HollisWealth®

MACROSCOPE the market bulletin from Luft Financial

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Disconnect between markets and the economy

A rising chorus of influential voices are warning about the risks posed by the global pandemic-induced lockdown to the economy and stock markets. Earlier this week, Federal Reserve officials including its chair Jerome Powell warned that the virus outbreak and shutdown of the U.S. economy would result in an output decline of historic proportions in the current quarter and potentially trigger massive bankruptcies. Hedge fund legends such as Stan Druckenmiller and David Tepper weighed in with their views on the markets, saying that the risk-reward of holding stocks is the worst they have encountered in years. Druckenmiller called the notion of a V-shaped recovery – a scenario that investors seem to be banking upon, judging by the strong rebound from the lows – a "fantasy," while Tepper said that apart from the dot-com bubble of 1999, equities are the most overvalued he's ever seen.

These dire warnings, coupled with resurgent tensions between the U.S. and China and uncertainty about the health risks from the economy's reopening, triggered the markets to stumble midweek. On Thursday, however, U.S. indices staged a comeback from significant intra-day losses to close higher.

As Figure 1 shows, the S&P 500 has been remarkably solid for more than a month, generally holding above the key 2,800 level since April 9, despite economic data continuing to surprise to the downside (Figure 2). The markets' tendency to be forward-looking implies that investors are looking past dismal current economic data to better times ahead. The disconnect between markets and the economy will be resolved either by (a) the markets trending lower in the months ahead, or (b) the economy displaying steady improvement (as record stimulus efforts pay off). Although it is impossible to predict which one of these outcomes will prevail, right now investors are wagering heavily on the latter. This uncertainty also means that the balanced strategy we follow in our portfolios is the right one for the current environment.

