Weekly perspective on current market sentiment

April 1, 2020

Expectations

Key takeaways

- We believe the stock market is anticipating that the economy and corporate earnings will be hit hard in the second and third quarters but be on the path to recovery as we move into 2021.

- Investors also appear to be pricing the current surge in new COVID-19 cases and deaths with a downturn in these statistics starting in the middle of May.

One of the most common questions strategists have received in recent weeks is “what is the stock market pricing in?” In other words, is the market correctly anticipating? High levels of confusion and uncertainty typically result in a high degree of day-to-day financial market volatility. That is exactly what we have been getting on a daily and weekly basis. Tune into any financial news broadcast over the last week or so and you hear things like “X hasn’t happened since 1933.” It truly has been an unprecedented five weeks.

So back to the original question—just what is the stock market pricing in? While full clarity on any answer to that question is not possible, we can speculate. Much of this speculation is based on a “gut feeling” following decades of market experience.

We believe stocks are pricing in that at some point the world will get past this virus. Numerous biotech and pharmaceutical companies are working toward a vaccine for COVID-19. That could be 9-18 months in the future. Equities are counting on a vaccine eventually coming to market. But what about in the very near to intermediate term?

The economy and earnings results are both on the near-term radar. Investors know that the probability of a recession is extremely high. Our forecast calls for a nearly 15% (annualized) tumble in economic growth in the second quarter followed by a third quarter that contracts by about half that much. That qualifies as a short but deep recession in our book. Some on the “Street” are calling for as much as a 25% contraction in the second quarter. We think stocks fully expect a recession and will give the range of contraction a wide berth. By that we mean the market will not be focused on a single “consensus” average growth contraction number and realizes the results will be quite bad but hard to exactly pin down. The same goes for earnings. Our work suggests earnings this year could be down 30% due to the recession. Second-quarter earnings comparisons are subject to a wide range of estimates.

In terms of the virus, investors know that we are currently in the midst of a surge in diagnosed cases and, unfortunately, deaths. Note that the S&P 500 Index has rallied 20% over the last five trading days through Monday despite this surge. It appears that most medical experts see the number of new coronavirus cases beginning to decrease in mid-May. The market appears to be in sync with that timeline.

Should the timeline for a decrease in the number of new virus cases extend into August or September, the resulting social distancing practices would dampen consumer spending for longer than currently expected and stocks would likely react quite negatively from current levels.

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Last Week’s S&P 500 Index: +10.3%
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