IS LAST WEEK'S MARKET SURGE SUSTAINABLE?

By Don McArthur, CFA®

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WHAT DO YOU MAKE OF THE RALLY IN THE STOCK MARKET LAST WEEK?

The stock market had the strongest one-week movement since 1974 with the S&P 500 up 12.1%. Investors added risk as news improved regarding flattening of the virus curve and hope for therapeutic discoveries for the virus. Additionally, the Federal Reserve announced new programs that helped calm debt markets and the associated operational aspects of the financial system. This was enough to bring buyers into the market.

COMPANIES BEGIN REPORTING FIRST QUARTER 2020 EARNINGS THIS WEEK. WHAT DO YOU EXPECT TO HEAR?

Remember, first quarter earnings will only show a portion of the slowdown with many areas mandating shelter in place orders in the last couple of weeks of the period ended on March 31st. The key part of earnings reports is what companies will say about their outlook for business. There is a lot of uncertainty on what companies will be able to do financially in the coming months as much of the economy is purposely closed or restricted. Many companies have already withdrawn guidance for 2020 and we expect more to do so in the coming weeks.

WHAT ARE ANALYSTS FORECASTING FOR RESULTS AND FUTURE EXPECTATIONS?

With so much uncertainty, many analysts have not adjusted their earnings expectations since companies reported fourth quarter 2019 results in late January or early February. Clearly, the world has changed. We expect estimates to come down for the remainder of 2020, as well as 2021.

WITH THE RALLY IN THE MARKET, ARE INVESTORS INDICATING THEY KNOW CURRENT EXPECTATIONS ARE TOO HIGH?

I don't think it's a secret that after shutting down a large portion of the economy that forecasts are too high. However, markets typically don't do well with negative revisions to estimates. Additionally, this unique situation adds to the uncertainty of what the future holds. Market volatility typically increases with uncertainty. To be sure, there will be companies that provide better than expected guidance and their stocks likely go higher. We tend to see this when expectations are lowered enough or too much.

ARE CURRENT DIVIDENDS SAFE?

Many companies have already cut dividends or suspended paying dividends. We see this in a few areas including Energy due to the lower price of oil and areas that are dramatically impacted by the coronavirus such as Travel and

Leisure. Additionally, any area that wants support from government programs likely won't pay a dividend. Clearly, the depth and duration of the economic impact from the virus are keys to a company's ability to pay their dividends. We saw other companies suspend share buybacks, which seems prudent in this environment. We expect bankruptcies to increase, but likely more concentrated in the 31 million small and medium size businesses in the United States rather than in larger publicly traded firms.

THE MEDIA DISCUSSES A POTENTIAL PEAK IN THE NUMBER OF COVID-19 CASES IN THE NEAR-FUTURE AND WAYS TO GET THE ECONOMY MOVING AGAIN. WHAT WILL THIS LOOK LIKE?

We can't be certain what the removal of "shelter in place" mandates will look like, but do not expect the economy to rapidly get back to where it was pre-COVID-19. This likely creates volatility in the coming quarters. While we look forward to the removal of isolation protocols, we see some type of social distancing being the norm for some time. It's hard to imagine large gatherings of people until there is a vaccine for COVID-19 or we reach herd immunity. Recall, we also have millions of people unemployed and many businesses that won't re-open. Additionally, supply chains are disrupted around the world. We will get a snap-back in some economic activity as people move around more and businesses re-open in the coming weeks, but we see it taking time to get to pre-COVID-19 levels.

ARE MARKETS PRICING IN THE BAD NEWS THAT YOU EXPECT TO COME?

Time will tell if the markets are pricing in all the bad news we expect to come out in the coming periods. Perhaps if they haven't we could see a range-bound market or a re-testing of the prior lows – this is why we have been actively reducing risk in portfolios.

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