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The Stock Market Is Ignoring the Economy

The Dow enjoyed its best two-week stretch in more than 80 years, but the economy is still struggling

Medical workers collect patient data this month at a coronavirus testing facility in Farmington Hills, Mich. Despite a sharp increase in virus cases and deaths, stocks have rallied.
PHOTO: EMILY ELCONIN/BLOOMBERG NEWS

By Gunjan Banerji
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The Dow Jones Industrial Average staged its best two-week performance since the 1930s, a dramatic rebound that has left many investors with a confounding reality: soaring share prices and a floundering economy.

The explosive rally is a sign that many are positioning for the U.S. to make a speedy recovery when the coronavirus crisis eases. Investors have been encouraged in recent days by signs that several states will move to resume business, along with hopes that a viable treatment for Covid-19 could be near.

The blue-chip index rose 2.2% this week, extending its rally over the past two weeks to 15%—its best performance since 1938. The S&P 500 climbed 3% this week, while the Nasdaq Composite surged 6.1% as investors piled into highflying technology stocks. The Dow and S&P 500 are still down more than 10% for the year, while the Nasdaq's losses have been cut to 3.6%

Many investors agree the most important driver of the rebound has been the Federal Reserve's massive stimulus plan, combined with the efforts of the U.S. government, which sent a signal that both were willing to step in like never before to buoy the economy. U.S. stocks bottomed March 23, after the Fed cut rates to near-zero.

"They took away the depression. That scenario is out of the picture now," said Zhiwei Ren, a portfolio manager at Penn Mutual Asset Management. "The Fed is the fundamental reason" for the rebound.

The central bank also unleashed a massive program to buy Treasurys and mortgage-backed securities, while President Trump signed a roughly $2 trillion stimulus package, the biggest relief package in U.S. history.

For some investors, it doesn't pay to bet against stocks after the Fed stepped in. The stimulus spurred a fear of missing out among investors and gave many the confidence to resurrect some of the most popular tactics of recent years—buying dips in the stock market and piling into shares of big technology companies.

The coronavirus' toll on the population and the economy has been dour. More than 150,000 people around the globe have died, while cases world-wide have topped 2 million. In the U.S., more than 22 million Americans have sought unemployment benefits in recent weeks.

Retail sales, a measure of purchases at stores, gasoline stations, restaurants, bars and online, fell by a seasonally adjusted 8.7% in March from a month earlier, the most severe decline since record-keeping began in 1992. Earnings for the first quarter among big U.S. companies are expected to decline nearly 15% from a year earlier, according to

FactSet, which would mark the biggest decline since 2009.

Still, as the data has darkened, investors have been buying stocks, extending the Dow's rally from its March low to 30%. It is a sharp about-face from March, the most volatile month in the stock market's history, when the 11-year bull market in equities abruptly ended.

"While it's great to be in the green, we do wonder, what is it that the markets are celebrating," said Amy Kong, chief investment officer at Barrett Asset Management. "Nobody knows how long this is going to last," she said of the pandemic.

Many analysts are now betting on a so-called V-shaped recovery—a sharp slowdown and then a quick economic recovery. Goldman Sachs Group Inc. economists expect the economy to significantly contract in the first and second quarters before rebounding later in the year.

Analysts are also looking past this year's abysmal earnings expectations and forecasting profit growth in the first and second quarters of next year, FactSet data show. Corporate earnings are projected to plunge by 27% in the second quarter of 2020, before rebounding.

Marko Kolanovic, JPMorgan Chase & Co's global head of quantitative and derivatives strategy, has been analyzing reams of data on the spread of the pandemic around the globe, looking at hospitalization rates and resources like hospital beds for clients. He expects U.S. stocks to be back at highs in the first half of next year. Why? Going against the Federal Reserve is typically a losing battle, he said.

Many stores like this one in Beverly Hills, Calif., are closed, hitting retail sales and corporate profit.

PHOTO: LUCY NICHOLSON/REUTERS

The Fed's latest move "reinforces our view of a full asset price recovery, and equity markets reaching all-time highs next year," Mr. Kolanovic said in a recent note. "Investors with [a] focus on negative upcoming earnings and economic developments are effectively 'fighting the Fed,' which was historically a losing proposition."

There may be limits to that approach, other analysts said. For example, a $350 billion small-business loan program from the U.S. government has already exhausted its funding, highlighting the mammoth challenge that lawmakers face—and sheer amount of cash necessary—to support the economy and keep Americans employed.

These types of loans can be forgiven if firms don't lay off workers, but U.S. lawmakers have recently struggled to agree on the next round of coronavirus emergency aid.

Despite the stimulus checks going to Americans around the country, measures by the central bank and government can't alter human behavior and force people to leave their homes, eat at restaurants, shop at malls and go to movies. That has led some analysts to say a recovery may take longer than many are currently anticipating.

"How long before you and I are going to feel comfortable going to a concert again?" said Dominic Nolan, a senior managing director at Pacific Asset Management, which oversees roughly $12 billion in debt. "A government program doesn't really help that."

Mr. Nolan said that he has recently bought bonds of investment-grade companies after the Federal Reserve's recent moves.

Some investors are still anxious because the bond market is sending a more cautious signal. Investors have continued scooping up traditionally safe assets like government bonds and gold as stocks have rallied. The yield on the 10-year Treasury note has fallen to 0.655% from 1.26% in mid-March as bond prices have risen, while gold prices hit their highest level in more than seven years this week. The concurrent gains across traditionally risky and safe assets alike suggest that many remain concerned about an extended downturn.

Investors have also treated some corners of the stock market as a hiding place, piling into the technology darlings that powered markets higher in recent years.

"The Nasdaq is trading like a safe haven in a way," Mr. Ren of Penn Mutual Asset Management said.

A sign urges people to social distance in Des Moines, Iowa. Most nonessential businesses in the state are closed until April 30.
PHOTO: JACK KURTZ/ZUMA PRESS

Amazon.com Inc. and Netflix Inc. both surged at least 14% this week and set records, while some of the momentum-driven trades that were popular earlier in the year also re-emerged. Tesla Inc. has risen for 10 consecutive trading days, its longest winning streak on record, bringing its gain for the year to 80%.

It seems like a "hold your nose, close your eyes and buy," situation, said Mike Bailey, director of Research at FBB Capital Partners. "Even though there's a torrent of economic data coming."

Mr. Bailey said he has been surprised by the "stocks going up on bad news" phenomenon. However, he has bought shares of Amazon and Apple Inc.

The recent rally among big tech stocks underscores their hefty influence on the market. The S&P 500, which is weighted by market-capitalization, is down 11% this year, while a version of the index that gives every company an equal weighting has plummeted 19%.

"You have the trillion dollar guys that are doing fine," Mr. Nolan said. "I think on average companies have gotten hit really hard."

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