MAY | 2020

RAYMOND JAMES®

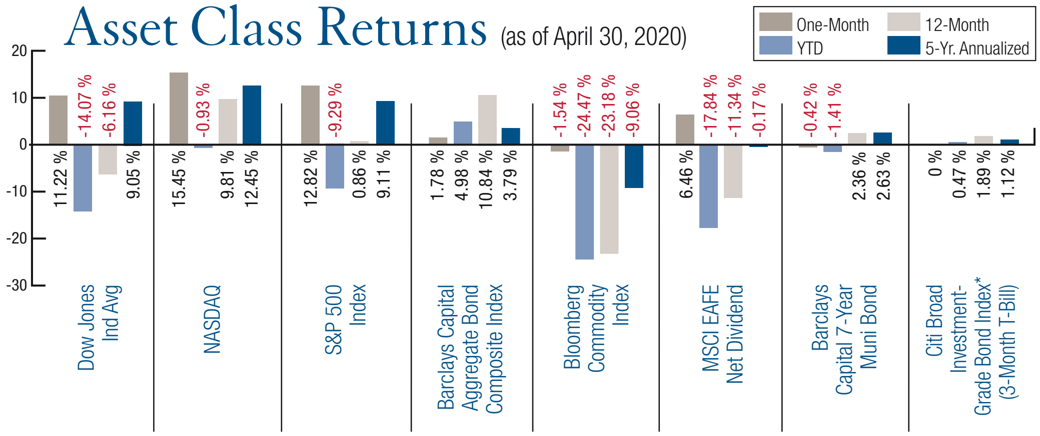
market update

From the Office of Jeff Sgroi, CFP®

"Not everything that can be counted counts, and not everything that counts can be counted."

– *William Bruce Cameron*

Asset Class Returns (as of April 30, 2020)



Market & Economic Synopsis

- After aggressive rate-cutting steps, the Federal Reserve puts the brakes on the notion of negative interest rate support.
- Congress works toward additional fiscal stimulus, although bipartisan support appears to be more of a challenge than in previous bills.
- As states begin to reopen for business, healthcare officials track correlation between economic activity and new COVID-19 cases.
- Monthly unemployment figures spike to 14.7% in April, as tens of millions of Americans wait to return to work.
- Crude oil prices bounce back from – $37/bbl to low $30s, as energy markets and demand begin to recover.
- Coronavirus vaccine from Moderna shows early signs of viral immune response.
- Volatility and uncertainty continue to rule the equity markets, as three-figure point swings in the Dow Jones Industrial Average have become the norm.
- Retail sales, housing starts, industrial production, and Consumer Price Index all dip in April.

Market Update

For years, market analysts have been proclaiming that the bull market rally that began in March 2009, and ended precisely 11 years later, was the least-loved market expansion on record. A 35% drop in the S&P 500 earlier this year twisted the equity markets into bear market territory in record time. In fact, after reaching an all-time high of 3,393 on February 19th of this year, it took only 23 trading days to make the precipitous drop to 2,191.

All the while, devastating economic news has continued to roll out — jobless claims have reached numbers not seen since the 1930's; CPI figures dropped by levels not seen in decades (signaling deflationary pressures); retail sales fell 16.4% in the initial estimate for April, preceded by an 8.3% decline in March; and Fed Chairman Jerome Powell recently noted that the unprecedented speed and scope of the current downturn is "significantly worse than any recession since World War II."

Alas, as of this writing, the S&P 500 has rallied 33% off of the March lows (though still below record territory reached earlier this year). In an economy where many continue to practice self-distancing, businesses remain shuttered, and travel and leisure have come to a screaming halt, the equity markets perform as if we have entered a minor, inconvenient economic downturn.

So why the hugely disparate action between the economy and the equity markets? The *Wall Street Journal* posted an article by Gunjan Banerji on May 8, 2020 that captured my attention, and quite succinctly, I believe, answered the question with five main points. Below are these five reasons, with comments and paraphrasing to emphasize and expand upon key concepts and shared opinions.

1. Bets on a "V-Shaped" Recovery

A "V-Shaped" recovery refers to the potential for a fast and steep drop in the markets (the first leg of the "V" occurred between February and late March), followed by an equally steep upward rebound, eventually returning the markets back to levels seen prior to the initial drop. Below are reasons why this scenario could play out.

Many analysts are looking past the grim economic data, forecasting a speedy recovery as state economies open back up across the country. New York, which has been the hardest hit by the pandemic, has begun developing a plan to restart its economy. Other states are farther ahead, with more than 35 allowing some businesses to reopen. Such moves have encouraged investors to believe that the economy is poised for a rapid rebound by early 2021.

Additionally, the number of new COVID-19 cases has moderated in the U.S., while stocks have surged on any signs of progress toward a potential vaccine. Recently, markets rallied on Monday (05/18/20) due to news that Moderna's COVID-19 vaccine candidate was making positive headway through early trial stages.

Many investors said April's unemployment numbers and other disappointing data came as no surprise after data in recent weeks showed a flood of people applying for unemployment benefits. As we have learned from previous market cycles, bear markets oftentimes overshoot lows, just as bull market cycles overshoot highs.

