LGIMA's Multi-asset Market Update

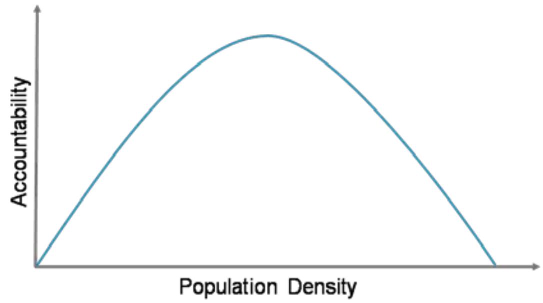
May 2020

Equity market

Markets continue their sharp rebound, up 36% from the March low and nearly 5% since we wrote last month. Three bullish factors are at play: hopeful results from phase one trials of a possible vaccine, the expectation for a sharp economic rebound with minimal permanent damage and continued action and rhetoric from the Fed. The consensus view—which we see confirmed through options pricing—is for near-term range-bound markets until there is further clarity on how quick and how complete the recovery will be. Our view remains that markets are overly optimistic about the recovery and efficacy of Fed actions.

Last month, we touched on some of the more sensitive debates around healthy markets and healthy people. We also questioned what benefit Fed purchases of ETFs would provide to individuals most economically exposed to the pandemic. This month, we extend those thoughts, focusing on dynamics that we think support our skeptical view of the current rally.

Your author is sheltered in place in a small community where we are not required to do so—a state that is on its way to fully reopening. Nevertheless, during grocery and hardware store pick-ups, we have observed nearly full compliance with social distancing practices (physical spacing, masks, utilization of contactless or curbside procurement) alongside the greater freedom and mobility. There have been only a handful of confirmed cases in this county, which I believe contributes to keeping fear low and sociability high. This is a different experience from our tightly packed Chicago suburb, although to be fair those observations were earlier in the pandemic when fear was generally higher. Nevertheless, our experience has led my wife and I to a hypothesis illustrated to the right. At the left of the x-axis is an episode of "Mountain Men", loners with few (if any neighbors) to whom they are accountable. At the peak is a community—tightly linked economically, dependent on each other's good health practices, and known to each other individually. However, as the group size grows, it becomes more difficult to know each other and links become more distant and weaker.



Of course, an important caveat is that people can define their community differently, regardless of location. Within New York City or Chicago, people can be bound together through greater accountability and responsibility in smaller groups despite the enormous city and population that surrounds them.

Now, before I lose readers who are wary of this becoming an ethical or socioeconomic soapbox, I will connect this hypothesis to aspects of the economic recovery. In discussions of this idea with my wife, I was reminded of the article "Ecology for bankers", published in the journal Nature in the earliest days

Contributors

DISCLOSURES

1. "Ecology for bankers". Levin, Simon, Robert May and George Sugihara. Nature. Vol. 451. February 21, 2008.
2. We use a weighted average of the Bloomberg Barclays US IG Corporate and US HY all-in yields.