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MACROSCOPE the market bulletin from Luft Financial

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"Relief Rally" could fizzle out as focus changes to economy and earnings

Recent weekends have brought a cascade of bad news centering around the coronavirus, resulting in huge down days for the markets on Mondays. Lately, however, the trend seems to be improving (Figure 1). Monday's 5% gain for the TSX was its best Monday performance in months, while the S&P 500's 7% surge was its third-best daily performance over the past decade, according to Bloomberg data.

Monday's rally was triggered by news that the regions that have been the worst affected by the coronavirus are seeing a leveling-off in new virus cases and fatalities. In Italy, the number of new cases and deaths is finally declining, suggesting that it may have "flattened the curve", while Spain and France are on a similar, improving trajectory.

In the U.S., figures released on Monday by New York Governor Andrew Cuomo showed that in addition to a downward trend in the number of hospital admissions and deaths, social distancing may result in only half of the 110,000 hospital beds estimated to be required in the state at the virus's peak. This positive development could avoid the tremendous strain on public health infrastructure that is widely feared.

Across the U.S., the number of states where the growth rate in new daily virus cases is above 20% fell to under 10 from over 40 in the past two weeks. JP Morgan technical strategists recently pointed out a correlation between state-level virus growth cases and the CBOE Volatility Index (VIX). The VIX has declined in line with the growth rate in new virus cases, which could moderate big down moves in the U.S. markets.

But while the TSX and S&P 500 have now appreciated more than 20% from their multi-year lows set on March 23, only the most unabashed optimists would call this the beginning of a new bull market.

Our view is that this "relief rally" has been caused by hopeful investors seizing on anything even remotely positive in an extremely negative environment. The economic damage already inflicted by the coronavirus continues to mount, as confirmed by the data that is beginning to roll in. Claims for unemployment benefits filed by Canadians since March 16 are now at 2.1 million, or about 11% of the total workforce; in the U.S., jobless claims are at a record 6.65 million.

We believe this rally will fizzle out as the focus moves from the coronavirus, to its toll on the economy and corporate earnings. In our opinion, the rally is likely to be capped by the growing realization that the economic recovery will be a long-drawn-out process, rather than the V-shaped recovery for which some investors are hoping. In a probable scenario where stocks are likely to be rangebound for months, our strategy is to bide our time and wait for the inevitable dips, rather than chasing the rebound rallies.

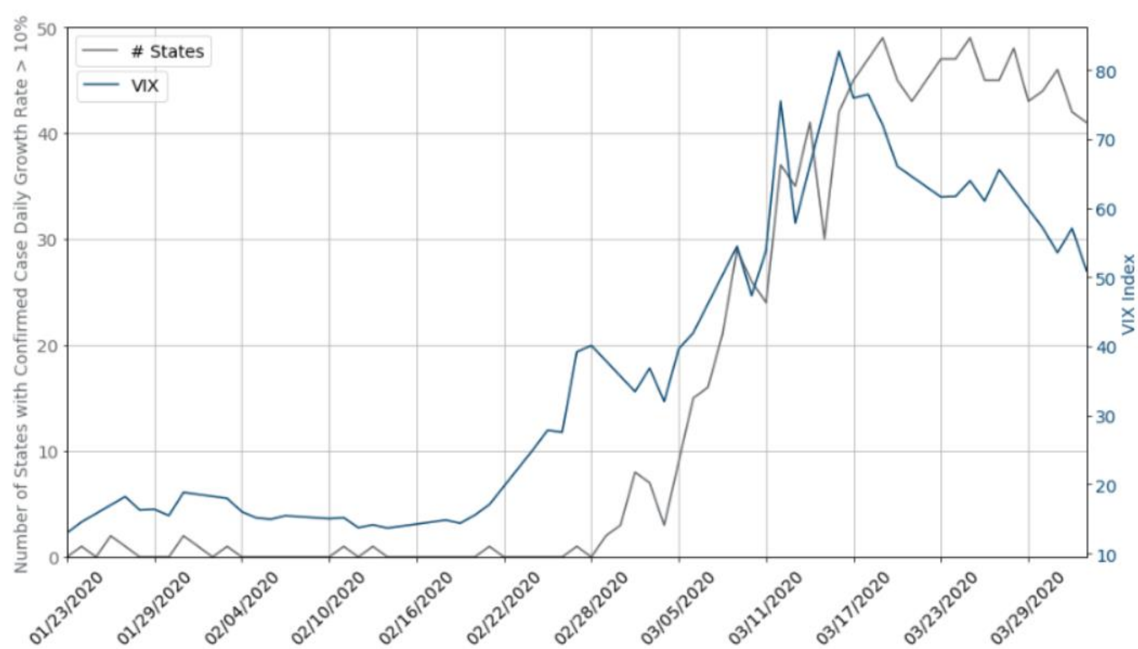
Figure 1: Monday, Monday – % Change

DATE	TSX COMPOSITE	S&P 500
6-Apr-20	5.06%	7.03%
30-Mar-20	2.76%	3.35%
23-Mar-20	-5.26%	-2.93%
16-Mar-20	-9.89%	-11.98%
9-Mar-20	-10.27%	-7.60%

Source: FactSet

Figure 2: Number of US states with daily coronavirus case growth >10% vs. CBOE Vol. Index

Number of US states with cumulative daily confirmed case growth >10% and VIX Index



Source: J.P. Morgan, JHU CSSE, CBOE

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