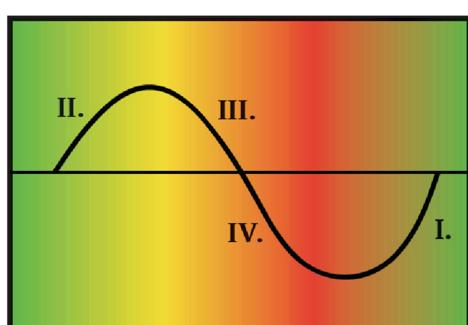
Month in Review

The S&P 500 lost 1.11% in January—the first negative month since October—as volatility and trading volumes surged. An historic run on thinly-traded, heavily-shorted stocks inflicted hundreds of billions of dollars in losses on some hedge funds and forced others to raise cash to reduce risk. A measure of stock market volatility shot up 62%--the second largest single-day spike in over a decade. It's time to check our indicators and see how the sharp rise in volatility has affected them. I have also provided a brief summary of my thoughts on the market going forward.

I. CREDIT CYCLE

PHASE II: EXPANSION



Financial conditions continue to be very favorable due to extraordinary interventions by the Federal Reserve. At some point, the Fed will have to scale back its purchases of government securities, and when it does interest rates will need to rise to attract new investors. Even the suggestion that a reduction is imminent would send rates higher and tighten financial conditions. Hence Fed Chair Jerome Powell's insistence that day is a long way off. "When the time comes to raise interest rates, we'll certainly do that, and that time, by the way, is not any time soon," he said in a recent interview hosted by Princeton University. That time will surely come, but for now central banks are injecting $1.3 billion in liquidity every hour and the credit cycle is alive and well.

II. RISK LEVEL INDICATORS

US STOCKS: Guarded

The Risk Level for **US STOCKS** is **GUARDED**. While January was a volatile month for stocks with scant returns at the index level, there were some big winners and losers in individual names. If history is a guide, this may be a good roadmap for 2021. A more volatile market with a wider dispersion of returns among individual stocks would be typical of this phase of the economic recovery. "We're at the beginning of a new economic cycle and that usually means a multi-year bull market run has begun," says Mike Wilson, CIO for Morgan Stanley. "However, new bull markets can get exuberant at times and need to correct. Our advice here is to take a pause and observe a bit as these excesses are wrung out." The SWING INDICATORS have reversed up so short-term momentum is positive.

INTERNATIONAL STOCKS: GUARDED

The Risk Level for **INTERNATIONAL STOCKS** is **GUARDED**. Global GDP growth has been held back by slow vaccine rollouts, and double-dip recessions are now expected in Japan, the eurozone, and the UK. China is the exception as its economy has roared back to pre-pandemic levels, reporting 6.5% growth in the 4th quarter and 2.3% for the full year. The nation's factories have ridden an export boom in medical equipment and consumer goods, including 224 billion masks or almost 40 for every man, woman, and child on the planet outside of China according to Bloomberg News. Just as China's economic recovery is ahead of the US, so is its monetary policy. The People's Bank of China (PBOC) appears to be turning more hawkish, draining cash from the financial system at the end of the month and warning about potential asset bubbles. Interestingly, the liquidity squeeze in China coincided with the sudden increase in volatility in US markets. Looks like the Robinhood raiders might have had some help in triggering the most significant hedge fund deleveraging event since March.

US FIXED INCOME QUALITY: HIGH

The Risk Level for **US FIXED INCOME QUALITY** is **HIGH**. After months of languishing near record lows, 10-year Treasury yields pushed back above 1%, the highest level since March 2020. It's noteworthy that the move came in the same week as the attack on the Capital and the weakest employment report in eight months. A key factor in the rise were the Georgia run-off elections that tipped the Senate in favor of the Democrats. The Biden administration has laid out ambitious plans for more fiscal stimulus. Even if the spending falls short of the goal, the bond market is pricing in stronger growth and higher inflation because of it. The BOND INDICATORS remain negative and we continue to underweight them.

III. LOOKING AHEAD

STIMULUS RESPONSE

The macro data is painting a mixed picture of the US economy. Manufacturing and service activity continue to expand and housing is an area of strength, with construction starts rising in December at the fastest pace since 2006 and accelerating home prices. On the downside, COVID is taking a toll on the labor market again. December was the first month since April in which the US economy lost jobs. Can the markets continue to look past the current economic slowdown, as they did last year when the global economy contracted by 4 percent yet stocks rose 13 percent worldwide? With government stimulus worth close to 10% of GDP in the pipeline, we wouldn't bet against it.

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