

The economy is in free fall. So why isn't the stock market?

Everything is bad, and yet somehow the stock market is good.

By Emily Stewart emily.stewart@vox.com May 6, 2020, 7:30am EDT



A stock trader blows bubble gum during the opening bell at the New York Stock Exchange on August 1, 2019. Johannes Eisele/AFP/Getty Images

The stock market is doing fine, even though everything else is definitely not.

Earlier in the **coronavirus** crisis, **Wall Street had a meltdown**. Stocks **plunged** amid fears of the disease's spread and its potential **impact on the global economy**, sometimes to the point that **trading was halted altogether** to rein in the chaos. But in recent weeks, the market has been doing okay. It's not at the **record highs** it was in mid-February, but it's not bad — the S&P 500 is hovering around where it was last fall. And given the state of the world — **a deadly global pandemic with no end in sight, 30 million Americans recently out of jobs, an economy that's fallen off of a cliff** — a relatively rosy stock market is particularly perplexing.

Sure, the stock market isn't the economy, but right now, it seems particularly divorced from what's happening on the ground. "The gap between markets and economic data has never been larger," wrote Matt King, global head of credit strategy at Citigroup, in a **recent note**.

It's impossible to pinpoint what exactly is driving the market's moves at any given moment — investors, after all, aren't a monolith. But there are a handful of explanations that get at what's happening now.

For one thing, the Federal Reserve and, to a perhaps lesser but still significant extent, Congress have taken extraordinary measures to pump money into the economy and prop up markets. The amount of spending they've done so far amounts to about one-third of

GDP in a very short period of time, and that's calming investors' nerves. "The fundamentals don't matter quite as much with that kind of liquidity deluge," said Isaac Boltansky, director of policy research at Compass Point Research & Trading.

Moreover, investors don't really have a lot of places to go with their money — government bonds are offering super-low returns, if much at all. Among some on Wall Street, there's a fear of missing out, and it appears **retail investors** have been playing the markets while in quarantine. Overall, it just seems the market may be feeling a bit more optimistic about the future than the science around coronavirus would suggest.

To be sure, there's no guarantee this market rally will last, nor that investors have it right. And many traders, analysts, and experts admit everyone is operating in a black box. One West Coast-based equities trader told me it makes "zero sense." A Goldman Sachs associate provided a variety of detailed explanations, but then offered a caveat, "If I'm being dead-ass honest, though, nobody knows what's really going on."



The "Fearless Girl" statue donning a mask across from the New York Stock Exchange on April 25. John Nacion/NurPhoto/Getty Images

You can't fight the Fed

Many people on Wall Street point to actions from the Fed as a main driver of the market's rebound in recent weeks. Since late March, the central bank has **announced a series of sweeping measures** designed to help stabilize the economy, including plans to buy both investment-grade and high-yield corporate bonds. That translates to the Fed saying it will buy corporate debt that's at low risk for default, and debt that is not.

The Fed's maneuvers have injected an enormous amount of liquidity in the market and restored faith of both private corporate bond buyers and equity investors that the central bank is there to back them up. The Fed **still hasn't spent money on its corporate bonds program**, but the promise that it could has been enough.

"This rally in equities is clearly not driven by fundamentals — it's driven by the liquidity support from the Federal Reserve," Torsten Slok, chief economist at Deutsche Bank Securities, **told the Financial Times**. "Companies are getting cash to keep the lights on through the significant support to credit markets."

"IN THE MODERN BAILOUT ERA, BETWEEN THE FED AND THE FEDERAL GOVERNMENT, THERE'S REASON FOR EQUITY INVESTORS TO FEEL OKAY"

This isn't an entirely new phenomenon, explained Kristina Hooper, chief global market strategist at Invesco. Something similar happened during the last crisis.

