Market Brief

August 14, 2020

Supplemental Commentary:

Market Snapshot	
Closing Values as of 08/13/2020	
Dow	27,896
S&P 500	3,373
Nasdaq	11,042
Gold	$1,963

Ladies and Gentlemen, FEAR has left the Markets!

With COVID-19 turning so much of our the world turned upside down and so many reasons to be anxious about what the future holds for us personally, for the economy and for our investments, I am constantly being asked "how can the stock market be doing so well when the world is falling apart?". With so many pithy quotes and axioms I could share, I think the most appropriate and useful might be; "**the economy is not the market, and the market is not the economy**." It may be little consolation for those who are wondering why there is such a disconnect between the markets and the real world (and there is) but, one of the most common mistakes I have observed individual investors make is conflating the two.

To put a finer point on this idea, the economy and markets are interrelated but do not necessarily move in lockstep. Markets routinely adjust in anticipation of economic change, as full-time market traders, analysts, and strategists digest financial and economic data, study trends and analyze sophisticated models to project possible future asset valuations. All this leads to daily trading activity that reflects the collective assessment of what the economy and corporate earnings are expected to look like in the months ahead. Anything that disrupts the flow, accuracy, ability to analyze or the collective assessment of the economic and financial data will impact daily trading activity and the overall pricing of the market. It is very likely the shutdown early in Q2 and continued quarantine of those in the financial markets has created a disruption in data flow and analysis. In today's world, where information is readily available and not always verifiable, it is easy to confuse headlines with data. The rapid distribution of information combined with readily available trading platforms can just as easily lead to incredibly efficient markets as it can end up creating wild distortions and "bubbles".

Even after being admonished about how the economy and the markets are interrelated but distinctly independent of one another, it is reasonable to question how there can be such a stark difference between current economic conditions and what the markets appear to be expecting in the near future. With the Nasdaq being up more than 20% and the S&P 500 up almost 5% for the year and both within a few points of fresh all-time highs, while the COVID-19 induced recession continues to wreak havoc on the global economy certainly has many scratching their heads wondering what the markets are seeing in the data that would justify such powerful performance.. Are the markets seeing something in the data the rest of us aren't seeing or have the markets become distorted by?

There is plenty of evidence to support the idea that current market values have become stretched and investors have become fearless. The Global market capitalization / Global GDP ratio is over 100% again (last time was 2018), and indication that global markets have grown faster and farther than the global economies are growing. The "investor fear gauge" (Put/Call ratio) has fallen below 50, a sign that investors are not worried about any future surprises. And the market volatile index has been falling, indicating investors aren't anticipating large movements in the markets in the near future. These conditions don't mean a correction is imminent but, these are the types of indicators we see leading up to major market corrections. If nothing else, this is a good time to be taking profits and ensuring your portfolio is balanced and well diversified.

Here is some food for thought:

The COVID-19 health crisis is still evolving here in the U.S. and abroad, there have been incredible advancements made in treatments and vaccines but there are still a number of unknowns and potential outcomes. The trend has been positive, but the timeline is far from being known or controllable.

Children going back to school in the weeks ahead will be the next major challenge. Without the ability to drop their children off at a physical school location, an enormous number of employees will need to stay home to care for their children or arrange daycare. Many restaurant owners have already indicated an alarming number of their current staff won't be able to show up once "school" starts in the weeks ahead. If and how schools open to students will have a huge impact on public health and the economy.

Pent-up demand and stimulus spending won't last forever. A huge part of the earnings reported in the second quarter was a result of pent-up demand caused by the many weeks of shutdown and the stimulus payment(s) from congress. With more and more of the economy being re-opened, pent-up demand is unlikely to exist as an earnings driver in the quarters ahead.

Washington STILL has not come to an agreement on the 4th stimulus bill. This means the any federal boost to unemployment benefits and individual stimulus checks that had played such an important role in stabilizing and growing the economy so far, aren't being distributed. All parties agree on the economic importance of these payments, yet the markets aren't disturbed by deeply partisan politics and the lack of political will to make them happen.

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