

Stock Markets Rebound, But Questions Linger

- U.S. equities are rallying today on overnight news.
- Linger uncertainties may drive market volatility in the coming weeks.
- We expect some near-term weakness but not to market-lows seen in March.

Optimism has returned to stock markets after a drug showed some effectiveness in treating the COVID-19 disease and President Trump identified the circumstances necessary for parts of the country to allow employees to start returning to work. Both developments bring us one step closer to answering questions that continually weigh on the minds of investors: what's being done to stop the spread of the virus and what's being done to limit the economic disruption. While equities are poised to perform well today, concerns remain that may lead to volatility in the coming weeks. We believe this is true for three primary reasons.

First, while Trump issued guidelines to open parts of the country, there is no actual timeline for the official opening. Many conditions need to be met before easing some of the strict measures imposed to combat the spread of the coronavirus pandemic. The guidelines state that the number of documented cases or positive tests as a percentage of total tests and reports of flu-like and COVID-19 symptoms in a state or region should be declining. There are concerns testing remains relatively insufficient and positive test rates remain elevated suggesting that meeting these guidelines and our return to a normal routine will still take more time. Also, the variety of conditions across U.S. states and regions make the national recovery picture a bit more complicated, and probably slower to develop, than that of other countries.

Second, there is still uncertainty about the full economic impact of the virus. Recently, we have seen terrible economic data that includes over 20 million newly unemployed Americans in just four weeks, a sharp decline in national and regional manufacturing activity, and poor readings on consumer spending. Clearly, the distancing measures designed to limit the spread of the virus have caused an abrupt stop in economic activity. Optimistic investors point to the fact that we are potentially looking at the nadir of economic activity, however, in our opinion, there is no clarity around how long the virus will last, how deep economic data will sink, or how many firms will survive.

Third, because the oil industry employs millions of Americans, the sharp drop in oil prices has impacted the U.S. economy as some energy-related companies face the threat of disruption, layoffs, and potential bankruptcy. With OPEC, Russia, and a variety of other oil-producing nations agreeing to reduce supplies, optimistic investors have taken this as a sign that oil prices will rise. We are skeptical, as we expect demand to fall by a greater degree due to the impact of the virus on the global economy.

The U.S. stock market has significantly rallied off its lows, but we are a bit hesitant to declare an all-clear signal. In our opinion, despite last night's news, the stock market cannot perfectly price in when the economy opens, what that opening could resemble, and the future impact on corporate profits. With investors possibly being a bit too optimistic despite lingering questions, we continue to expect a near-term pullback in the coming weeks. With that said, more importantly, we are not likely to hit lows seen earlier this year due to the unprecedented monetary and fiscal stimulus applied to limit economic disruption. Beyond near-term weakness, our base case remains a slow market improvement as policymakers continue to work to reduce the virus spread and limit its economic disruption. A second wave of infections or a new vaccine would likely change this base-case scenario.

Despite last night's positive news, we continue to recommend sticking to risk tolerances consistent with your long-term goals and objectives. We do think there will be opportunities in this market, but we are looking for more clarity before we get too optimistic. These are challenging times, but your financial professional can help you stay on course.

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