"I think of it as a great decoupling, and I'm not surprised that we're seeing it, because this is very similar to what we saw during the global financial crisis, and it has to do, primarily, with monetary policy," she told me. "What we saw during the global financial crisis is a Fed that provided extraordinary policy tools that it had never used before ... and that was what decoupled the stock market's fortunes from that of the economy. And so it came as no surprise that we saw the same thing happening this time."

This can all feel a little wonky, but it boils down to: **In the modern bailout era**, between the Fed and the federal government, there's reason for equity investors to feel okay.

The best multiple a printer can buy pic.twitter.com/sOcG0hvCzs

— Not Jim Cramer (@Not_Jim_Cramer) April 30, 2020

A concrete example of the impact of the Fed's maneuvers is Boeing. Last week, the aerospace company **said** it had raised \$25 billion in a bond offering, and it didn't need federal aid to do it because private investors had taken up the offer. **Other companies have done the same**, including Nike, Procter & Gamble, and Visa.

"If there's that much appetite in the bond markets to invest in debt, as an equity investor, that's a reason to feel okay about things in relative terms," the Goldman associate, who asked to remain anonymous, told me.

Political will to do more on the stimulus end of things may be waning in the White House and among some Republicans, **at least in the near term**, but the Fed has indicated it plans to forge ahead. **At a press conference last week**, Fed chair Jerome Powell said the central bank is committed to using its "full range of tools" to support the economy as long as needed. "We have a number of dimensions on which we can still provide support to the economy," he said. "As you know, our credit policies are not subject to a specific dollar limit."

Gillian Tett, editorial board chair at the Financial Times, **recently argued that what's happening now with stocks** is a test of whether you think this is a liquidity crisis or a solvency crisis — basically, whether you think corporate America's woes are a short-term question or a long-term one. The Fed's actions solve the immediate liquidity problem — they keep companies afloat right now — but they don't solve whether a business is going to be viable and therefore able to pay back their debts in the long run. To go back to Boeing: That \$25 billion bond raise is helpful right now, but the future of the company hinges on someone buying its planes.

“Many zombie companies will fail, no matter how much is sprayed around by the Fed,” Tett wrote.

The music’s still playing, so Wall Street’s still dancing

Ahead of the global financial crisis in 2007, then-Citigroup chief executive Chuck Prince **made an observation**: “When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you’ve got to get up and dance. We’re still dancing.”

While the context of his remarks was different — he was talking about private equity deals — in the current moment, the spirit of them still holds. The music’s still playing, and Wall Street’s still dancing.

Part of the issue is likely that there isn’t really a lucrative alternative to investing in stocks right now. As **Paul Krugman at the New York Times** recently noted, bonds offer super-low returns:

The interest rate on **10-year U.S. government bonds** is only 0.6 percent, down from more than 3 percent in late 2018. If you want bonds that are protected against future inflation, their yield is *minus* half a percent. So buying stock in companies that are still profitable despite the Covid-19 recession looks pretty attractive.

The West Coast trader joked, “It’s tough for me to make a bull case on stocks right now that isn’t, ‘Welp, everyone else is buying and bonds are trash.’”

Which gets at another facet of this: fear of missing out. The market, broadly, is going up, everyone else still seems to be playing, and so people are staying in. And it’s not just big institutional investors, it’s individual retail investors, too. **Bloomberg** reports that E*Trade, Ameritrade, and Charles Schwab all saw record sign-ups in the first three months of the year, a lot of it amid coronavirus-induced volatility. One analyst speculated to Bloomberg that with casinos and sports betting closed down, some people were playing the markets instead.

Many companies are doing well, particularly in tech: Microsoft, Apple, Amazon, Google-owner Alphabet, and Facebook reported strong earnings last week and make up about one-fifth of the S&P 500’s market value. And the stock market doesn’t reflect the economy in total; small businesses and companies that aren’t publicly traded are being hit hard right now, and that doesn’t show up in stocks.

