The Christmas rally

And the return of politics

A tumultuous, strange, dramatic year has come to an end: a round and leap year 2020. A difficult year to assess because it offered us everything and announced a future of great changes. Between March and April, the markets and risky assets recorded impressive losses in a very short time. But immediately afterwards, in a very short time, already in May, they recovered most of their losses. After a period of laterality, until September, the markets increased their volatility. Then they continued their run until they even gave us the Christmas rally. In December, the S&P scored +3%, the NASDAQ even +4.7%. In Europe, the Eurostoxx50 grew by 1.5%, while the German index rose by 2.6% and the UK index by 3.1%. However, it was not only the Asian indices that shone in December, but throughout the year, driven by China: the CSI300 rose by 5% in December and by 17.5% in 2020. During the year, however, the American flagship indices did very well, with the NASDAQ even registering +42.5%. One of the fastest bear markets in history has triggered, since March, one of the strongest recoveries of financial assets in memory. Judging from this data, it seems that the existential challenge that nature has set for us in 2020 with COVID19 is about to be won by economic and health science.

Economic science realized that the ratio of debt to Gross Domestic Product (GDP) had to be revised. The experience of the previous decade had clearly shown that reducing debts at all costs to consolidate the economy caused recession and deflation. This strategy was strongly determined by the vision of a global economy free of ties and restrictions, as Milton Friedman wanted. There was a belief that this path was the only viable one for unstoppable global growth. This strategy tied the hands of states, politics and politicians. Only liquidity had to be free to flow where it was best remunerated. There is no denying that, globally, this has been a success. Several countries around the world have seen large parts of their

populations lift themselves out of poverty and hooked into the engine of global growth. Chief among them has been China. But it took years to realize that this country's success was primarily determined by its *political* ability to manage the financial flows coming in from the industrialized countries. While economic science remained blinded by liberalist ideology.

Why is the productivity of advanced economies not growing? Why is the middle class in rich countries weakening? To these answers only central bankers were able to give operational answers that allowed the financial system to survive itself after 2009, flooding the world with liquidity and bringing interest rates even into negative territory. They knew that their role was disproportionate to the needs of democratic countries. They have long warned that their interventions would lose force and impact. They needed fiscal policies to redistribute income: decisions that only the political world could take. While waiting, they refined their theoretical tools, not even disdaining *Modern Monetary Theory* to face a new crisis they saw coming. As a matter of fact, however, financial facilities, which have only minimally succeeded in improving the lives of the most disadvantaged, have played a fundamental role in the transition to a new digitized economy that produces products at marginal cost ever closer to zero.

The crisis came last year. There was no risky, uncontrollable strain on the financial system. Instead, it was a health crisis, an epidemic, not predicted by policy or econometric models. But the theoretical apparatus developed in recent years allowed central banks to be extremely responsive to the crisis. States have also implemented the precepts developed in recent years: the *helicopter money*, discussed by former Federal Reserve Chairman Ben Bernanke, that is the distribution of liquidity directly into the pockets of citizens, was immediately implemented in the United States, but also in other countries. The European Union, free from the sovereignist brakes of the United Kingdom, has even managed to take a decisive step. The integration process could restart thanks to the first form of common indebtedness in order to help the most struggling states, especially Italy. Monetary and fiscal policies have thus enabled the stock markets to

overcome the enormous difficulties of 2020.

By 2021, the answer will come from vaccines. Science and companies such as Pfizer, Moderna, Astra Zeneca, Johnson & Johnson have not only succeeded, or are about to succeed, in a very short time to produce vaccines capable of defeating the pandemic effect. In fact, they are demonstrating to the world that the productivity calculations of the major economies are fundamentally flawed. What is the real and potential productivity of the pharmaceutical industry if in a few months it has managed to achieve what in the past required years, not to say decades, of studies, experiments, tests and then, finally, production? From this question, one can easily go further. What is the real effect of digitization on global productivity? In 2020, the process of transformation that touches on working from home, shopping online, studying online and whatever else has become established in just a few months, demonstrating that we are already technologically ready for the new digitized economy. We have therefore been able to become aware that we are also ready to face the transformation towards the decarbonisation of our productive system. Now, even the most skeptical of global warming - who often preferred to ignore it because they were afraid of having to call into question the well-being they had achieved - perceive the economic value of latent productivity. The digitized *Green economy* is the business of the next thirty years.

Stock exchanges have embraced the change. It is no coincidence that the classic digitalisation stocks Apple, Microsoft, Google, etc. have exploded, as have newcomers such as Zoom and the NASDAQ that best represents them. Then the stocks of the *Green Economy* and, more generally, those with a solid ESG (Environment, Social and Governance) rating: more attentive to sustainability. At the end of the year, we realized that liquidity is so important that even the stocks that lagged behind, the *value stocks*, those with good intrinsic value, are attractive. Big winner of the year was China. In 2009, after the G20, it had helped the world by focusing on developing its domestic demand, investing when others were focusing on saving. In the pandemic, it benefited from having contained the virus earlier and better than

others. It also benefited from the liquidity that others produced and that went into the most active productive area, its own. This has helped strengthen its currency, confirming its ambition to turn it into a global reserve instrument. Now it is opening up its financial market by pushing the large American banks - and not only them - finally authorized to operate with independent structures, to invest in its economy by assuming the entrepreneurial risks of the Chinese companies they finance. The European Union, in terms of the stock market, initially suffered the delay it has accumulated in the last twenty years in digitalization (there are no european Apple or Microsoft). But then the fantasy of the *Green economy,* which the Commission intends to ride, the European Central Bank's ability to intervene, but also a common financial plan of 2,800 billion Euros to be spent in the next few years, have given the boost that was missing. The weakening of the American dollar, due to the reduction in rates and the explosion of twin deficits, have opened up interest in those european companies capable of distributing substantial dividends.

If the vaccine successes are borne out, seriously and quickly, 2021 could be another good year for risky assets, hence the stock markets. The Fed has made it clear that it will prioritize employment over inflation. The other central banks, including the european one, do not seem willing to raise rates. On the contrary, after the experience of the 2008 financial crisis, they consider it dangerous to intervene at the first modest signs of inflation. Which, in any case, will raise its head in 2021. The savings accumulated by families are important. Companies, those that will survive the crisis, will have to invest heavily. The States, first and foremost Joe Biden's America, will intervene directly on the demand side with an investment plan in infrastructure, especially in the *Green economy*, which will be enormous and bipartisan (it is a question of agreeing on how to divide up the cake). But it won't be an easy year. Because now politics is back together with the accumulation of frustration of the losers of globalization who seek protection from technology and international competition. Politicians will have to give inclusive and generous responses, becoming aware of the latent productivity of the new economy that they are called upon to promote with force. The real challenge is to succeed in exploiting the sectors with greater productivity in

order to have significant growth while managing to contain inflation: thus reducing the Debt/GDP ratio (not by reducing Debt, but by increasing GDP). Investments, given that many will come from the public sector, must be driven by the general interest and not only by electoral interests. But in the last twenty years, in the most advanced democratic countries, there has not been an adequate selection of the political class. The risk of producing more Trump is therefore important. The market will at times notice this through inflation signals. Financial markets will not be in a bubble as long as dividend yields can offset the risk of those who cannot invest in bonds at negative rates. But if inflation, the historical companion of politics, starts, the discourse changes. The strength of the financial instruments in place, if not frustrated by vaccine inefficiency, should allow for a volatile but positive 2021.

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