Reality Sets In: Markets Drop Nearly 6%

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Ben Pace
Chief Investment Officer

One can argue the nearly 6% decline in equity markets today makes more sense than the 45% increase we have seen since the March 23 lows. Global economies continue to struggle with the pandemic-induced lockdowns and their aftermath. Here in the U.S., while the reopening process has begun and economic results are rebounding, the country still has more mid- and longer-term effects to address.

- Many businesses and industries are operating at less than full capacity, which heightens the risk of bankruptcies and business failures. If this occurs, supposedly temporary, cyclical unemployment would turn into permanent structural unemployment. Hesitancy on the part of consumers could exacerbate this risk.
- The Fed was not as forthcoming as many would have liked with a more immediate policy response regarding future rates or the capping of longer-term bond yields.
- The markets appear particularly disappointed with the lack of progress on the latest fiscal package, which would help support state & local governments, further finance the Payroll Protection Program, and extend enhanced unemployment benefits. With the hesitancy of Congress to quickly pass another stimulus bill primarily based on equity market recovery and some surprisingly good economic numbers, the markets may be trying to increase the sense of urgency.
- The reopening of state economies has led to a spike in Covid-19 infection cases and subsequent hospitalizations in some cities. This outcome was expected at a certain level, especially with the increase in testing. States will likely not reinstate shelter in place orders and business lockdowns unless the health care systems experience severe capacity constraints.
- It's possible the markets may also be starting to discount a more muted longer-term earnings growth rate in advance of the November elections even after a 2021-earnings rebound.

Investors have become accustomed to extreme intraday equity market volatility in 2020, although the last two months have seen a rather steady climb toward the February highs. Whether using technical terms such as "overbought" or dusting off an old Fed term "irrational exuberance," there was growing speculation in these markets that needed to be tempered.

We were expecting a market decline in June. As such, we will await further information on virus infection rates and a greater sense of urgency around policy responses before considering this a prime opportunity to deploy cash in client portfolios.

Ben Pace is the Chief Investment Officer and a member of the Investment Committee. Prior to joining Cerity Partners, he was Chief Investment Officer, and Head of Global Investment Solutions for Deutsche Bank Private Wealth Management in the U.S. Ben has more than 25 years of experience in investment management. Prior to joining Deutsche Bank in 1994, he managed equity income funds for two investment organizations.