COMMENTARY

06/11/2020

Investors Reassess the Pace of the Recovery

- Market sentiment has been focused on an optimistic V-shape recovery.
- Cautious tones from economists and a rise in virus cases is shifting sentiment.
- We continue to expect a U-shape recovery and increasing market volatility.

Equity markets have been rallying on optimism that recent economic data indicate a V-shape or quick recovery and that virus containment efforts have been successful. Unfortunately, recent events suggest otherwise as both the Organization for Economic Cooperation and Development (OECD) and the Federal Reserve (Fed) suggested a more cautious tone towards the economy and there has been a notable increase in the number of COVID-19 cases. This reversal has led to a negative tone in equity markets as investors reassess their market expectations.

Since the March 23 lows, equity markets have been on a tear as optimistic investors focused on the reopening of the U.S. economy and the likelihood that the worst was over. They could point to a barrage of economic data that continually exceeded expectations such as manufacturing activity, an increasing number of air travelers, and an improving labor market. In fact, the data points were so strong, that investors believed an optimistic V-shape economic recovery, where the economic decline and subsequent rise are both quick, was likely. Unfortunately, two events occurred yesterday that has led to uncertainty about this quick recovery and dampened sentiment.

Early in the day, the OECD, an intergovernmental economic group, released a gloomy forecast that the global economy will decline by 6% this year and rise just 5.2% next year. If a second virus wave were to occur, they pointed to an even gloomier picture. Later in the day, during its interest rate policy meeting, the Fed also painted an economic picture that was more cautious than the V-shape recovery that investors have priced in. In short, the Fed suggested the economy will take much longer to reach its pre-recession levels. Comments from both the OECD and the Fed suggest that the more likely scenario is a U-shape recovery where the economy grows at a slow, modest pace.

Further weighing on market sentiment has been a notable increase in the number of COVID-19 cases. The U.S. reached a dire landmark as health officials confirmed 2 million cases on Wednesday. Moreover, according to data tracked by the Washington Post, since the start of June, 14 states have experienced their highest seven-day average of new coronavirus cases since the pandemic began. Since many of these states were the early reopened ones, investors are concerned that a potential second wave of the virus could lead to cautious consumer spending and impact the economic recovery.

With market valuations at levels not seen since the early 2000s and well above long-term averages, it is clear that investor sentiment has been optimistic around the reopening process and the likelihood of a quick, V-shape economic recovery. We, on the other hand, have been less optimistic. Yes, we have seen improving economic activity, however, we have always been concerned about the severity of this recession and the subsequent caution in consumer spending. Plus, the virus has so many unknowns that without a vaccine, a second wave would also weigh on the individuals. In early May, we laid out our primary economic and market predictions for the balance of 2020. With this recent news, a U-shaped economic recovery and elevated market volatility are still likely in our opinion. Despite this market weakness today, we still do not anticipate a retest of March lows. Instead, a likely scenario is a mild correction as investors reprice a V-shape to a U-shape economic recovery. Keep in mind that markets tend to average a correction about once every 12 months, so these pullbacks are fairly normal.

We continue to recommend sticking to risk tolerances consistent with your long-term goals and objectives and being diversified among sectors and asset classes. These are challenging and uncertain times, but your financial professional can help you stay on course.

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