TRANSITIONS

MARKET DISCONNECTS

An underlying current, not widely acknowledged, is the disconnect between the stock market and the economy. As a student of the markets over many decades, I have always found it important to visit stores and listen to business owners. It is easy to get seduced by the Wall Street activity on my market screens, but it is important to observe what is really happening in the economy.

Herb Diamant
PRESIDENT & SENIOR PORTFOLIO MANAGER

The year 2020 may be a year that is best put behind us. A sharp market correction of 34% in February and March ended the longest running bull market. Then the stock market abruptly turned course and moved up over 50%, back to where it was at the beginning of the year. With the market index back at the levels of the beginning of the year, is it reasonable to conclude the economy is in the same shape as before the Pandemic began?

During this time, a global health Pandemic began which created upheavals for nearly everyone. Many small businesses were forced to close. These closures ripple through the economy, impacting their owners, employees, along with their supply chains of vendors. With diminished incomes, all these consumers reduce their consumption of goods and services. Since the U.S. is predominantly a consumer-based economy, less consumption often translates into lower sales across many industries. This was seen in many areas, including retail sales, gas prices, along with the near seizing of the entire travel and entertainment industries.

The stock market's upward march relies on a story that the Pandemic is behind us, and the economy is back to normal. Or is it? Maybe the market is now priced for perfection, where everything must turn out right. This feels much like the euphoria of the Dot Com Bubble in 2000, which is when the S&P 500 Index last traded at 26 times earnings.

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An example of today's euphoria is the parabolic rise of Zoom Video Communications. Back in March we knew they had a great video platform, but the company was barely profitable and had already tripled in price since its recent IPO. Then their product instantly became a social lifeline, supporting both virtual learning and work from home. The stock moved up 523% this year despite nobody really knowing what will happen to their growth in a post-Covid economy.

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During our ongoing review of stock charts across industries, many stock charts are flat or declining. This is at odds with indices that are portraying a broad based, upward move. When parabolic rises in a handful of technology stocks move indexes upward, there is a divergence from the overall stock market.

Market disconnects can resolve themselves in several ways. The economy and the rest of the stocks can catch up to the story that everything is back to normal. Or the opposite could happen where the markets begin a correction in high flying stocks. A third possibility is a fragmentation into two markets, one where speculators trade stocks on headline news, while the other market focuses on the underlying opportunities in each stock. As external events influence market disconnects, the only thing we can be assured of is greater market volatility over the coming months. With the market fully valued, up and down moves of 1% a day may become common and part of our investment experience.

Visit our Resource Center for more market commentary and insights.

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Managing wealth through the transitions of life. It's what inspires us to do what we do every day.