MARKETS CAN GO UP ON BAD NEWS AND DOWN ON GOOD

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The coronavirus has had a deadly human impact and the methods used to combat its spread have devastated the global economy in 2020. Stock markets reacted by dropping at the sharpest rate on record but have then enjoyed a rapid recovery. Yet at the same time the economic news has been dire.

The first half of 2020 has been tough for the global economy in the midst of the Covid 19 pandemic. For example, a record 35 million Americans have lost their jobs since mid-March and the UK had its largest jobless claims on record. Meanwhile, growth has slumped as countries have gone into 'lockdown' and the International Monetary Fund (a global institution which promotes financial cooperation) is expecting the global economy to suffer its worst downturn since the Great Depression during the 1930s.

Understandably, people are confused as to why the stock markets managed to move in the opposite direction to the economy and staged such a significant rally from March onwards. Part of the reason lies in the nature of the stock market and what economic data imply. The value of a share should be a reflection of the future prospects of a company. Meanwhile, economic data is quite often either based on past events or a comment on the present. If investors can see beyond current events they may take a different view on the picture painted by current economic data. Given this difference in nature and focus, it is not unusual for there to be a 'disconnect' between current economic data and stock market returns in the short term.

SO, WHAT HAS BEEN HAPPENING TO GIVE INVESTORS GREATER CONFIDENCE?

Naturally, there are many influences on the behaviour of financial markets, and especially now, but the catalyst for the market recover has been the support and stimulus measures taken by governments and central banks globally. These have created an even bigger 'disconnect' between markets and the current economy. As pointed out previously, we believe that there is more stimulus to come and these measures could be longer lasting than the virus impact. The sheer scale and speed of implementation of these measures so far has improved the outlook. In a matter of weeks, they far exceeded applied over two years of financial crisis in 2008-9.

The lifting of lockdown rules is clearly good news at many levels for the economy. So while the economic releases show historic data that reflect the deepest period of shut down, the market was trying to work out the extent that economic activity would recover as economies opened up again.

In addition to a rise in economic activity in developed markets, investors have also been buoyed by the fact that subsequent Covid outbreaks in East Asia have been muted. This has allowed countries like China, which is a very important component of global growth, to achieve a "V" shaped type recovery over recent months, albeit one that is not sufficiently advanced so as to give the government enough confidence to state a formal GDP target for 2020 at this year's delayed National People's Congress. But recent economic numbers have been encouraging.

BUT, AND THERE IS A BUT!

Until an effective treatment or a vaccine is available in sufficient quantities, there is always the possibility of a second wave of [Covid] infection as freedom of movement gradually increases across the globe. The rate of infection in many US cities has only just come under control and with protests on the streets of America and many other countries it is hard to think that infection rates won't spike in the coming months. This concerns investors as it creates uncertainty.

In recent years, investors have at times of uncertainty turned to the central banks or governments for additional support to calm their nerves. This has undoubtedly been the case during the volatility caused by the virus and as we pointed out earlier it has been a major source of fuel for the recent rally. But there is also a danger from hanging on every word from the Federal Reserve (the US Central Banking system) because quite quickly you can look to put words into their mouth.

Earlier this week, the Chairman of the Federal Reserve gave a downbeat assessment of the near-term prospects of the US economy. That much was to be expected but at the same time he stated that interest rates would stay at current levels through 2022. Ordinarily, the latter would be taken as a huge positive by markets but on this occasion, investors wanted more.

They had wanted the Federal Reserve to explicitly say that they are trying to control the level of yields across all timeframes and not just keeping short term interest rates low.

The combination of disappointment in the Fed and rising fear of an increase in infection rates across the US drove equity markets sharply lower yesterday. The mix of company news is decidedly that, mixed, which does little to help matters. We won't get a clear picture of corporate health for some months. In the absence of this investors will once again turn to the authorities for fiscal support. We do expect it to be forthcoming but we cannot predict the scale nor the exact timing. For now it looks as if volatility has returned and bonds will be a safe haven whilst equities fluctuate based on news flow.

IN SUMMARY

- There is quite often a disconnect between market behaviour and current economic data, because the data often reflects historic events and investors take a forward-looking stance when trying to establish the value of financial assets.

- A key reason for the strength of the bounce in markets has been the extent of fiscal and monetary support and stimulus, that has been applied to markets in a very short space of time. We expect more to come and for the world to worry about how to exit such extraordinary measures at a later date.

- The relaxation of lockdown restrictions in a number of developed markets will lead to a 'bounce' in economic activity that is not reflected yet in current data. Although it is too early to judge the extent of this increase in activity and whether we will be prone to a second wave of infection.

- China is an important component of global economic activity and it is encouraging that they have beaten the virus and it appears that their economy has returned to growth in some areas.

- Markets have reacted to comments by the Federal Reserve chairman and fears of a second wave of infection in the US following protests on the streets.

- We remain vigilant and will continue to update you as things develop.

Toni Meadows
Chief Investment Officer, Omnis Investments Limited