



The Stock Market is Not the Economy

April 2020

- The economic fallout from the coronavirus crisis ramped up in April. Since the start of the crisis, the U.S. has lost over 27 million jobs, and the unemployment rate is estimated to be 17%.³
- If one Wall Street adage explained April, it's this: "the stock market is not the economy." Although April was one of the worst months for the economy on record, it was also the best month for the stock market in 33 years.
- The sustainability of this disconnect is unclear. Are investors looking beyond the current economic wreckage and anticipating a swift and full recovery, or conversely, are they simply caught up in a liquidity-fueled buying spree that will eventually stall out or fail as the long-term consequences of the pandemic become clear?

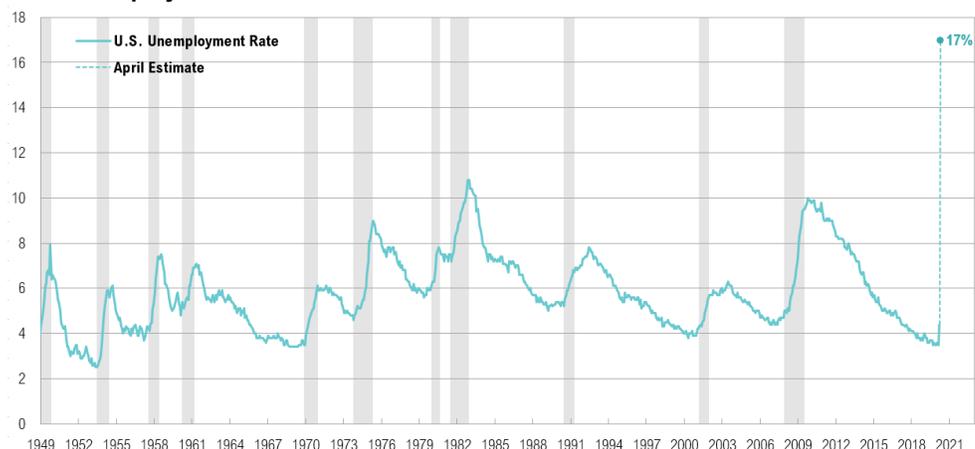
The Coronavirus & the Economy

The devastation wrought by the novel coronavirus has been profound, both in terms of loss of life and the economic costs of containing it. The economic situation was summed up well by U.S. Federal Reserve Vice Chairman Richard Clarida in early May: "We're in a period of some very, very, very hard and difficult data that we've just not seen for the economy in our lifetimes, that's for sure."¹

The first quarter Gross Domestic Product (GDP) report released on April 29 showed economic activity contracting 4.8% (at an annual rate), the worst slump since the Financial Crisis. U.S. initial unemployment claims eclipsed 27.8 million (not seasonally-adjusted) over the six weeks ending April 25, more than six times greater than the prior record.² Researchers at Oxford Economics expect Friday's payroll report for April to show the unemployment rate increasing to 17%.³ If there is any good economic news, it is that the pace of job losses has slowed since the peak of 6.9 million, which was reached on March 28, but that is no doubt scant consolation for the millions who are jobless.

News about the virus itself has been equally dismal, but we continue to cling to the hope that the worst may be behind us. The number of new cases has shown little improvement,

U.S. Unemployment Rate



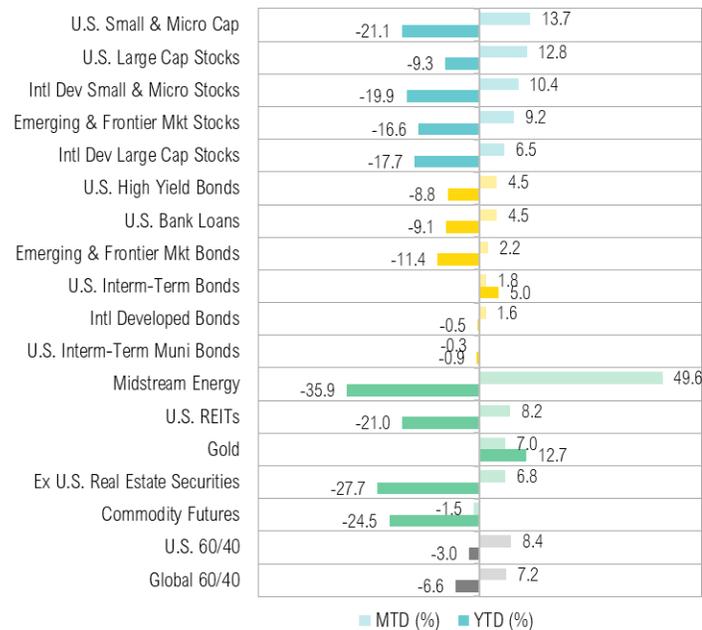
Source: U.S. Bureau of Labor Statistics

averaging slightly less than 30,000 for the last month⁴, though as the number of tests administered has increased, the ratio of positive cases relative to the total tested has been declining and is currently at 16.5%, down from a high of almost 20% on April 14.⁵

The Stock Market is Not the Economy

If one Wall Street adage explained April, it's this: "The stock market is not the economy." (A close second would be, "Don't fight the Fed.") While April was one of the worst months for the economy on record, it was also the best month for the stock market in 33 years, with the S&P 500 Index rising 12.8%. Most risky assets experienced dramatic gains, with especially strong showings from the Consumer Discretionary and Technology sectors, which were up 19.0% and 13.8%, respectively.

