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"There is nothing riskier than the widespread perception that there is no "

— Howard Marks

The legendary investment letter writer Richard Russell always said that the stock market would do whatever it took to make the most people wrong. 2020 has proven him right once again. Two of the most respected traders, Stanley Druckenmiller and Paul Tudor Jones, both admitted last week that this market has "humbled" them. Druckenmiller remarked that while the S&P 500 was up around 40% since the March lows, his fund had only risen 3%. Even the best have been caught offside. Despite depression-like economic numbers due to a global pandemic and increased U.S. civil unrest the market having no conscience continued higher. Bears have noted, for the most part quite correctly, that the market has been historically overbought and overvalued, but to no avail. Market strength spread to all sectors and as a consequence most internal technical indicators were positive. Investors have obviously taken the view that the pandemic will fade away, the economy will experience a robust recovery and markets will be off to new highs by the fall. I don't want to be a "Debbie Downer" but I find it hard to accept such a happy outcome. I wrote in the last letter about not taking too adamant a position in these uncertain times but be prepared to change your outlook as new information becomes available. Having reviewed my thinking, I remain of the opinion this market needs to retrace some of the recent rise and build a stronger base. The almost 6% one day decline in the S&P last Thursday provides an indication of how quickly it can happen. As an aside some commentators have pointed to the increase in retail investor participation in markets and particularly the increased volume in option trading. If you're bored sitting at home playing Game of War, sign up on the Robinhood Trading app and buy some call options. Someone wrote recently, "sell in May and go away" no longer applies. Instead it's "buy in June and retire by noon". There is only weak research on the impact of these new buyers, but they are real and of concern, since they are likely to be weak holders.

What I am sure is having a positive impact on both financial markets and the economy globally, particularly in the U.S., is the swift and massive intervention by central bankers and governments when the effect of the pandemic became apparent. The Fed has increased its balance sheet by $3.5 trillion this year alone to over $7 trillion. Before the financial crisis of 2008-2009 it stood at $870 billion. Credit has been extended to banks to increase loans and the Main Street Lending program for small and medium sized businesses most affected by the lockdown is being expanded to allow broader participation and easier payback terms. Perhaps the most surprising program was the $600 billion set aside to support the bonds of corporations that had lost their investment grade rating. Propping up that sector of the fixed income market worked and is partially responsible for almost a billion dollars of new corporate debt coming to market since early March. Junk-rated companies like Avis & Viking Cruise have done issues which are surprisingly up 15-20%. It's interesting that the Fed's mandate does not in fact allow it to buy non-government bonds, so it opens what is called a "special facility" and lends money to it which then makes the bond purchases. These are curious times.

The U.S. federal government has chipped in with the $2.2 trillion CARES Act that provided direct payments to individuals and greatly expanded jobless benefits. Another $3.5 trillion of stimulus stands ready in Congress if deemed to be needed. All of this liquidity has stabilized the economy at least for the time being and has been partially responsible for the strength in stock and bond markets both in terms of actual dollars and better investor psychology. With both the Fed and the Government prepared to step up to the plate if for instance there is a strong second wave, it is hard to envision a really serious market downdraft for the foreseeable future. So I referenced my book of investment quotes and found two that should make us all pause and reflect. "If it's obvious, it's obviously wrong" (Joe Granville); and "There is nothing riskier than the widespread perception that there is no risk" (Howard Marks).

When you write an investment letter it is wise not to make fun of the forecasts of others but in the case of economists' estimate that May non-farm payroll employment would indicate a further 7.5 million job losses when it actually came in at a 2.5 million increase, it is hard to be polite. Of course, there was lots of pushback that inside the numbers weren't that great (like my favorite that too many of the jobs were dental assistants going back to work) but it is still a positive indication that a recovery is on the way. Other factors such as the fact the survey was taken in mid-May before the auto industry restarted could mean the number will get even better. A question I find very important about job losses is how many are of a temporary nature and how many are permanent. A job that will still be there when the lockdown eases is one thing, but we are seeing more forced closures due to the losses caused by the pandemic and that is much more serious matter. Much of the current positive economic narrative comes from a belief in the second derivative. The theory is that it is not as important that the next economic release is positive or negative but is it better or worse than the previous one. Thus, when our old favorite the ISM manufacturing report for May came in at 43.1, well below 50 which demarks contraction versus growth it was viewed positively by most because it was better than April's 41.5. The economy is still contracting but at an encouragingly slower rate it's said. In summary we are far from out of the woods, but already GDP estimates are being raised and unemployment estimates lowered.

The November U.S. election appears to matter once again. A weak economy is never good for the incumbent President and his party. Add to that the questionable responses by Trump to the pandemic, civil unrest and just about anything else has had the effect of weakening his position as the front runner. While Mr. Biden appears to be a much more pleasant fellow, should he be elected he would bring with him policies on taxation and regulation that are less than positive for financial markets. On a final geopolitical note, while it might be just a passing circumstance the uncertainties surrounding the election, the handling unrest and with the President attacking other countries including supposed friends the famed "safe haven" reputation of the U.S. is being called into question in certain circles. If there is an impact on the U.S. dollar it may well have an effect on financial markets.

Stay well.

Disclosures