Market Commentary

INVESTMENT STRATEGY GROUP | APRIL 16, 2020

Have Stock Markets Hit Bottom?

The impact of the economic shutdown due to coronavirus (COVID-19) is beginning to be quantified and the observations are staggering. After the Department of Labor (DOL) reported an unprecedented 3.28 million initial unemployment claims for the week ending March 21, the DOL then reported initial claims exceeding six million per week for the following two weeks. The unemployment rate rose from 3.5% to 4.4% in March, and most analysts believe it is headed well into double digits. These numbers and scenarios are jarring.

However, financial markets seem almost bored by the hard data. Global stocks have rallied from the March 23 low after falling about -33% from February highs. Stock markets try to anticipate news—both good and bad—ahead of time, which suggests that a significant amount of economic disruption is probably priced into the markets already.

This leads many investors to wonder if the markets have bottomed and if they have priced in enough of a discount to compensate for the economic interruption yet to come.

Some believe that what we've seen so far is merely a relief rally. Historically, virtually every market bottom results in lows being retested. The containment of the virus is still very open-ended and the path back to a humming economy is probably farther off than most expect. The negative data are just starting to trickle in and many businesses may yet fail. Households will lose income during this time, which will feed into higher unemployment and recession, maybe even a depression.

However, the fiscal and monetary backstops offered by the Fed and the federal stimulus package provide a significant down payment on the future that should not be discounted. Additionally, the recent equity market sell-off and the considerable widening in credit spreads provide ample valuation support—meaning asset prices are cheaper—which positions those assets better for most longer-term growth outcomes.

Also, the case can be made that the financial plumbing of the credit markets is functioning properly. The Fed has aggressively stepped in to address liquidity concerns by backstopping loans, adding liquidity to the system, bringing assets onto its balance sheet and essentially doing anything it can to bring stability and confidence. Goldman Sachs estimates central bank balance sheets will expand by 15% of GDP by year-end. As the liquidity concerns are alleviated, questions about economic disruptions are being met head-on globally with government stimulus plans. In fact, global discretionary fiscal spending has increased by about $4 trillion — or 4.7% of global GDP— so far with potentially more on the way. These massive fiscal and monetary responses are likely larger than the consumer wealth that will be lost. Markets appear to be reassured, at least so far.

Do we believe the markets have bottomed? It is impossible for anyone to know conclusively. There will no doubt be significant changes that materialize out of this crisis. Markets will eventually migrate their focus to other events and circumstances, such as deglobalization, the elections, or perhaps the growing government deficits. With the rise of each concern, the markets' focus will become myopic, narrowly focused on the event at hand.

Stocks are a long-term investment. Even most bonds have a multi-year time horizon. No one knows what will happen in the near term, but we believe that human capital is highly adaptable, even through crises. Wealth is generated over the longer term through this ability to innovate, increase productivity, and find a way forward. It's hard to believe that Amazon is only a couple of decades old or that the iPhone is younger than today's teenagers. And, despite many ups and downs, including significant pullbacks that were double-digit in magnitude like we've seen recently, stocks provided investors an average annual return of 10% over the last 100 years.

While it can be unsettling to see such volatility in the stock markets, history tells us that when the potential downside becomes more fairly reflected in asset prices, investors can expect to see opportunities for future returns, regardless of when the markets bottom.