Weekly Market Insights

April 20, 2020

Bad news, good market?

United States equity markets had an excellent week, and a better two weeks, particularly in the face of poor economic releases. For the week ending April 17, the Dow gained 2.21%, the S&P increased 3.04% and the NASDAQ closed up 6.09%.

There are, of course, a number of reasons for this, some sensible, some not. But, it was clear that investors wanted to be in the market.

The Economy

The Federal Reserve was, as we have written many times, the economy's and the market's first line of defense. Governments and economies run on confidence. At the moment, investor confidence rests primarily with the Fed. Investors are looking for stability and liquidity. The Fed has assured markets they will do all they can to maintain both. The Administration and Congress have come together and enacted positive legislation, which have helped both the economy and financial markets. At this time, the public appears to have less confidence in elected officials than the Fed.

The Market

Each day, headlines point to new economic releases showing how the economy is slowing and in a recession. At this time, neither is headline news. One has to be an ostrich not to expect very poor economic signals when most of the country is in lockdown. So why the rally? Investors, thinking we have seen the worst, start bottom fishing. Or, their portfolios had gotten so underweighted in equities that they felt the need to do rebalancing. Lastly, traders may have been looking for a dead cat bounce. Or, all three.

Bears will ask—why invest in the face of an economy that is facing a stern test with the coronavirus, and an economy that will continue to deteriorate, at least for the foreseeable future, and PE ratios remain high? A number of reasons. First, history tells us that the equity markets start to recover months before the economy. In a crisis, overseas investors prefer U.S. dollar denominated investments, particularly now, because foreign markets are facing economic problems that will not be solved by ending the pandemic. As for high PE's, investors may justify them because this has been a very unusual recession, most likely short, but very deep. The economy, when it revives, will likely make rapid gains. Investors under these circumstances may view the rate of profit growth far more important than the current level of earnings and feel abnormally high price to earnings ratios are justified. This is a strong case to rebalance portfolios by adding to equities for those investors who are underweighted.

International

International economies remain under pressure. As we wrote last week, serious cracks are appearing in Europe and China. Their problems are very different, indeed, but both are exacerbated by the pandemic and economic slowdown. If these problems are not resolved, they will create economic difficulties long after the pandemic is over, and both may struggle for quite some time.

Caveat

It has been a very dramatic time. Investors' sentiment, and therefore markets, can change very quickly.

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Please click here for the Economic Release Calendar - April 2020.