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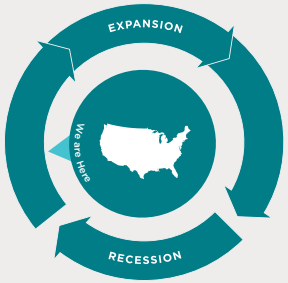
Cycle Watch | Recovery downshift

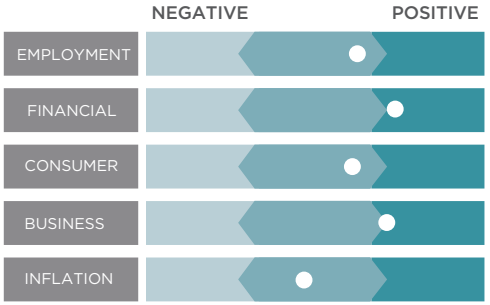
Economic and financial commentary as of November 2020

Business Cycle Update



Gross Domestic Product growth for Q3 showed a record surge, but the economic recovery has slowed recently with dips in job gains and consumer spending (although still historically strong). The business sector continues to show momentum and could help maintain above-trend growth into 2021, as long as the pandemic spread can be kept at bay. Policy support for the recovery has become more mixed in recent months. While the Fed has promised to maintain a highly accommodative monetary policy for some time, further fiscal stimulus is on hold until after the November elections. The key for a strong recovery remains widespread vaccine availability, which hopefully will occur in the first half of 2021.

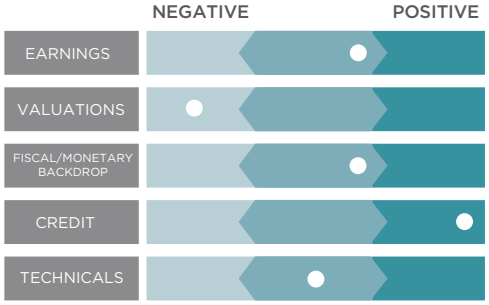
Economic Review



Nationwide Economic Dashboard, November 2020

Some components of the economic recovery downshifted in recent months, but this was expected given the unsustainable surge in activity during the summer. Job growth, while still well above normal, slowed in September and October, but the unemployment rate dropped to its lowest level since March. Additionally, business surveys remained strong with improved hiring expectations by service industries and for small businesses. Retail spending jumped in September and is now 4.2% above its pre-pandemic level and up 5.4% from a year earlier. Big-ticket expenditures remain especially hot, with continued strong increases in auto (both new and used) and home sales. Economic growth is expected to slow in Q4, but should remain well above trend into 2021 as the recovery continues.

Financial Review



Nationwide Financial Market Dashboard, November 2020

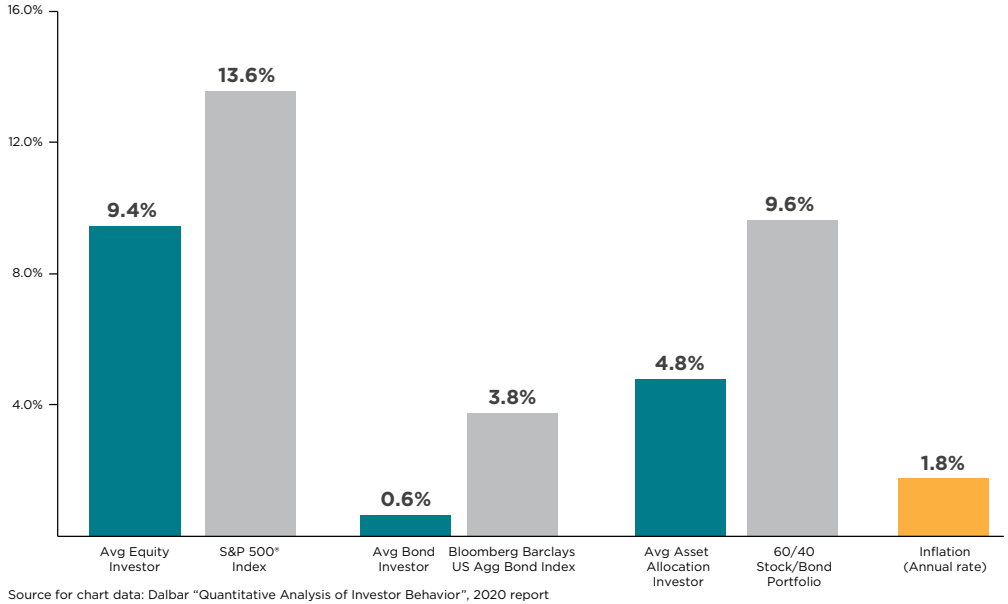
Equity markets are in a period of directionless volatility as improving earnings and ample liquidity have offset concerns about rising coronavirus cases and economic uncertainty. Despite recent weakness, the S&P 500® Index has been resilient throughout 2020 given the levels of unprecedented stress. Long-term interest rates rose in October, moving near the top of their post-pandemic range, but remain at historically low levels with the prospect of Fed tightening far into the future. Stock market is likely to remain elevated due to continued uncertainty around the COVID-19 pandemic, worries about the economic rebound and the outcome of the presidential election.

