The Cobblestone Advisor
Investment Brief
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COBBLESTONE CAPITAL ADVISORS

Stock Market ≠ Economy

US equities staged a powerful rally off their March lows before slightly stumbling over the last few weeks of the quarter as a second wave of COVID-19 hit certain economic regions and reality set in that it will likely be a long, tough slog to return to economic normalcy. Nevertheless, through the end of June, domestic stocks delivered their strongest quarterly performance since 1998, with the S&P 500 up +20.1% for the three-month period, and up +39.3% since the March 23 trough. Small cap stocks (+25.4%) and international equities (+14.9%) also delivered strong performance for the quarter, as did nearly all risk asset classes.

Bonds delivered notably positive performance as well, with the Bloomberg Barclays US Aggregate Bond Index—a measure of broad US fixed income markets—up +2.9% for the quarter. Fixed income performance was largely driven by riskier areas of the credit market amid an ultra-accommodative Federal Reserve, including investment grade corporate credit up +9.0%, with investors preferring to lock in the relatively higher yields for a longer duration.

The strong performance of risk assets comes at a time when much—if not all—of the economic data being released globally is the weakest on record, leading some investors to question the seeming disconnect between recent moves in financial markets and the economy. So what gives?

First, it is important to remember that the stock market does not equal the economy. The stock market is a forward-looking, discounting mechanism. In contrast, many of the most widely publicized economic data releases are backward looking and have largely been factored into stock prices by the time they are released. The market seems to be looking beyond the current cessation of economic activity, with investors pricing in what they believe the economic environment will look like for businesses as the world continues to reopen and ultimately returns to a state that resembles at least an approximation of "normal."

It is also worth noting that the stock market is not a single entity, but rather—in the case of the S&P 500—a compilation of 500 different companies with very different business models and end markets, each being uniquely impacted by the pandemic. While many companies are struggling during this difficult period, there are others that have been able to thrive.

Taking a deeper look into these company-specific dynamics shows that the persistent outperformance of a handful of mega-cap stocks with strong balance sheets and secular growth prospects has supported the level of the S&P 500 index. As an example, and

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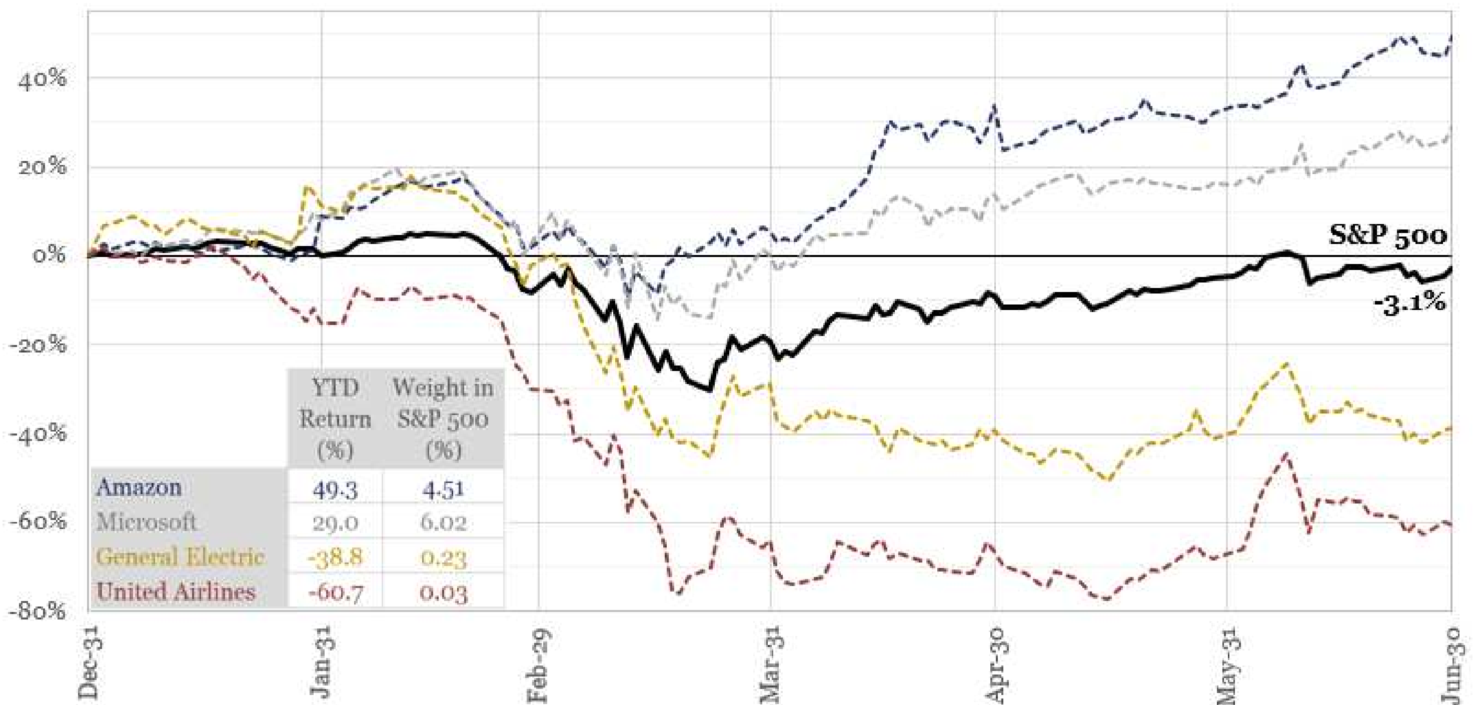
Total Return (%), Ending 6/30/2020				Annualized		
	Qtr	YTD	1 Year	3 Years	5 Years	10 Years
S&P 500 Stock Index	20.54	-3.09	7.49	10.71	10.71	13.97
Russell 2000 (Small Cap Stocks)	25.42	-12.98	-6.63	2.01	4.28	10.49
MSCI EAFE (International Stocks)	14.88	-11.34	-5.13	0.81	2.05	5.72
MSCI EM (Emerging Markets)	18.08	-9.78	-3.39	1.90	2.86	3.27
Bloomberg Barclays US Aggregate Bond Index	2.90	6.14	8.74	5.32	4.30	3.82
Dow Jones US Select REIT	9.11	-22.01	-17.71	-1.99	2.44	8.27
Consumer Price Index (% Chg over Period)	-0.85	-1.04	0.14	1.56	1.48	1.65

