Weekly Market Missive

How "Normal" is a Return to Normal?

June 14, 2021

By most accounts, the battle against Covid-19 is almost over. Cases as well as deaths have fallen to record lows, the government promises over 1 billion additional doses of vaccine this year, the domestic and foreign airlines have re-opened their routes, and hotels and rental car companies have run out of rooms and cars. Moreover, there is another vaccine on the way from Novavax telling us that it is time we move on from the crisis that paralyzed the world for over a year.

Financial markets shrugged off the negative effects of the virus long ago. After growth stocks surged in 2020, the winners on the 2021 stage have changed. Through last Friday, the S&P 600 small-cap index is up 25% while the NASDAQ Composite and the NASDAQ 100 are up single digits—9.2% and 8.6%, respectively, so far this year. The "rotation" into the world of smaller, more cyclical (read value) companies is an indicator of the broadening out of the bull market in stocks, not a long-term change in leadership.

Over the last three years, the bumps in returns are smoothed out with the NASDAQ 100 being the clear winner with an annualized return of 25%. The NASDAQ Composite is not far behind with an annualized return of over 22%. More diversified indices such as the Dow Jones Industrial Average has returned 10.8% over the past three years, near its long-term trend, and the S&P 500 has had an annualized return of just over 15% for the same time-period. These favorable returns have not been confined to domestic equities, as global equity markets have also performed quite well. For example, the MSCI World ex-U.S. index is up 11.2% year to date and the MSCI Emerging Markets index has gained more than 7%. For the past three years, these indices have had annualized returns of 5.7%% and 6.6%, respectively.

History tells us that a strong stock market is a very good indicator of a better economy ahead. So far that relationship is holding as the strong rally in stocks in 2020 is confirming a strong economic rebound so far in 2021. The sensitive GDP Now forecast from the Federal Reserve Bank of Atlanta is calling for 2nd quarter GDP growth of 9.3%.

The combination of this surge in economic growth has been driven by the pent-up demand for consumer goods and the federal government's unusual financial decisions to revive the economy. The commitment by the Federal Reserve to keep a financial safety net under the economy while the Administrations of both President Trump and President Biden wrote the check to consumers to replace income lost due to the virus tell us that the outlook for the economy and financial markets remains unusually favorable. A general rise in wealth for both individuals and corporations to record levels almost guarantees that economic growth will continue in an uptrend for the foreseeable future. Equity markets are expected to move higher in this favorable environment.

These commitments by our federal government are being duplicated by the governments of other countries continuing to improve the outlook for economies around the globe. Normal is not the same "normal" anymore.

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