U.S. Bank Capital Market Update: Choppy waters but the glass remains half full

Summary highlights:

- The largest percentage drop in the S&P 500 since mid-March reversed two weeks of gains
- The current capital market landscape is fluid and two-sided price volatility remains a key market feature
- Policy is important to continued gradual economic improvement and repair
- Investors who center on a well-defined financial plan can weather today’s market volatility
- We retain our “glass-half-full” view of the path forward

The current capital market landscape remains highly fluid as investors contemplate news flow related to COVID-19 (novel coronavirus), the economy, and policy responses to bridge the gap to an eventual sustained economic recovery.

Today, U.S. equity markets followed global markets sharply lower with the Chicago Board Options Exchange (CBOE) Volatility Index, a measure of market volatility, surging nearly 50 percent. The S&P 500 fell 5.9 percent, the largest percentage drop since the 12 percent decline on March 16th. The worst-performing sectors today, Energy, Materials, and Financials, had risen sharply in the most recent market upswing. They are also sensitive to investors’ forward growth expectations and are subject to more speculative rallies.

Causes for today’s weakness

Global markets remain in a muddle-through recovery period, subject to two-sided outcomes in three key areas: growth in COVID-19 infections; the magnitude and pace of labor market recovery; and policy support from the Federal Reserve and government stimulus. Today’s market action reflects realization of these risks relative to the previous constructive tenor of progress.

- The COVID-19 (novel coronavirus) pandemic is ongoing, with confirmed cases numbering 7.5 million worldwide. Virus resurgence remains a key risk as the economy reopens and resurgence risk rose to the forefront with Texas reporting the single highest daily increase in new cases since the virus’s outbreak.

- Today, the Department of Labor documented 21.5 million Americans filed for continuing unemployment insurance standing in stark contrast to payroll gains in May of 2.5 million jobs announced a week ago. Investors will remain challenged to project significant future economic
recovery should labor markets continue their uneven and unclear progress toward recovery.

- With a balance sheet exceeding $7 trillion and interest rates near zero the Federal Reserve (Fed) remains an important support for well-functioning markets and improving economic sentiment. In yesterday’s virtual press conference, Fed Chair Jerome Powell noted that additional stimulus may be necessary to raise and elongate the bridge to reach the next horizon of economic growth, stating that the Fed is “strongly committed to using our tools to do whatever we can, and for as long as it takes.” (https://www.federalreserve.gov/mediacenter/files/FOMCresconf20200610.pdf)

Over the past several weeks, riskier asset class performance had been positive and prices extrapolated a more positive future path after last week’s surprising Bureau of Labor Statistics report and a stronger-than-expected policy response from the European Central Bank (ECB) and the traditionally staid German government.

In our latest market commentary, we noted that market optimism appeared justified, given net positive job hiring in May suggested a faster-than-anticipated economic reopening, but we cautioned that risks remain and that we expect to see continued volatility in parts of the market that may have extrapolated a too buoyant future relative to our analysis.

Contextualizing today’s market action within the global economic and policy framework outlined above, we are mindful of risks but continue to hold a glass half-full outlook:

- Companies continue to hire, evidenced by last Friday’s report.
- Consumers are transitioning to more normal life activities as states continue to reopen.
- And as we’ve written in the past, the medical concept of gradual improvement and repair over time, homeostasis, continues.

While we view price volatility as an ongoing market feature during this muddle-through phase, we strongly believe the most powerful thing you can have is an investment plan. Working with your U.S. Bank team, determining the right asset mix and plan for your unique situation remains job number one. Investors who center on a well-defined financial plan can weather today’s market volatility and work in concert with their lifestyle. As we have said often, living and investing within your means is critical, and today’s data does not alter the need for a plan or the need to remain within your means.

We will keep you posted on any changes to our views that could affect your specific portfolio. As always, thank you for your trust and do not hesitate if we can help in any way.
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