Ignoring Economic Statistics

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Over the past couple of weeks, the economic damage from the coronavirus was of such magnitude that comparing economic data to the pre-virus statistics has become meaningless. An explosion in unemployment claims to 5.2 million last week, industrial production falling by 5.4%, retail sales declining 8.7% and the consumer price index falling at an annual rate of 4.8% are just a few examples. This morning the price of oil plunged to under $11 per barrel down 40% from Friday's closing price for West Texas Intermediate Crude. These data are only a sampling of what could come over the next few months even if the economy begins to reopen as directed by individual state governors who have the power to make the decisions to open gradually or not at all. For the next few months, economists will be hard-pressed to make some sense out of these data. For long-term investors, decisions regarding these short-term economic statistics could be counterproductive. For example, deciding to jump into stocks benefitting from the virus after these stocks have run up in price could be counterproductive as any perceived "cure" for the virus could see investors moving back into traditional investment positions.

Surprisingly the stock market continued to rally since the bottom was reached in late March. Even though the number of deaths from the virus rose dramatically since then and economic statistics were falling, stock prices were rising. There were at least two reasons: Rebalancing of institutional portfolios that we have discussed in prior writings and the Fed's promise that it would backstop the financial sector with another $2.3 trillion by buying both government and corporate bonds of all ratings. Note that the Fed can come up with as much money as needed to provide a safety net under the economy.

As the stock market rallied, so did bonds that resulted in record-low yields. For example, the yield on the two-year government note fell to 0.2% or twenty basis points. The ten-year bond fell to 0.65% or sixty-five basis points. The thirty-year bond yields 1.27%. Meanwhile, the yield on large-cap stocks as measured by the S&P 500 is 2.02%! Investors are getting a raw deal in trying to save for retirement using government bonds. Such bonds should be used to preserve capital with emphasis on short-term maturities.

Even though the equity markets in general have been bouncing around, there has been a wide discrepancy in stocks when classified by large-cap vs. small-cap and growth vs. value. In addition, there is a wide performance divide between the winners and losers due to the coronavirus and the oil price collapse. Foreign exposure should also be evaluated when it comes to investment decisions. In our current investment environment, active stock selection will likely prove to be a value-added strategy.

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