April 2020 Key Market Total Returns



Source: Bloomberg

Aside from the clearing of oversold conditions that is common coming out of panics, a significant portion of the market recovery was precipitated by the litany of fiscal and monetary support programs aimed at creating an economic stopgap. In addition to fiscal measures totaling 13% of GDP in March⁶, in April the U.S. approved a fourth stimulus package, totaling \$484 billion and including a \$384 billion expansion of the Small Business Administration's lending programs, as well as \$100 billion to support testing for COVID-19 and healthcare providers.⁷

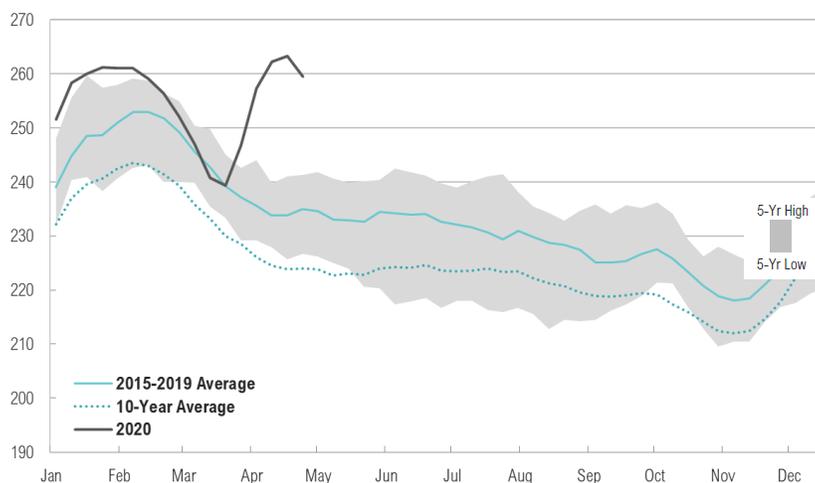
The U.S. Federal Reserve also continued its bond-buying program, rapidly expanding its balance sheet from \$5.3 trillion at the end of March to \$6.7 trillion on April 29. This astonishing \$1.4 trillion jump in asset purchases represents another 6.5% of 2019 GDP.⁸

All told, the various stimulus programs will add up to 26% of expected 2020 GDP, which is a staggering number.⁹ These measures will of course not be costless over the long term, but they do put cash in consumers' pockets and inject liquidity into the financial markets immediately.

Crude Carnage

Supply and demand imbalances continued to wreak havoc on the energy sector in April. The hardest hit area was the WTI crude oil futures market. While a significant portion of this market is represented by speculators who are betting on the price of oil—rather than hedging it—these markets are nevertheless linked to the physical oil markets. That link is most relevant when each month's futures contract expires and its holder is obligated to take delivery of 1,000 barrels of oil in Cushing, Oklahoma. Normally, these speculators—often called “paper traders”—will roll expiring contracts to a future month, thereby avoiding the need to take delivery. But these are not normal times. For example, retail gasoline demand was down an estimated 29 million barrels/day in April versus the same month last year, a 29% decline and a level not seen since 1995¹⁰. In addition, suppliers have yet to adjust to a reality in which fewer miles are driven and fewer flights are taken. As a result, gasoline and crude oil inventories have swelled to record levels, and storage prices are at a premium. These factors drove prices on the May WTI crude oil futures contract to below negative \$37 per barrel, an all-time low.

U.S. Gasoline Inventories



Source: U.S. Energy Information Administration

Looking Forward

A short-term divergence between the markets and the economy is understandable, if not to be expected. However, the size of the current disconnect is worrisome, and its sustainability remains unclear. Are investors looking beyond the current economic wreckage and pricing in a swift and full recovery—presumably after the virus has run its course or a vaccine developed—or are they ignoring the long-term damage of the pandemic and engaging in a liquidity-fueled bear market rally that will eventually stall out or even fail? We suspect the answer lies in how we will all, collectively, behave once the lockdowns ease, as they are starting to across the U.S. Will we all travel, shop, and invest—deploying our now coveted capital—the way we did at the end of last year, or have things changed? We will soon find out.

Risks

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Citations

1. CNBC: <https://www.cnbc.com/2020/05/05/cnbc-exclusive-cnbc-transcript-federal-reserve-vice-chairman-richard-clarida-speaks-with-cnbc-sara-eisen-today.html>
2. U.S. Department of Labor
3. Oxford Economics: <https://bit.ly/3dpAy1c>
4. Bing, aggregated from CDC, WHO, ECDC, Wikipedia, 24/7 Wall Street and BNO News
5. Bloomberg data, SpringTide calculations
6. Congressional Budget Office, Hoisington
7. Library of Congress, Congressional Budget Office
8. Board of Governors of the Federal Reserve System
9. Charles Schwab: <https://bit.ly/2WuKEXH>
10. U.S. Energy Information Administration

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