Jobs, Not Mobs Lead Stocks Higher

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In the face of ongoing civil unrest and coronavirus challenges, equity markets surged in the first week of June with the S&P 500 posting a gain of nearly 5%. Both small and mid-capitalization stocks surged with the S&P 600 up 12% and the S&P 400 (mid-cap) gaining more than 8%! The index leader so far this year has been the tech-heavy NASDAQ 100 index that hit an all-time high on Friday. Even foreign equity markets rallied by 7% and emerging markets by 8% demonstrating a healthy broadening out of the global rally in stock prices. Conversely, bonds fell as the 10-year Treasury yield rose to 0.91 from 0.65 -- not a good omen for bond investors. This move equates to about a 2% decline in these bonds. Even though there remains massive unemployment, forecasters were expecting another loss of 7.5 million jobs for May, but the actual report on Friday came in at a gain of 2.5 million jobs which also contributed to the rise in equity markets. The unemployment rate was expected to be 19% but came in at 13.3%! An important aspect of this continuing rally in equity markets is that stocks that were previously lagging reversed and surged higher.

The good news on employment is unlikely to stop here as more and more states are "opening" and allowing people to go back to work, many of whom were effectively unemployed during the shutdown. While the coronavirus continues to cause death across the globe, the rate of increase is slowing and more studies about the disease are resulting in mostly good news such as a natural weakening of the virus and one that is susceptible to new drug cocktails and antibody treatments. There are fears that the riots and related lack of social distancing will cause the virus to re-emerge in coming weeks that could prolong the recovery but the trend to unlock the economy will continue as states learn from the lessons of the first coronavirus wave.

Many investors had abandoned stocks as the market collapsed in March even though the unexpected crisis was unrelated to a traditional business cycle market decline. Without a reasonable source for providing liquidity support, the stock market plunged by a record amount in a very short period. On the other hand, The Federal Reserve stepped in and announced the planned purchase of both government and corporate bonds to provide a safety net under financial markets. The Fed even provided support for the high yield bond market, a proxy for stocks. Given the Fed's announcement to back these securities, equity markets bounced back quickly as investors gained conviction that there would be a buyer of last resort if illiquidity became a problem. Last week, the news that the Fed had yet to buy any bonds in this program provided additional evidence that this safety net can make the difference between normal market fluctuations and a meltdown.

Investors who stayed the course and recognized the temporary nature of the crisis are approaching breakeven (and many are in the green) and being rewarded for their patience. History provides us with an unending record of stock market declines only to be followed by subsequent rallies to new highs. We will always be confronted with challenging times ahead and related market volatility, such times require conviction and faith in our financial markets.

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