Market Update from Thrivent

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Charting an economic recovery amidst a pandemic

During the coronavirus pandemic, markets across equities and credit sold off with unprecedented speed and volatility, breeching bear market thresholds quicker than ever before in the past. Never have modern economies shut down with such rapidity in peacetime, opening the door to a global recession. Volatility has cut both ways with sharp moves up and down, as investors struggle to price in potential outcomes.

Much uncertainty remains over the course of the coronavirus pandemic, markets and when and how to restart the economy. There are no roadmaps for navigating through pandemic-driven markets. Nevertheless, there are signposts than can help guide investors.

Here are a few things to monitor.

Tracking the coronavirus

The global coronavirus pandemic triggered this crisis, rather than economic excesses or imbalances as often is the case with recessions. The key to the recovery, then, will lie in the depth and breadth of the pandemic. The progression of the pandemic will inform markets about when the economy will begin to recover, which in turn will shed light on a rebound in earnings. Corporate earnings drive stock markets over the long run. They also enable companies to pay interest on bonds and repay their debt. In this way, the course of the virus will drive the economy—which will then drive markets.

Investors have keyed in on tracking the global spread of the pandemic, particularly in European and U.S. hotspots. The pandemic hit Europe harder and earlier than in the United States, so watching the trajectory of new cases and countermeasures in Europe will give us clues on how it will play out in the U.S. Investors also have focused on New York City and the surrounding area. A key metric to monitor is the trajectory of new cases, noting that new case counts only reflect people who are tested. Only about 1% of the U.S. population has been tested so far. Statistics such as hospital admissions and deaths can help paint a clearer picture of the pandemic's severity. Both markets and health officials are looking for growth-rate declines in new cases, often referred to as flattening the curve. Additionally, it's important to watch countries that were hit early, like China, as people go back to work. Markets would very likely react negatively to a second wave of cases in China.

The encouraging news is that the growth rate of new cases and deaths appears to have peaked and is now declining in key countries such as Italy and Spain. It also has declined in hot spots within the U.S., like New York City. The Centers for Disease Control and Prevention (CDC) believes the peak in the U.S. may be near. This has buoyed markets.

After cases peak, the main concern is a second wave of coronavirus spread when movement and work restrictions are lifted. Discouragingly, Japan declared a national emergency recently as new cases started ramping up; the country was previously seen as an early success story in containing the virus.

How the pandemic plays out over the coming months will be key to the markets and economy. A recent survey by ISI Evercore asked institutional investors what the market needs for sentiment to shift higher. The clear number one answer was a peak/stabilization in coronavirus cases, followed by a pharmacological solution.

Treatments

Globally, tremendous resources have been poured into finding effective treatments for the coronavirus. The more we learn, the better armed we are for the fight. A vaccine appears unlikely until next year, but other pharmaceutical treatments already have shown promise, although nothing has emerged yet as a silver bullet. A highly effective treatment could be a game-changer, enabling economies to restart, sparking a durable and strong market rally. Investors are closely tracking progress.

Monetary policy and the Fed

Supportive monetary policy is critical in an economic downturn. The good news is this box has largely been checked, especially in the United States. The Federal Reserve acted quickly, broadly and massively to support market functioning and the economy. The Fed cut rates to zero, in addition to the open-ended buying of Treasuries and mortgages. It also has launched programs to support money markets, corporate credit markets, small businesses, critical industries, municipalities, securitized assets and consumer lending. The Fed has even taken the unprecedented action of supporting parts of the high-yield bond market, including ETFs. Announced liquidity programs total nearly $5 trillion and the Fed's balance sheet already has ballooned by nearly $2 trillion.

The bottom line: we expect the Fed to do whatever it takes to stabilize market functioning and support the economy.

Fiscal policy

Classic economic theory calls for government to fill the void in a sharp downturn when households and businesses slash spending. So far, the U.S. government has stepped in with unprecedented spending, but more may be needed. Congress has passed three support packages totaling nearly $2.4 trillion, which dwarfs the response following the Great Financial Crisis in 2008. The packages are wide ranging, including support for front-line medical care, direct payments to individuals, paid sick leave, increased unemployment insurance and assistance to small businesses and large companies. The $2.4 trillion, however, totals about 11% of the size of the U.S. economy, which will not replace the lost production. Also, the policy that's been passed functions more like a safety net for households and a life vest to troubled companies. It doesn't substitute for spending that will stimulate growth.