Financial market insight: Emotional investors lose ground

In periods of uncertainty, investors tend to want to "do something," which often leads to the panicked selling we saw in March, and occasionally the panicked buying we saw in certain segments of the market in August. A recent DALBAR survey shows the price emotional investors pay in lagging performance. Over the past 10 years (2009-2019), the average equity investor underperformed the S&P 500® Index by more than 4% per year, while the average bond investor underperformed the Bloomberg Barclays US Aggregate Bond Index by more than 3%. (See chart at right.) The performance lag is due largely to the difficulty investors face when trying to time the market and the penalty they incur from trading on emotion. Investors will need to temper their emotions as volatility rises and remain disciplined to navigate through periods of market stress.

Emotional investors continue to underperform the market

Annualized returns, 2009-2019



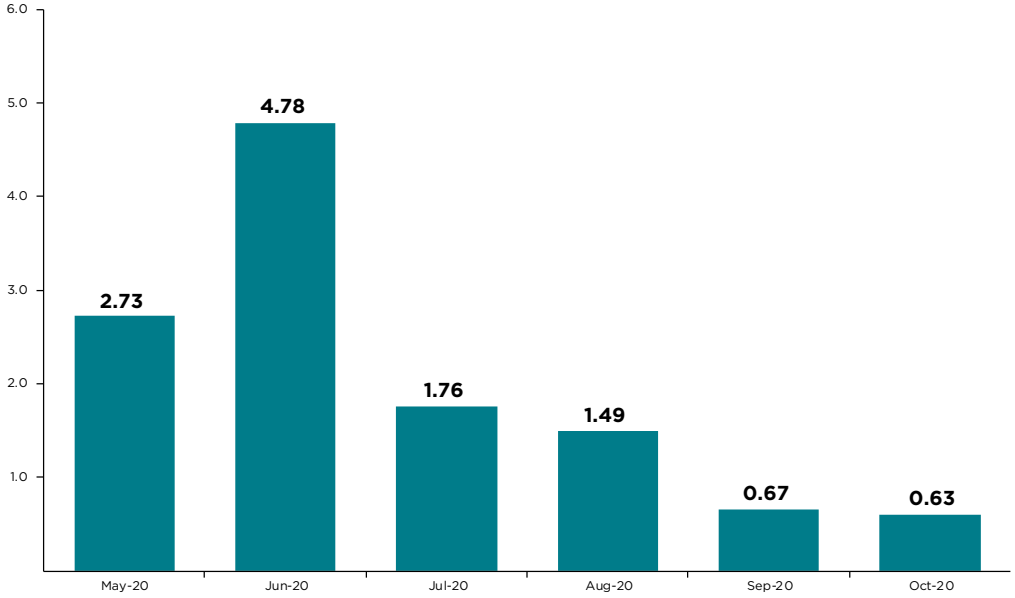
Source for chart data: Dalbar "Quantitative Analysis of Investor Behavior", 2020 report

Economic insight: Slumping job growth hints at a slower recovery

The economic recovery surged ahead in the 3rd Quarter, increasing at an annualized pace of 33.1% as rehiring by businesses helped spur a jump in consumer spending. The pace of job gains slowed considerably in September and October, although remained strong compared to pre-COVID trends. Moreover, more than 10 million workers are still unemployed from February's peak employment level due to the record-breaking job losses from March and April. This suggests the recovery will enter a slower phase in Q4, especially with elevated new infection rates holding back consumer mobility. Still, the economy should expand at a relatively rapid rate through year-end 2021, with between 4-6% annualized real GDP growth per quarter, as the recovery matures with an expected boost from widespread vaccine availability at some point next year.

Positive job growth, but the gains are slowing

Non-farm payroll employment gains, in millions. May to October 2020



Source for chart data: U.S. Bureau of Labor Statistics (BLS)

Key takeaways

1

The economic recovery remains on track, despite slowing job growth and consumer spending.

2

The availability of effective COVID-19 vaccines, which are expected in the first half of 2021, are key for a strong recovery.

3

Investors should continue to check their emotions as markets are likely to remain volatile through year-end.

Cycle Watch is a collaboration between Nationwide Economics and Nationwide's Chief of Investment Research. Our goal is to present a monthly update of where we are in the business cycle and insights from both perspectives to help investors and advisors understand the factors driving economic and financial market performance.

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