Figure 1: S&P 500 – Past three months (closing prices) **Source: FactSet**

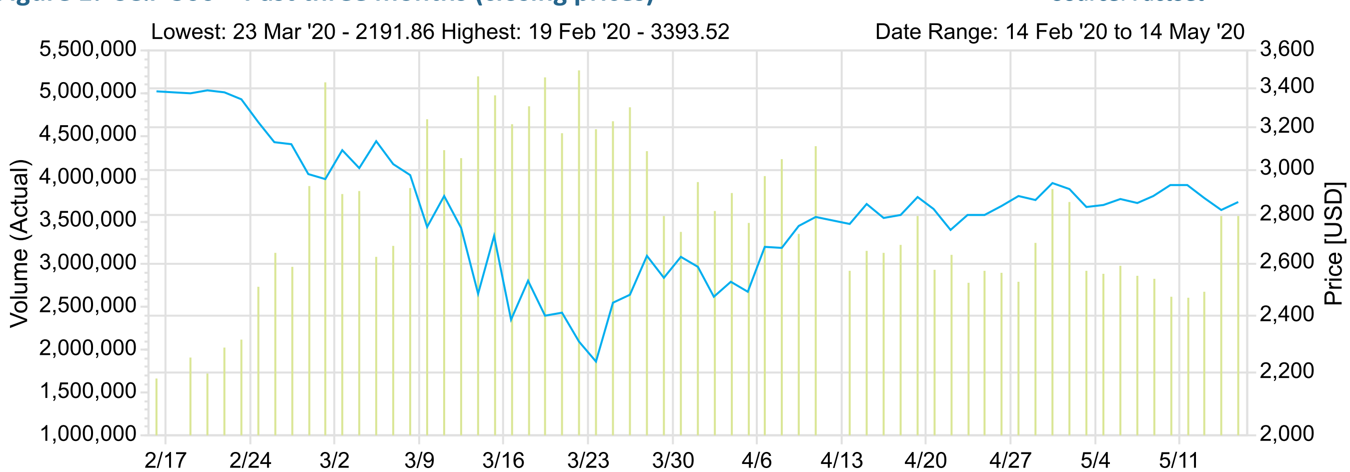
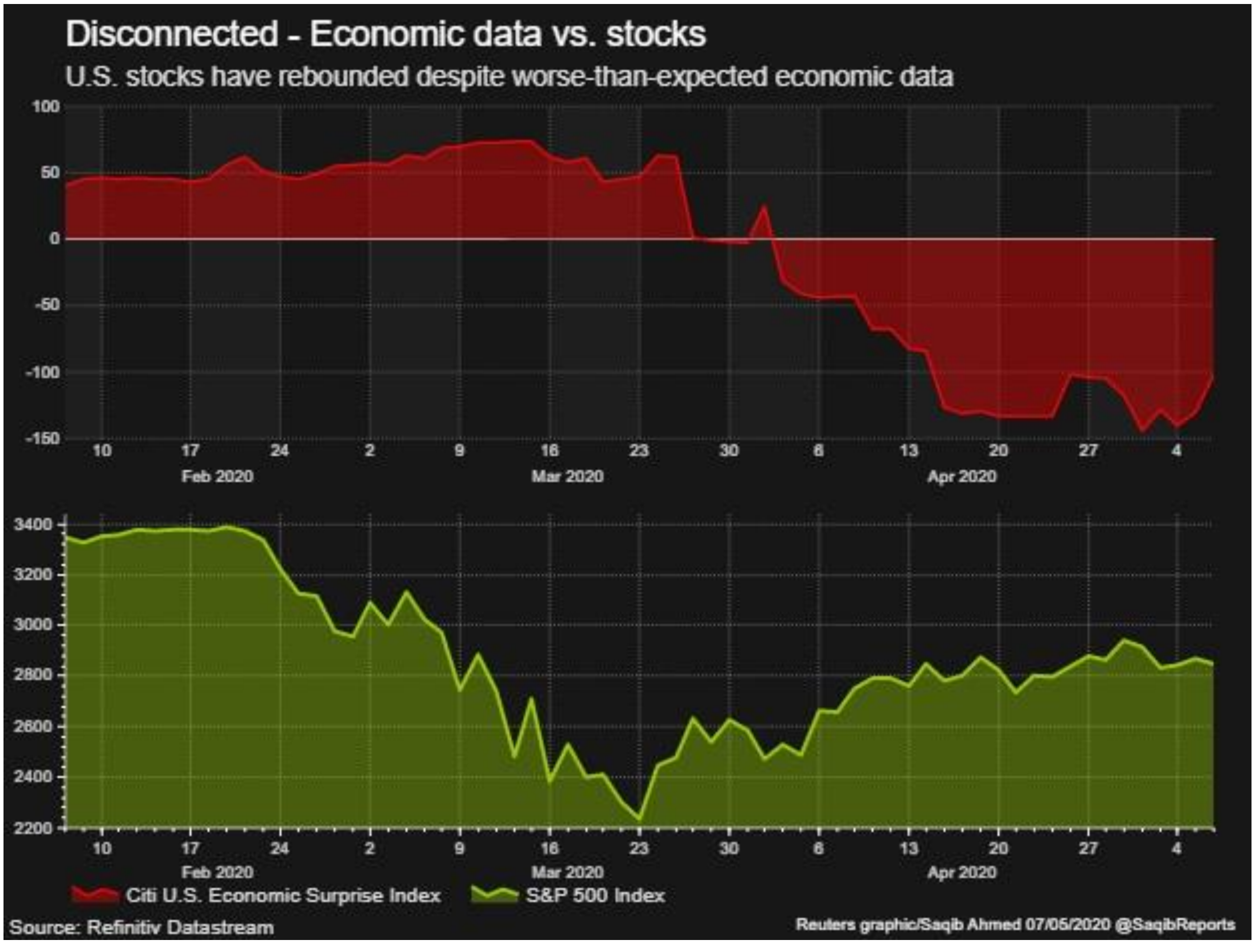


Figure 2: Citi US Economic Surprise Index vs. S&P 500 **Source: Reuters**



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