“THE MARKET IS PROBABLY PRICED SOMEWHERE BETWEEN THE MOST LIKELY CASE AND THE BEST CASE, CERTAINLY ON THE MOST OPTIMISTIC SIDE OF THE MOST LIKELY CASE”

The stock market is sometimes considered to be a leading indicator of what's going to happen in the economy. And at the onset of the pandemic, it sounded the alarm before the economic data did, giving up 30 percent of its value in the course of a month. If you think it's a leading indicator now, that means investors think things will be better in three to six months from now. Investors are pegging some of their hopes to a treatment for the coronavirus, and they're excited about states reopening.

Jack Ablin, the chief investment officer at Cresset Wealth Advisors, told me the market is certainly looking at the sunnier side of the possibilities. "I will say the market is probably priced somewhere between the most likely case and the best case, certainly on the most optimistic side of the most likely case."

Is the optimism warranted? Well, that's the issue of the entire coronavirus crisis: No one has any idea what's to come. "The coronavirus outbreak has rendered forecasting impossible," wrote Ian Shepherdson, chief economist at Pantheon Macroeconomics, in a recent note.

"As a policy analyst, the motivation in the market right now is driven by the policy intervention and not the economic fundamentals, and so when investors are focused on contouring the policy intervention, it's possible that they miss some of the broader fundamental trends, or at least neglect them," Boltansky said.

Even if the stock market recovery holds, that might not translate to a comparable recovery for the economy. Hooper, from Invesco, pointed out that Main Street America had a "very anemic recovery for years" coming out of the global financial crisis compared to Wall Street. If there isn't enough fiscal stimulus, namely from Congress, that could replay now.

Investors could be completely wrong

One theme of the coronavirus crisis is that anyone who tells you they know what's about to happen next is lying, and that holds when it comes to the stock market. It moves on day-to-day news and headlines, which are constantly changing, and has been pretty volatile in recent months. There are plenty of voices out there warning that just because the market is up now doesn't mean it will stay that way. The Wall Street Journal over the weekend delved into the ways investors are "**flying blind**," where no one is exactly sure what's going to happen with corporate earnings or the economy.

Bob Michele, chief investment officer at JPMorgan, told Bloomberg in a **recent radio interview** that the market's current optimism reminds him of the early days of the financial crisis. "There's a lot of hardship ahead," he said. "This feels to me like the second quarter of 2008, where the first quarter was horrible, there were policy responses, and the market immediately became optimistic, and the horror of what actually happened starts to hit into the data."



A trader signals offers in the S&P 500 stock index futures pit at the Chicago Mercantile Exchange on March 17, 2008, as Bear Stearns was collapsing. Scott Olson/Getty Images

In the current moment, we have some data about how bad the economic crisis is. The **economy shrank by 4.8 percent in the first quarter**, and 30 million people have filed jobless claims. We'll get a look at April unemployment numbers on Friday, and other data is still trickling in.

“Beware of the oddity in this bear rally,” Solomon Tadesse, head of North American quant equity research at Societe Generale, wrote in a recent note. “Given the overall negative undertone from the economic challenges ahead, the dramatic reversal of global markets after the pandemic lows is more puzzling.”

High-profile investor Jeffrey Gundlach recently said he is shorting the market, **meaning he's betting it will go back down**. Former Goldman analyst Will Meade **predicted** this year is poised to look “exactly like” the dot-com bubble. Billionaire Warren Buffett, who in 2008 encouraged investors to “**buy American**,” at Berkshire Hathaway’s annual meeting over the weekend, **struck a more somber tone**. “You can bet on America, but you kind of have to be careful about how you bet,” he said.

“If we haven’t hit the bottom yet, things will get very, very bad, because then you’ll see a lot of cascading effects where a hedge fund will blow up, which means the pension fund that is invested in the hedge fund now has to take that loss, which means they have to de-risk, so they have to move out of equities,” the Goldman associate said. “There’s a very real possibility that people could get washed out, not just retail investors, but everybody.”

Correction, May 13: A previous version of this article misidentified the author of the Societe Generale note.