Market Update from Thrivent

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The Fed provides more "financial flu therapy"

During this shortened holiday week, we've seen an incredibly strong recovery in stock and corporate bond prices, while the safe haven of treasury bonds has experienced modest price declines. The predominant reason for this is that COVID-19 infection rates appear to be declining in Europe and plateauing in New York, while efforts related to testing, therapies and vaccines are significantly ramping up. Markets were given another huge dose of "therapy" today with the Federal Reserve announcing another enormous package of targeted financial support totaling $2.3 trillion. This represents another stunning measure of financial support in response to the news that an additional 6.6 million Americans filed for unemployment claims in the past week.

Stock market performance differentiation

The S&P 500 has now rallied 25% from its March 23rd low in only 13 trading days. As of now, the market is down 18% from its high on February 19 and 13% since the end of 2019. The stock market has been responding solely to news on COVID-19 statistics and the enormous government policy responses that have been put in place. Corporate earnings, which drive market valuation in the long term, are much less relevant now given the little insight investors have regarding how this crisis will impact profits. However, it is instructive to look at how various dimensions of the market have behaved during this exceptionally dynamic and swift bear market.

Since the peak of the market on February 19, U.S. domestic stocks have fared meaningfully better than international developed market stocks, especially when adjusted for currency moves (the dollar has strengthened relative to other currencies). Emerging market stocks have tracked about in line with the U.S. This is not surprising given that China, which is well ahead of the rest of the world in going through the crisis, dominates emerging market indices. However, in the U.S., there has been remarkable differentiation in returns across the key market sectors. Large cap stocks, and especially large cap growth stocks, have performed significantly better than small cap or value stocks. This should not be surprising given that small cap stocks are by nature less resilient given their size, access to capital and less diverse business lines. Value stocks are dominated by banks, industrials and commodity-related companies, all which have been at the epicenter of the problems caused by the coronavirus pandemic crisis. Overall the differential in performance between large cap growth stocks and small cap value stocks is nearly 17%!

There are also certain characteristics, known as factors, that have shown clear differentiation in equity performance, not only during this crisis, but even before the emergence of COVID-19. In summary, companies that have characteristics of sustainable growth, higher quality (i.e. lower debt to cash flow), high profit margins and price momentum have performed much better during this 6-8 week period than companies that have low valuation, low growth and higher debt characteristics.

In the long term, we expect these relative performance trends in equity sectors to persist. Domestically, high-quality, large growth companies are better suited to weather this economic storm. Basically, the modern economy is such that a subset of large growth names, particularly in technology and consumer services, have some level of immunity to an event that forces people to “shelter in place.”

Internationally, we believe that emerging market equities, especially in Asia, are better suited for this environment than developed market equities, particularly Europe. As mentioned previously, Asia is much further along the pandemic timeline than western economies and was able to deal with the problem with more agility and discipline.

Aside from the news flow, economics and markets, let’s take a moment to recognize that spring and Easter have arrived. It’s a time of rebirth and gives us a new season with new possibilities. Happy Easter to all!

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