Percents and Perceptions

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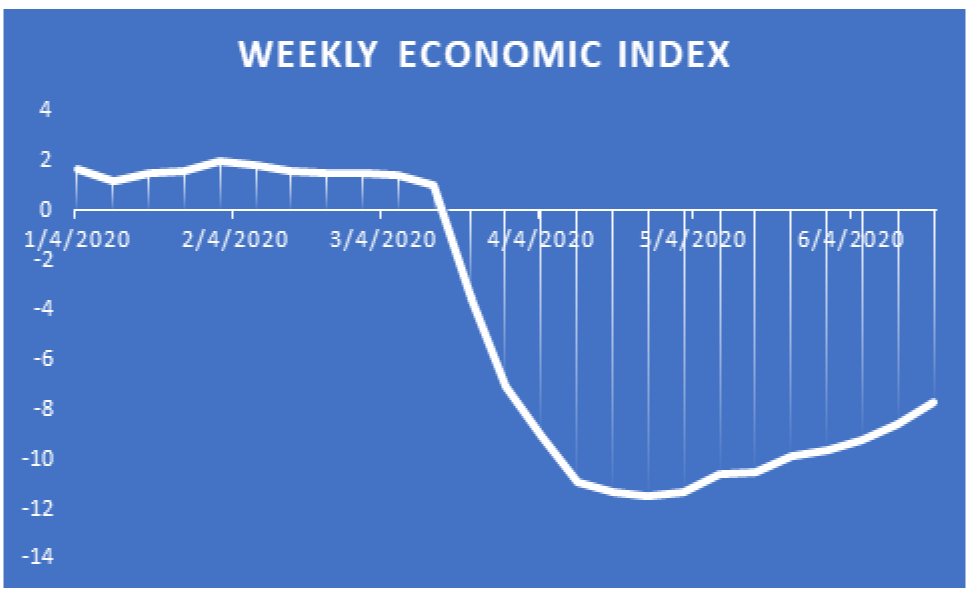
Recently we have witnessed, through client reactions, a big increase in what we call the contradiction between percents and perceptions. Emotional calls to sell have started up again, despite the fact that we are now 3 months removed from market lows. Percentage losses have been drastically reduced over the last 3 months, but the perception is that the markets are wrong.

We'll start with the indisputable. The following chart is from the Federal Reserve of New York. As the chart shows, the economy hit its lowest point in late April or early May and has started to recover. The market, forward looking as it is, bottomed on March 23rd, with the Dow Jones Industrial Average rebounding from minus 37% at its low to its current minus 13%.



People have a list of things to worry about – riots, elections, divided politics, and of course, the coronavirus. We think that politics may well move the markets at some point, but right now our concern is the virus, since it was the virus that got us where we were on March 23rd.

We are not as concerned as most about the large increase in positive tests for the coronavirus. New cases are now higher than they were on March 23rd – that's clear. But the U.S. is now testing at more than three times the rate of testing on March 23rd. According to the CDC, the hospitalization rate is a fraction of what it was in late April. Given the time lag between catching the virus and the onset of the disease, we do worry, but until we see hospitalization rates across the country at levels the Northeast experienced in April, we won't panic.

Investors also have to realize that as far as the economy goes, and of course our hearts go out to all those directly affected by the virus, we have to differentiate between the virus and the lockdowns. The lockdowns are the economic problem, and as long as businesses continue to find ways to open, letting people get back to work, this economic cycle should continue on its way up.

Many have said that the stock market's gains are disconnected with reality. We don't agree. As of today, the Dow Jones Industrials are down about 13% from their mid-February highs. Given the fact that retail sales are down only 8% (as recently reported by the Commerce Department), we might even make the argument that the market should be slightly higher than it is. Many are asking whether this is a V-shaped recovery, an L-shaped recovery or even a W-Shaped recovery. We don't know, but all of those answers have the word recovery in them and that's what we are seeing.

While the media like to report on industries that are suffering the most, like the travel industry, people are finding ways to spend their money and at the same time, support the economy. People are spending money on furniture, pools and cars. Even home building is seeing a strong uptick – maybe people are tired of lockdown in a small house – or of living with their grown children, and vice versa.

Investment Opportunities

In fact, we believe that home building is a good place to invest. Data supports the idea that household formation, lacking during the last economic cycle, started to pick up before the pandemic and has since picked up again. In fact, on Monday the National Association of Realtors reported that pending home sales jumped 44.3% in May, the biggest gain for that series ever, and more than triple the expected 14% gain. Home builder sentiment and building permit data also support new household formation. Given that this sector missed out during the last economic cycle, activity may help offset the harm to the economy from hard hit sectors like the travel business.

As we review portfolios over the coming weeks, we may be positioning you into opportunities like home building (the sector is riskier than most) or we may be looking for opportunities if the market does sell off. But for the most part, we believe the greatest argument to invest in stocks is that guaranteed investments are not a strong alternative. Yields range from near zero for short term and safe investments to not much more than 2%. In fact, to get 2%, you have to look at maturities longer than 10 years.

Stocks have risks, but the yield differentials favor stocks. There are many stocks in the S&P 500 that yield 3.5% or more. Some investors should consider that as a reason to buy stocks, but not as investments to time by attempting to buy low and sell high. The reason race horses are fitted with blinders is that the jockey has little control of the horse. As long as we have the virus to worry about, not to mention the elections, expect the market to be a bit out of control. Find some good horses for your portfolio and put the blinders on the jockey.