BLOG POST
The Great Disconnect
6/1/2020

Breath-taking, staggering, astounding, inconceivable. These are a few of the adjectives used to describe the markets in 2020. The stock market began 2020 in positive but pedestrian fashion gaining a little over 4% through mid-February. That is when COVID-19 became a household name, and government, and economies, around the world began to shut down.

It is not difficult to predict the economic damage when economies shudder; more than 35 million Americans lost jobs in the first 6 weeks, driving the unemployment rates higher than at the peak of the Great Financial Crisis. The official unemployment rate, called the U-3 rate, is not the only calculation the BLS provides. The more comprehensive U-6, that includes full-time working only working part-time, was at 22.80% at the end of April. Based on BLS figures for average earnings, the lost jobs equate to nearly $1 trillion in reduced consumer spending after factoring in government benefits.

Economist David Rosenburg believes 20% of the jobs lost due to the shut down will be permanent, and that double-digit unemployment will last into 2023 (unemployment peaked at 10.0% in the last recession). It is not just jobs being lost — thousands of companies have filed for bankruptcy, including high profile names like Pier 1, JC Penney, Nieman Marcus, Gold's Gym, J Crew, and Dean and Deluca, and we are no where near the economy fully functioning.

The collaborative efforts of the Fed and Congress to address the economic pain has been admirable, and costly. More than $3 trillion has been allocated and estimates are for at least that amount in future stimulus. Baring a revocation of the Laws of Economics, this additional debt will result in slower future growth as there is no free lunch. Markets priced economic calamity at breakneck speed with the S&P 500 falling 35.5% in just 23 trading days, the fastest onset of a bear market in history.

If the story ended here, you could make the argument the markets are efficient and priced in the uncertainty risk of halting the global economy. What causes many to scratch their head is the recovery off the March 23 lows when the full economic impact is still largely unknown. The S&P 500 has bounced back 22% in the 41 trading days since the March bottom.

Many have posited theories on the recovery in equities while the economic carnage deepens based on growth in the money supply and the Fed's intervention. No doubt, the Fed publicly stating they will buy junk-rated fixed income ETF's suggests a strong backstop for investors. Fed action and Congressional stimulus helped with confidence but have done little to impact corporate earnings. The data, however, provides a clear explanation of the sharp rebound in stocks.

The chart shows the concentration in the S&P 500 of just the five largest market caps: Microsoft, Apple, Amazon, Google and Facebook. Before the Tech Crash, this concentration rose to 18% and many thought that would never be repeated. Today we are above 21% and the chart looks like a Space-X liftoff. The S&P 500 is down only 9% YTD when heading into a Depression because of the performance of those five stocks. All five are positive, ranging from +5% (Google) to +32% (Amazon). The median price gain is +15% YTD, but they have risen a cumulative 170% from the March bottom.

I have been in the camp that the recent rally is a powerful bear market rally as has occurred in every bear market since 1929, so equity investors are clearly not out of the woods. The question is how long can the top five companies maintain earnings to sustain current levels? This contraction is very unique being self-imposed and forcing significant changes as a result of social distancing and work from home. Not surprising, companies like Amazon, Microsoft, and Apple are benefitting from some of the changes, with the jury out on what will happen with ad revenue from Facebook and Google. More than any time in the past, there seems to be clearly delineated winners and losers from this period.

COVID-19 is not just an economic catastrophe, it has taken a massive human toll as well. Sadly, the human toll is greatest in the developing world where my friend David Beasley of the World Food Programme has said the economic shutdown has put 260 million people at risk of starvation. U.S. leaders like Oregon Governor Kate Brown pledging to keep the economy in shutdown into July, even though fewer than 150 deaths from COVID at this writing, seem oblivious to the physical harm their actions are having.