Money Talks by Dave Helscher

September 2020

The S&P 500 was up 9.7%, total return, for the year through 8/31/20. Since hitting a bear market low on 3/23/20, the S&P 500 gained 54.5% (total return) in 116 trading days through 9/4/20. The recently ended 11-year bull market, lasting from 3/9/09 to 2/19/20, gained 53.3% during its first 116 trading days. The cycle from peak to peak was the fastest recovery in the history of the index. Based on the traditional definition of market cycles, the new record confirms that a bull market began on March 23 when the index closed at it official low point. This also confirms that the February-March bear market was the shortest on record, lasting just 33 days.

Although the strong comeback is good news for investors, there is a disconnect between the market and an economy still struggling with high unemployment and a public health crisis. The market is not the economy, but the economy certainly affects the market. It may seem puzzling that the market could reach a record high not long after the largest quarterly decline in gross domestic product (GDP) in U.S. history. Whereas GDP measures current economic activity, the stock market is forward looking. The rapid bounce back suggests that investors believe the pandemic will be controlled in the not-too-distant future and that business activity will return to normal. Whether this optimism is warranted remains to be seen, but there are hopeful signs.

A vaccine could be available during the next 6 months, offering light at the end of the tunnel. In the meantime, the virus continues to suppress business activity. The 8.4% August unemployment rate represented a big improvement over the previous months. Recent projections of corporate earnings suggest they will avoid a worst-case scenario. GDP is projected to make up ground in the third and fourth quarters but remain negative for the year. The proliferation of low-cost trading apps has encouraged less experienced investors to trade aggressively, which might be driving some of the market surge.

The single, most important factor behind the market recovery is the commitment from the Federal Reserve to provide unlimited support through low interest rates and bond buying programs. For some investors, the fact that the economy is still struggling has a strangely positive effect in guaranteeing that the Fed will keep the money flowing. Further support, in the form of fiscal relief, is more uncertain, but the strong market suggests that investors may be counting on another stimulus package. Low interest rates make it easier for businesses and individuals to borrow, but they have reduced bond yields to the point that many investors are willing to take on greater risk in equities in order to generate income. Money that might normally be invested in the bond market has poured into stocks, driving prices higher.

While the S&P 500 is generally considered representative of the stock market as a whole, the recovery has centered around technology companies, which have helped provide goods and services throughout the pandemic. The big six tech stocks – Apple, Facebook, Amazon, Netflix, Microsoft, and Alphabet (Google's parent) – were up collectively by more than 43% for the year through mid-August.

By contrast, the rest of the companies in the S&P 500 were down collectively by about 4%. The big six tech stocks now represent more than one-fourth of the total market capitalization of the S&P 500 and thus have an outsized effect on index performance.

One question facing investors is whether to chase the winners or look to stocks and sectors that still lag their previous highs and may have greater growth potential. Chasing performance is seldom a good idea, but there are solid reasons why certain stocks have been so successful in the current environment. Keep in mind that these are extraordinary times, and traditional expectations and measures of value may not tell the whole story. If nothing else, the extreme volatility and rapid market cycles of 2020 have illustrated the importance of maintaining a diversified all-weather portfolio and the danger of overreacting to market movements. While new records are exciting, they are only signposts along the road to achieving your long-term goals.