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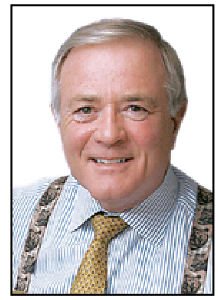

William Rutherford

# OP-ED: Market's bounce from pandemic low is fastest in several decades

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It took the S&P 500, a proxy for the U.S. stock market, 354 trading days to double in value from its 2020 bottom. That was the fastest bull market double since WWII. Usually it takes a bull market 1000 days to reach that milestone, according to CNBC analysis.

What powered the rally? Relief from the pandemic ignited the rally, as people ached to get out, liberate themselves from virus-related constraints (however misplaced) and spend money.

In 2020, the Federal Reserve slashed interest rates to near zero and released $120 billion in emergency bond purchases in response to the fastest drop in S&P 500 history. The federal government also injected trillions of dollars in COVID relief spending into the economy. The response of the Fed and the legislative and executive branches of government primed the pump and overwhelmed the sagging economy.

The resulting massive earnings comeback further fueled the rise. Corporate profits jumped off the pandemic bottom, with S&P companies reporting a 53 percent year-over-year growth in earnings in the first quarter and poised to post a 98 percent surge in the second quarter, according to Refinitiv market data services.

The second quarter of 2021 was characterized by not only a large number of beats, but also an impressive magnitude of surprises, said David Kostin, head of equity strategy for Goldman Sachs. For example, the economy added 943,000 jobs in July, above the consensus estimate, but failed to follow through in August.

Can the market continue to move in this direction? Now, the Fed is reevaluating its easy money policies and weighing whether to raise interest rates. The market has not had a sizable pullback in about 10 months, so a reversal could be in the cards.

As the market continues its record streak, the question arises: Is market sentiment too stretched? Investors continue bullish bets. For instance, 2021 inflows to exchange-traded funds topped $500 billion in late July, sailing past the 2020 record with only seven months of the year gone. Long-term trends remain healthy. The decline in the number of stocks trading above their 50-day moving average hasn't been large enough to dent 200-day moving average trends.

But hanging over the market is the virus. It has resurged and developed ever more variants. The virus represents a big headwind for the market and shows no sign of abating.

Climate issues also present uncertainty for the economy and hence the market. Forest fires, hurricanes and excessive flooding all created massive problems for emergency crews and medical facilities. The impact on casualty losses for insurers (which will have to sell securities to draw down investment reserves to pay claims) is huge.

A massive lack of computer chips is weighing on industrial production: Chip manufacturers cannot keep up with demand, which further slows production – especially for automobiles. Logistics problems interrupt deliveries. There are many headwinds for the market.

Even so, per-share earnings growth is expected to exceed pandemic levels, according to Charles Schwab Market Perspective. The rise in earnings has lowered stock market valuations, as measured by price-earnings ratios. International stocks are relatively undervalued, trading at the largest discount ever to U.S. stocks.

Prime-age workers continue to return to the market, with the labor participation rate for those ages 25-54 at 81.8 percent. Yields on U.S. Treasurys are climbing, also suggesting that the economy is strong. The Fed will likely announce a decision to reduce its bond purchases. But its balance sheet will continue to grow, because it will be reinvesting the interest from its bond holdings.

The Fed may taper its bond purchases, as long as economic data confirm that the recovery is gaining strength. The stock and bond markets have priced in rate hikes for mid-2022. Portions of the bond market, such as high yield and emerging market bonds, have benefited from the Fed's very easy money policy and from rising equity values, but volatility could return as the Fed shifts policies.

In 2019, Congress voted to suspend the debt ceiling (the cap on the total amount of debt the U.S. can accumulate) until July 30, 2021. That date has come and gone. The U.S. Treasury has already begun employing "extraordinary measures" to ensure that the U.S. does not default on its debts, but these measures will likely run out soon. Congress will have to raise or suspend the debt limit, but there is no clear path to do so.

In a letter to Congress in late July, Treasury Secretary Janet Yellen said the Treasury could run out of money to pay its bills soon after lawmakers return to Washington in September. She did not set a specific date. Analysts have estimated that the deadline will be reached by mid- to late October. Congress has always managed to find a solution. The expectation is that it will do so again, but there is no assurance.

And so it goes. Ride the record streak or choose your poison. The choices are not clear, but historically the stock market has been the best place to hide out. We recommend a cautiously defensive portfolio, diversified toward growth.

William Rutherford is the founder and portfolio manager of Portland-based Rutherford Investment Management. Contact him at 888-755-6546 or wrutherford@rutherfordinvestment.com. Information herein is from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. Investment involves risk and may result in losses.