The current administration and Congress are already talking about a fourth round of funding, including possibly further support for small businesses and households in addition to infrastructure spending.

While fiscal support may not kickstart the economy, it does soften downside scenarios. The key will be how quickly the money reaches people and businesses. If the economy doesn't respond quickly, policymakers will need to determine what further measures to take. It's important to prevent a cycle of layoffs and failed businesses, which lowers demand and in turn creates more layoffs. Watch for more on the fiscal front.

Tracking economic data

Most economic data are backward looking. The information tells us where we have been. The best indicators to decipher trends are high frequency data, such as weekly jobless claims, which have smashed previous records. Watch for signs of stabilization in jobless claims. Also, survey data, like that from consumer and business confidence surveys, tend to lead hard data, such as industrial production. These are important to watch.

It's also important to monitor China's economy and parts of Europe as hard-hit countries attempt to normalize. It's unclear how quickly economies can reopen while still preventing a resurgence in new coronavirus cases.

Restarting the economy

Many questions remain about when and how people can return to work and when the quilt of stay-at-home orders across the country can be lifted. The first steps of returning to normalcy could begin in a month or so, but setbacks are possible too. Much is uncertain.

Experts do generally agree on key conditions that need to be in place to lessen the chances of a second wave and more lockdowns. These include:

- Widespread testing to determine who is infected.
- Antibody tests to determine who has immunity and could return to work.
- Monitoring positive cases and tracing contacts of infected people so they can be quarantined.
- Increased hospital capacity to handle possible surges in coronavirus cases.

Watch for progress on these fronts that would enable the economy to restart without fueling the pandemic.

Markets

Markets are forward looking and tend to bottom on average across asset classes about one quarter before the end of a recession. Often, credit leads markets down and then up in a recovery. Also, follow the Fed. Asset classes targeted by the Fed tend to lead recoveries. In this downturn, the Fed stepped in to stabilize short-term markets, such as money markets, in addition to high-quality assets, such as Treasuries and mortgages. The Fed also launched programs to buy short-maturity corporate bonds as that market had become dislocated. Short-maturity corporate bonds subsequently rallied sharply with Fed support. As higher-quality assets recover more fully, look for riskier segments to rally more deeply, including high yield and leveraged loans. For equities, earnings drive performance. Clarity on the length and depth of the downturn will be critical for analysts to get an accurate read on future earnings.

Expect volatility in the meantime. Using past bear markets as a guide, markets may not have not found a durable bottom yet. The median bear market length has taken about a year and half to fall from peak to the trough since the middle of the mid-1800s, according to Goldman Sachs. No bear market has taken shorter than three months. This is not an ordinary recession, however. The economy was strong before the pandemic hit suddenly. It could bounce back strongly should the pandemic come under control.

Oil

Markets are closely watching oil prices, which tumbled in the wake of a price war between Saudi Arabia and Russia. The price war has ended, and OPEC and other oil producers have agreed to production cuts to support pricing. The main issue, however, is severe demand weakness with economies shutting down. Why are higher prices good when they could raise gas prices for consumers? The U.S. is now the largest oil producer globally. Oil production has become a key part of the economy. Also, oil pricing is particularly important for the high-yield bond market, which has about a 12% weighting in energy.

Positioning

Markets tend to bottom when seller exhaustion sets in and positioning gets extreme. That's exactly what happened in late March. Too many investors bailed or had to sell as leveraged positions unwound. Selling had outpaced fundamentals. The market is more balanced now.

While watching for these signposts, remember that bear markets end during recessions—not after them. The key for investors is to look for signposts of a turn in the pandemic and a sustainable turn in markets. Markets have rallied strongly but still may retest lows set in March. A good strategy is to take advantage of dips and more attractive valuations that emerge while staying within one's risk tolerances. Valuation over the short run explains only about 10% of the moves in stocks over a one-year holding period. This rises to more than 80% over a 10-year holding period. Buying low and holding long enough increases the chance of positive returns.

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