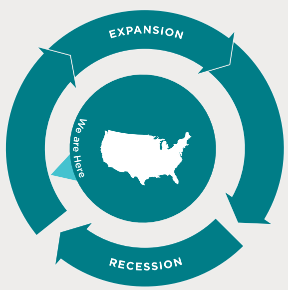
Cycle Watch | Stimulus returns

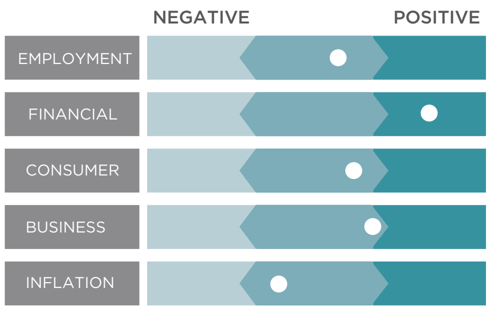
Economic and financial commentary as of January 2021

Business Cycle Update



The pandemic relief bill signed by President Trump at the end of December is set to boost economic activity in 2021, especially early in the year, and help the large number of workers still unemployed due to COVID-19 shutdowns. Prior to its passage, risks of a negative quarter of GDP growth for Q1 were rising due to the recent jump in new infections and additional rounds of government restrictions. Now with the renewed stimulus program in place, we estimate growth in 2021 should accelerate to around 5.0% for the year, with Q1 growth up to an annual rate of 2.5%. That would be fastest pace of annual growth since 1984.

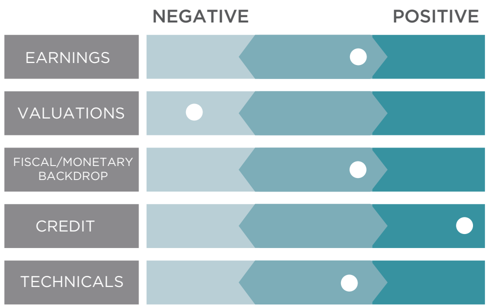
Economic Review



Nationwide Economic Dashboard, January 2021

Business hiring and consumer spending both slowed at the end of the year as rising COVID-19 cases and government restrictions on activity put the brakes on economic recovery. Service industries were most at-risk as consumers pulled back from in-person interactions, potentially leading to further layoffs in these sectors. The slowdown should be temporary as renewed fiscal stimulus and the increasing availability of vaccines is likely to prompt a return to robust consumer activity. Highly accommodative monetary policy is expected to remain in place through at least 2023 and should help sustain the expansion even after the stimulus surge subsides. Core inflation should edge only modestly higher from current low levels.

Financial Review



Nationwide Financial Market Dashboard, January 2021

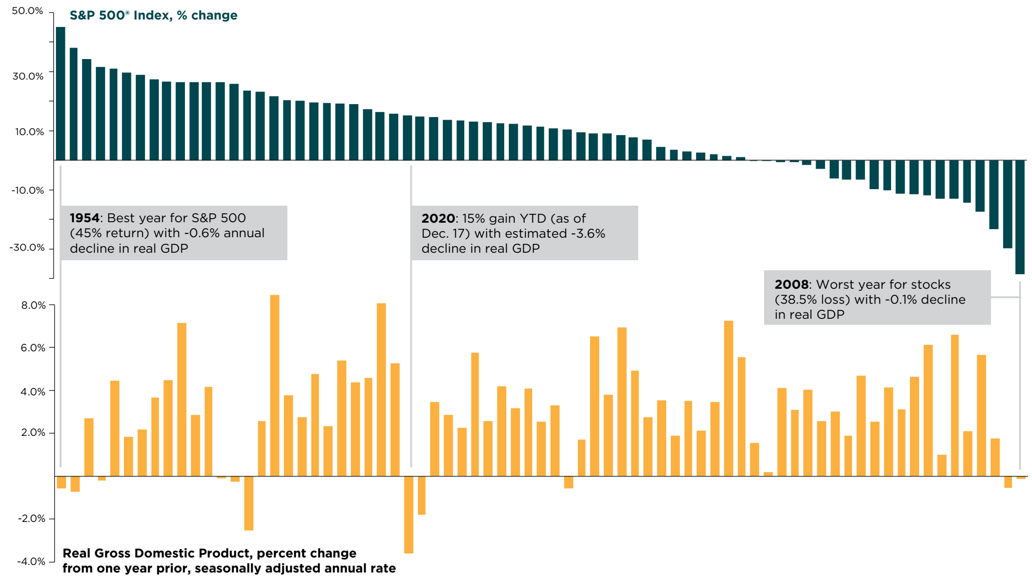
Equity markets closed the year in strong fashion, with the S&P 500® Index making its 33rd record close for 2020. Optimism around vaccines and the benefits from the latest round of fiscal stimulus continue to drive market strength. The S&P 500 gained 68% from the March low, after losing more than one-third of its value in less than a month, to finish the year with a 18.4% annual return, the sixth-best performance in the past 20 years. Breadth is strong, with small caps and international markets increasingly participating in the rally. The market has momentum entering 2021, although valuations are extended and challenges remain.