Still, analysts are watching for any minute signs that the bottom of the economic downturn is near. Goldman Sachs Group Inc. analysts have been tracking varied measures for signs of a recovery, such as gas demand, Starbucks mobile application downloads, and traffic in restaurants as measured on the reservation website OpenTable. Gas demand, having fallen tremendously, started improving recently, while other data tracking flow through workplaces and transit is showing small gains as some states have reopened.

"There are some small, early signs that life is resuming some form of normalcy," the analysts said in a research note recently. "We expect these small signs of recovery to continue as the country gradually reopens and consumers resume their daily activities."

2. Market Leaders Keep Rising

The stock market is increasingly divided between the haves and have-nots, and the recent rally reflects the outperformance of a handful of stocks. Big technology companies, which are heavily weighted in the indexes, have driven much of the rebound, continuing a trend that was prevalent during the nearly 11-year bull market.

"The whole market is not up," said Giorgio Caputo, a portfolio manager at J O Hambro Capital Management, who said his firm has added to stockholdings in recent months. "It's the best of times for some firms. It's the worst of times for other firms."

Five big tech stocks— Microsoft Corp., Apple Inc., Amazon.com Inc., Alphabet Inc. and Facebook Inc.—together make up about 20% of the S&P 500. Those companies have benefited as Americans around the country have been sheltering from the pandemic at home, spending time on social media and ordering online home essentials and groceries.

Meanwhile, the entire energy sector constitutes just about 3% of the broad stock-market index. That means the companies that have suffered the most have little sway over the market's direction. The energy sector is down 35% this year, in conjunction with a plunge in oil prices, making it the worst-performing group in the market.

In short, the rally has been a very narrow one, leaving many companies behind. This type of rally creates another risk if some of the largest publicly-traded companies falter, bringing broader index prices lower along with them.

3. Corporate-Earnings Expectations Remain High

Earnings have been abysmal and the coronavirus has already pushed large retail businesses and energy companies into bankruptcy. But investors are counting on a quick rebound.

Earnings are expected to register a decline of 14% in the nearly completed first-quarter earnings season, which would mark the biggest decline since 2009 according to FactSet, before falling further later in the year. Analysts are projecting earnings to bottom in the current quarter with a 41% drop—and rise 13% in the first quarter of next year.

"While the earnings outlook will remain challenged at least through [the first half of 2020], investors are increasingly discounting the COVID-19 hit to fundamentals this year and turning their gaze to a 2021 recovery," JPMorgan Chase & Co. analysts wrote in a note recently, adding they are bullish on stocks forecasting a return to previous highs by the first half of 2021.

As we know, the stock market is a forward-looking indicator. Historically, the market has very closely tracked forward estimates of earnings. Admittedly, since many companies have elected to not provide guidance for future earnings given the uncertain economic outlook, markets (as a "voting mechanism") are indicating optimism in future figures. Furthermore, much of the economic data is backward-looking and historic, even if on a short-term basis.

4. Old Habits Die Hard

Another fear among some investors is missing out on a quicker-than-expected recovery.

The moves to buoy the economy by the Federal Reserve and U.S. government have been wide-ranging and so far have elicited confidence among investors. If the stock-market bulls end up being right about a speedy recovery and the economy stages a strong rebound, other investors would be left behind in a potential stock market rally, missing out on gains.

As has often been the case in recent years, investors find themselves faced with few attractive alternatives if they opt out of betting on stocks. The problem is so familiar, it has its own acronym: TINA, or There Is No Alternative to stocks.

"It creates a two-sided risk to this equation for investors," said Jim Paulsen, chief investment strategist at the Leuthold Group. "It may be the virus continues to burn hot. There's also a risk on the other side."

Treasury yields are hovering near record lows and the corporate-bond market has recovered since the Fed introduced its stimulus plan. That means returns on high-grade corporates remain thin as well.

With lifespans running longer than ever, investors must consider inflationary and cost-of-living pressures. As highlighted above, because fixed-income yields are stretched to historic low-levels, higher return through equity performance is, in many cases, a must.

5. The Fed's Backing

Measures by the Fed and U.S. government have underpinned the recent rally across markets. The Fed made it clear it was willing to step in to buoy the economy. Why bet against the market when the central bank is willing to do that?

"You can't forget the amount of policy that's under the stock market," Mr. Paulsen said.

Between accommodative monetary policy, already passed and proposed fiscal stimulus, and a seemingly endless level of support of central banks worldwide, investors believe a major backstop is in place in the financial markets.

In the meantime, markets remain volatile. It is our belief that the best, strongest market will be one that is supported by a healthy underlying economy. That is most likely to occur when we have a medical solution to the ongoing pandemic. Markets have no way to determine when that will be.

Ms. Banerji's full article may be located on the *Wall Street Journal* website at:

https://www.wsj.com/articles/why-is-the-stock-market-rallying-when-the-economy-is-so-bad-11588974327

From the Homefront

From our family to yours, we hope you are happy, healthy, and smiling! (photo from Stella's 10th birthday, mountaintop in Snowmass, CO).

RAYMOND JAMES®

Raymond James Financial Services, Inc., Member FINRA/SIPC

617 West Main Street, Suite E | Aspen, CO 81611 | 970-925-4334 | 888-925-4335 | www.raymondjames.com/sgroi

302 S. David Street, Suite 200 | Casper, WY 82601 | 307-234-3473 | 866-934-3473 | www.raymondjames.com/sgroi