# Disconnect Between the Markets & the Economy

*Trying to reconcile the recent market advances with awful economic data*

U.S. stock markets continue to trend up as optimism returns to Wall Street while Main Street USA continues to reopen. Yes, there is plenty of social unrest around the country, geopolitical tensions with China are increasing and horribly negative economic data continues to be released almost daily, but the major U.S. markets are trading at levels not seen since the very early days of COVID-19.

In fact, while the DJIA and S&P 500 are close to their pre-COVID-19 days, NASDAQ reached a new high, cresting the wholly-psychological 10,000-point threshold mid-day on June 9th.

## The Markets Have Covered a Lot of Ground

If you go back to the beginning of 2020, many market pundits were suggesting that the stock markets were a bit ahead of themselves, but most economists would have agreed that fundamental conditions were still supportive of a favorable environment for stock markets. Unemployment was at a 50-year low, interest rates were at historically low levels, corporate earnings were solid and GDP growth was slowing but still growing.

In just a few short months, everything changed. We entered into official correction- and then bear-market territory, unemployment is at historically high levels, corporate earnings in Q1 were hammered and we saw the largest quarterly decline in GDP growth since the fourth quarter of 2008. And GDP numbers for the second quarter of 2020 are predicted to be so much worse. But that's not the whole picture.

In those few short months we also witnessed an impressive market rally, including the month of April which saw the DJIA and S&P 500 turn in their best monthly gains since 1987. Further, the DJIA, S&P 500 and NASDAQ have all climbed over 30% since their lows in late March.

In other words, the markets have covered quite a bit of ground in a very short period of time. And that begs the question, did the markets move too far and too fast?

## The Markets Look Forward, Not Backward

It can be challenging to reconcile why stock markets could conceivably perform well amidst a constant barrage of negative economic news. Intuitively, it just doesn't make sense. But, the apparent disconnect between markets and the economy is actually normal.

This is because the economic data we are bombarded with is backwards looking. It tells us what happened. The Employment Situation Report, for example, reports the previous week's unemployment numbers. Most of the other monthly economic data, by comparison, captures what happened in the previous month – with some data reports going back two months.

The stock markets, on the other hand, are forward-looking. Consider this: the massive sell-off in late February and early March was more about the markets (i.e., investors) feeling uncertain given the new and growing coronavirus pandemic. But the economic data received during this sell-off was actually showing very healthy signs.

How forward does the market look? Well the answer to that depends on who you ask. But generally speaking, the markets look forward at least a couple of quarters, maybe even as much as 18 months.

## Does That Mean It's Over?

Well, we might like to think that we're out of the woods, but we're not. Especially when you consider that the market corrections and rallies were really over a very short-term period. In addition, we have not witnessed the effects of a similar global pandemic on our economy or markets in recent history, so we don't have much to offer by way of comparison.

That being said, the recent market rallies are encouraging. In fact, often times, strong rallies occur in the later stages of bear markets and maybe we can look back five years from now and recognize that this was the case for our recent rallies. Or maybe not.

Going forward, we do know this: we will continue to receive more very negative economic news, especially in the second quarter.

Case in point: it is generally accepted that GDP will sink further in the second quarter of 2020, when the impact of shutdowns and layoffs are felt more dramatically. In fact, many economic models are predicting that GDP will sink to an annual rate of more than 50% in the second quarter, which would be the biggest quarterly decline on record and a whopping 5-times greater than the previous record set more than 60 years ago in 1958.

## What Should Investors Do?

The U.S. stock markets can and do move faster than the U.S. economy, but longer-term, the two are absolutely connected. And while there are reasons to be optimistic, there are also plenty of reasons to worry too. As such, it's important for investors to manage their expectations appropriately.

Further, investors should ensure that they are appropriately diversified, given their tolerance for risk. This includes ensuring periodic rebalancing – not short-term trading – to ensure that the original asset allocation that was deemed appropriate is still intact.

Your financial advisor can help.