Big Picture

Markets Stumble Mid-Week as Rising Infection Rates Dampen Recovery Hopes

It looked like it was going to be another week of steady and modest gains for N.A. markets, as investors focused on economic data, largely shrugging off rising infection rates in the U.S.

On Monday, U.S. stocks rallied after a choppy morning session, finishing higher as the Dow added 154 points, while the TSX added 43. That positive momentum continued into Tuesday as investors parsed improving economic data. U.S. private sector business activity improved for a second consecutive month in June, while new homes sales jumped nearly 17% in May, dwarfing analysts' projections of a 3% rise. Tech stocks led the way for much of Tuesday's session as the Nasdaq posted its 21st record close of the year. By Tuesday's finish, the Dow was up 131, the Nasdaq climbed 75, and the TSX added 48.

Another emerging storyline on Tuesday was gold prices, which approached a new seven-and-a-half-year high. Prices are up 16% for the year, boosted by coronavirus-related economic uncertainty and expectations for more stimulus and rock-bottom interest rates.

It was quite a different picture on Wednesday, however, as the three major U.S. indexes saw their biggest daily percentage drop in almost two weeks, largely due to surging coronavirus cases in the U.S. Shares of airlines, resorts and cruise operators tumbled as the spectre of a second wave of infections soured investors. The TSX was also hit hard, dragged down by a nearly 4% decline in the energy sector.

Adding to the gloom on Wednesday was a report from the International Monetary Fund, which predicted that the global economy will contract nearly 5% in 2020, worse than its previous forecast of a 3% contraction. Also weighing on sentiment was increasing tensions between the U.S. and Europe. According to reports, the U.S. is considering levying tariffs on $3.1 billion worth of European products. That news came on the heels of Tuesday's warning from the EU that Europe might not allow visitors from the U.S. once it reopens, citing the U.S.'s failure to contain the virus.

N.A. markets struggled for direction Thursday as the Labor Department reported another 1.5 million jobless claims last week, while coronavirus cases continued to surge in Texas, Florida, Arizona and California. Although U.S. stocks opened lower, all four N.A. indexes finished the day in positive territory.

Nasdaq Continues Climbing; Dow, TSX and S&P Slightly Off

For the four days covered in this report, the Dow fell 125 points to close at 25,746, the S&P 500 dropped 14 points to settle at 3,084, while the tech-heavy Nasdaq climbed 71 points to close at 10,017. In Canada, the TSX surrendered 23 points to end at 15,446.

Strategy

Rising U.S. COVID-19 cases leave investors largely undeterred, for now

Earlier in the week, U.S. equity markets wobbled briefly as rising case rates in the south and on the west coast suppressed risk-on sentiment. Despite some weakness observed in the last few weeks, the S&P 500 Index is up more than 35% from its March 23rd lows, and roughly 10% within its all-time highs. We believe market participants may be looking through the rising case counts for a number of reasons. First, the rate of testing in the U.S. has soared across major centres in the last month, and cases as a percentage of testing continues to trend lower. Higher testing levels will certainly reveal a higher number of cases, though this should lead to better test-track-contain practices. Second, an increase in cases is likely baked into prices at this juncture as large gatherings, due to long-weekends and protests, increased the likelihood of transmission. Lastly, valuations remain justified given the extraordinary amount of monetary stimulus and expectations of 0% interest rates for the foreseeable future. The next leg up for stocks will likely rely on earnings recovery, suggesting economic data and estimate revisions will become essential in driving equities forward. Accordingly, we continue to believe that careful selection of individual securities, with a preference for quality holdings, will be essential drivers of portfolio performance. Further, opportunistically deploying capital into core names should benefit long-term investors.

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