Market Commentary

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Why Is the Market Up If the Economy Is Getting Worse?

Since hitting its recent bottom on March 23, the S&P 500 has gained over 30%. During that same span of time, more than 30 million U.S. jobs have been reported lost, confirmed U.S. cases of coronavirus (COVID-19) have exceeded one million, and oil prices have continued to plummet. With no immediate end to the pandemic in sight, and likely worse economic data still to come, why are we seeing such a rally in the stock market?

It's important to remember that markets trade on expectations of the future, not current or past realities. During the height of the sell-off in March, the U.S. had only just begun the process of shutting things down; it was the anticipation of the economic pain we are starting to feel now that drove things down. Therefore, markets are pushing higher now in anticipation that things will improve in the future, though few know when exactly that is or how things will play out in the meantime. If it's true that sentiment has improved, what is likely causing this shift? No one knows for sure, but we will explore the potential causes and how we view the recent rally.

POTENTIAL REASONS FOR THE RALLY

Here are a few common theories on why markets have rebounded:

- **The initial downturn was oversold** – It's possible that the initial shock and uncertainty surrounding the pandemic, paired with the liquidity crunch caused by oil prices falling, caused markets to fall more than was fundamentally justified.
- **Uncertainty has decreased** – Markets hate uncertainty and a wider range of potential outcomes tends to push markets lower. Therefore, as the economic picture becomes clearer, it's possible for stocks to rebound even if recent news isn't overly rosy.
- **Government intervention** – Many believe that this rebound was fueled by the record-setting stimulus actions taken by governments and central banks. This is compelling as the rebound began right around the time that many of these measures began to materialize.
- **Optimism around medical innovations** – Although we have not seen a clear breakthrough to date, and a vaccine is likely a ways off, there have been many encouraging reports of treatments being tested, as well as speculation that mortality rates could be much lower than originally expected.
- **Sentiment may be overly optimistic** – It's common to see bear markets retest lows after an initial bounce. This could mean the current rally is somewhat premature and we may see markets head lower temporarily before the eventual recovery.

OUR PERSPECTIVE

All of these factors may have played some role, and we believe that these reasons all deserve consideration. The challenge is it's impossible to quantify the degree to which these events are driving things, or to know exactly what the market is expecting at any given time. We can only observe events as they unfold and how the market responds to gain some perspective in hindsight, though it still does very little to help predict what the future holds.

These uncertainties illustrate the difficulty of making short-term decisions with long-term money. In the long run, we can pay attention to fundamentals and stick to our process, knowing that we will hit pockets of volatility from time to time but ultimately recover and earn a reasonable return, as long as we stay diversified and do not miss the rebounds whenever they occur. In the short run, we would be forced to guess what will happen in the future, as well as how markets will respond. During this pandemic, we've already seen markets sell off after the Fed aggressively cut rates; we've also seen them rally after record-level jobless claims reports. History has shown that stocks do not need to avoid sell-offs to earn a reasonable long-term return; however, investors who make abrupt decisions to avoid short-term losses run the risk of missing out on the rebounds that help drive performance. We do not believe this is a risk worth taking.

CONCLUSION

While no one knows where the market will go from here, we do know that the markets always behave in anticipation of the future, not what has already happened. We saw a stock market plunge in March in anticipation of the pains we're feeling today due to unemployment and economic constrictions. Now, the market is up because it's anticipating recovery because of a potential improvement in fundamentals, the effects of the stimulus, and optimism around innovation.

It could continue higher in the coming weeks; it may give back some gains and retest March's lows. While there's no doubt that the economy will struggle in the short term, ultimately, we can expect the market to recover, based on historical patterns. We believe that long-term investors who try to side step market downturns are following both a risky and unnecessary investment strategy.