Financial market insight: Stocks go their own way in turbulent economy

The resilience of the equity market in 2020 has amazed analysts, given the unprecedented challenges that COVID-19 brought to the economy. This strong performance occurred despite an estimated 4% decline in GDP growth, the weakest year for economic growth since 1933. The decoupling of economic and market performance is not unusual in a calendar year, as the chart at right shows. What is unusual, however, is that the year leading into the COVID-19 recession was strong; 2019's growth of 29% was the seventh-best year for the market over the period. 2020 most closely mirrors 1982, when the market gained 15% despite a decline in GDP of 2%. Similarly, in 2009, the market rallied 25% on a 3% decline in GDP, though 2008 was the weakest year for stocks since 1937 at -39%. This anomaly reflects the speed of the decline and recovery, but also the unprecedented nature of conditions in 2020.

Stocks have decoupled from the economy in the best and worst of times

Calendar year return and growth data from 1948 to 2020, ordered by best to worst year for stocks

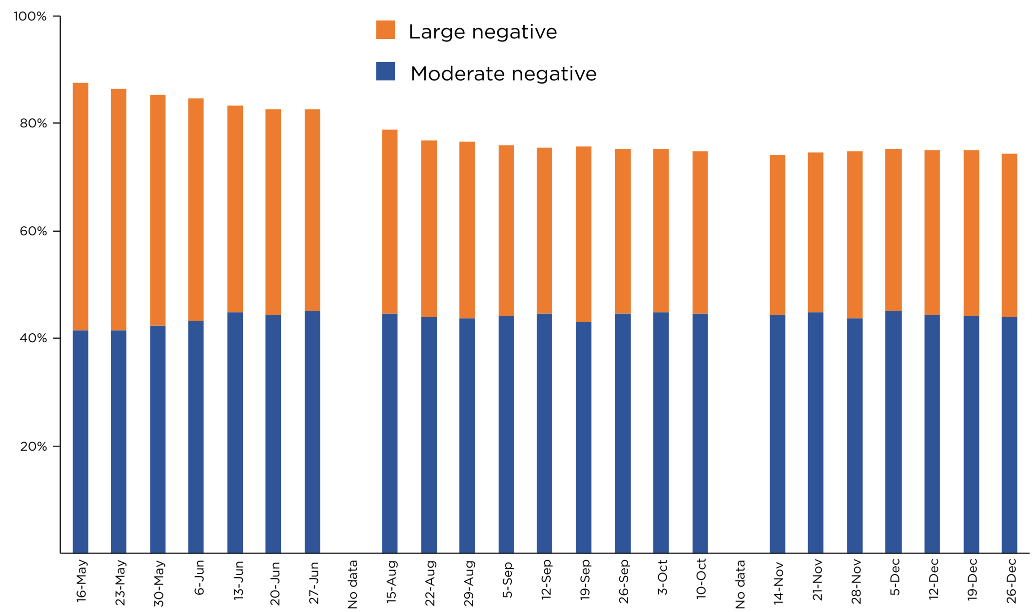


Source for chart data: Federal Reserve Board of St. Louis (FRED data), FactSet

Economic insight: Most small business still experiencing pandemic shock

Many small businesses continue to struggle in the COVID economic environment as more consumer activity shifts away from face-to-face interactions to online purchases. Service sector operations and employees have taken the brunt of the impact with spending and staffs still well-below normal nearly a year into the pandemic. At the end of December, about 75% of small businesses reported a moderate or large negative pandemic effect, according to survey data from the Census Bureau. The recently passed stimulus package provides some hope for small businesses even as new COVID-19 cases remain highly elevated. Direct checks to consumers should help to lift spending activity in the first quarter of 2021 while roughly $300 billion was added to the Paycheck Protection Program to support struggling businesses. Moreover, widespread rollout of vaccines should provide a significant boost to economy activity later in 2021.

Share (%) of small businesses reporting negative pandemic impact



Source for chart data: U.S. Census Bureau, "Small Business Pulse Survey"

Key takeaways

1

Renewed fiscal stimulus and increasing vaccine availability should help the economic recovery resume.

2

Highly accommodative monetary policies should sustain growth even after the stimulus surge ends.

3

Conditions in the stock market remain favorable heading into 2021, although valuations are a concern.

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.

Nationwide® is on your side

S&P 500® Index: An unmanaged, market capitalization-weighted index of 500 stocks of leading large-cap U.S. companies in leading industries; gives a broad look at the U.S. equities market and those companies' stock price performance.