Weekly Market Flash

Getting the Memo

October 30, 2020

The stock market has been having a pretty rough week. As usual, financial media types have supplied us with a couple go-to explanations. If you tuned into CNBC or a similar market-focused source you probably heard something along the following lines: "stocks fell this week because Covid cases are up and there are no prospects for a fiscal relief package from Congress before the election." Maybe someone tossed in the phrase "election jitters" because, well, it just sounds good and appropriate in the week before a highly consequential election with still a number of moving parts.

Yes, But Why Now?

All those go-to reasons are valid. They were also valid on October 2, when Covid cases were rising again from late-summer levels, when the differences between what Democrats and Republicans were demanding for fiscal relief seemed insurmountable, and when concerns over the likelihood of a contested election were, if anything, somewhat higher than they are today. Yet from October 2 to October 12 the S&P 500 rose more than five percent. Same news, different market response. What gives?

We call this "getting the memo." The market seems to chug along on its merry way, impervious to anything that might call for reconsidering. Then one day, seemingly out of the blue, all those algorithms that power the daily buy and sell triggers move in the same direction. Greed turns to fear in a single heartbeat. We've seen this happen plenty of times before. In 2018 the Fed spent most of the year communicating its intention to continue raising interest rates as it implemented a monetary tightening policy. All summer long the market enjoyed a steady rally with very low volatility. Then one day in early October everyone got the memo, and a 19 percent correction took place over the next two months. Go figure. This is why we always say that market timing is a fool's errand.

About That GDP Number

Depending on where you get most of your news from, you may have wondered why the market didn't rally more strongly than it did yesterday, when the third quarter Gross Domestic Product (GDP) numbers came out. After all, if you just went by the headlines or a quick one-liner from a local news anchor you would have heard that the third quarter saw a record-breaking rise in GDP growth. Fastest quarter of growth since 1948, when record-keeping started!

In this as in most cases, context matters. And the context here is that the record-breaking third quarter growth followed what was by far the worst quarter in GDP history, reflecting the near-total shutdown of the economy that occupied much of the fiscal quarter from April to June. The net effect of the pandemic is that US output, as measured by GDP, is still about three percent less than it was in the third quarter of 2019. It is still likely to be below last year's levels when this year (finally) comes to an end.

2021 Memo Still In Development

We expect there will be more instances in the year ahead when markets seem to ignore the circumstances at hand until that day when they get the memo. Whatever is going to be on that memo is still very much in development. In our opinion this is not a good time to be making strong directional bets, because those bets could wind up being spectacularly wrong. In recent weeks we have been writing quite a bit about the possible reappearance of the "infrastructure reflation trade" in which a new Democratic-led administration implements a massive double-dose of pandemic relief and infrastructure spending. The bond market continues to suggest a growing conviction in this outcome, with the interest rate yield curve steepening at intermediate and long maturities.

But there is a long way to go from here to there, including an election that hasn't happened and Senate procedural rules that haven't been overturned, among others. For our part, we are comfortable staying put with an allocation that we believe offers a bit more defensive positioning while maintaining exposure to growth opportunities. All the while we will continue to spend our days analyzing the many factors contending for mention in that eventual 2021 memo.

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