shown in the accompanying chart, Amazon and Microsoft—two of the most heavily weighted constituents in the S&P 500—have significantly outperformed in 2020, which has had a considerable impact on index-level performance due to these two holdings accounting for more than 10% of the index. Conversely, while other well-known companies such as General Electric and United Airlines have meaningfully underperformed, each has a very modest weighting in the index, leading to less of an impact on index-level performance.

More broadly, the recent move higher in equities and other risk assets may also be justified by the unprecedented monetary and fiscal stimulus response of US Federal Reserve and governmental policymakers, not to mention the early signs that an economic restart is materializing. Regarding the former, in just 18 weeks, aggregate US stimulus put forth totaled 26% of US GDP, compared to combined stimulus amounting to 21% of US GDP over an 18-month period during the Global Financial Crisis (GFC). The Fed has been especially active in their rollout of programs designed to support the flow of credit, providing $2.92 trillion by way of balance sheet expansion, compared to just $1.38 trillion during the GFC. In short, the measures undertaken have provided much-needed liquidity to markets and have kept capital flowing freely to areas of the US financial system and economy that need it most.

Regarding the latter, certain economic indicators suggest that disparate signs of recovery are beginning to emerge. China, which took the earliest economic hit from the pandemic, has experienced a strong rebound in electricity consumption, a proxy for economic activity throughout the country. In the US, gasoline demand has recovered to near pre-pandemic levels, and mortgage applications—a leading indicator of housing market activity—advanced to an 11-year high in June. All this is to say that though broadly, the economic data may continue to paint a grim picture, there are certain segments of the economy that have quickly recovered and are acting in support of investor risk taking.

In closing, although the backdrop may appear marginally more sanguine, we would point out that significant uncertainty persists as to the economic outlook and where financial markets will end up from here. In our view, a high likelihood of an uneven recovery punctuated by recurring bouts of market volatility reinforces the need to avoid becoming complacent, remain diligent by assuring that your portfolio is appropriately diversified, and strictly adhere to your long-term investment strategy.



Source: S&P Dow Jones; Bloomberg. Data as of June 30, 2020.

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