

WORLD ECONOMIC OUTLOOK - FINANCIAL MARKETS TO MARCH 2021

Hughes Economics – November 2020

The world currently enjoys the “New Normal” economic climate. This is a slow, irregular recovery from the virus effects into next year with world economic activity achieving pre-covid levels later in 2021. New treatments and vaccines against the virus will arrive boosting world confidence. But a super-fast recovery now seems impossible given the spread of the virus at this time. The UK’s latest lockdown and the Brexit developments are also bad for the world economy, especially the UK.

Attention is now focussed here on world financial markets and their immediate outcomes. We concentrate predominately on US markets since these lead the world. In previous WEOs (see website hugheseconomics.com), 3 scenarios were outlined for the future world financial markets in the face of the Covid-19 outbreak. These scenarios comprised TINA, there is no alternative and stock markets head higher with no significant corrections (gold at \$1900 - \$2000 an ounce), BB or the bubble bursts with an up to a 30% correction before markets stabilize at lower levels than currently (gold \$2000 - \$4000) or SQ the status quo with markets moving sideways (gold \$1800 - \$2000) but no substantive moves in either direction for up to the next 6 months. This includes a pull-back of say up to 10% followed by a slow recovery back to previous levels. BB on the other hand involves a significant correction and stabilization at a much lower level. BB could also be triggered by a geopolitical event unforeseen currently. Prior probabilities were calculated previously with TINA at 0.017 (2%), BB at 0.367 (37%) and SQ at 0.616 (61%). These probabilities now need to be updated in the light of the most recent events or “news” to early November.

A brief summary of the latest “news” follows. US antitrust action versus the big-tech names is gaining momentum. A reduction in income inequality is seen as a coming big issue with higher taxes etc. on the agenda. Future market outlooks by some reporting companies are cloudy or absent entirely in some cases. China is not accommodating on world trade. Vaccines for covid-19 are on the horizon but not imminent. And in the elections, a Democratic sweep of Presidency, Senate and House now appears a distinct possibility. An analysis of consistency with this “news” using “more likely” judgments has TINA at the base level of 1.0, SQ at 3.0 times “more likely” than TINA and BB 1.5 times “more likely” than SQ. An equally likely judgment at any point would use 1.0. Also note that a scenario with zero consistency with the “news” would receive a zero likelihood and be eliminated from further consideration. All scenarios (no matter how unlikely currently) should be kept “alive” even with only a small probability.

CONSISTENCY OF SCENARIO WITH LATEST “NEWS” – “NEWS” LIKELIHOODS

Scenario	Pairwise Judgment	Compound Likelihood	“News” Likelihood	Percentage Likelihood
TINA	1.00	1.000	$1.0/8.5 = 0.118$	12%
SQ	3.00	$1.0 \times 3.0 = 3.000$	$3.0/8.5 = 0.353$	35%
BB	1.50	$3.0 \times 1.5 = 4.500$	$4.5/8.5 = 0.529$	53%
TOTALS		8.500	1.000	100%

Note that 6 decimals have been used in calculations with results rounded to 3 above.

The significant “more likely” values for SQ over TINA and BB over SQ ensure a lowish likelihood for TINA at 12% for consistency with the latest “news”. Combining the prior and likelihood information given this latest “news” now results in the posterior probabilities as below.

POSTERIOR DISTRIBUTION AFTER LATEST “NEWS” ON ELECTION AND MARKETS

Scenario	Prior Probability	“News” Likelihood	Joint Probability	Posterior Probability	Percentage Probability
TINA	0.017	0.118	0.002	$0.002/0.413 = 0.005$	1%
BB	0.367	0.529	0.194	$0.194/0.413 = 0.470$	47%
SQ	0.616	0.353	0.217	$0.217/0.413 = 0.525$	52%
TOTALS	1.000	1.000	0.413	1.000	100%

Note that 6 decimals have been used in calculations with results rounded to 3 above.

Updated probabilities show TINA is now seen as only a 1% chance to reflect future market behaviour, down from 2% previously or minus 1%. Scenario BB advances to 47% (+10%) while current market behaviour SQ is now seen as a 52% chance (-9%) to continue on for the next 6 months. BB now becomes a scenario with almost the same likelihood as SQ.