



GREAT DIAMOND PARTNERS

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“I don’t understand. There’s so much bad stuff going on, but the stock market is near its old highs. How can we have 13% unemployment, a resurgence in the virus, substantial political and societal strains, *AND* the stock market is doing so well? It just doesn’t make sense.”

The above paraphrases the most common question we hear. If the economy is in the worst shape *since the Great Depression*, how can the stock market be near an all-time high? The S&P 500 is up 38% since the March 23 low and only down 4% year to date.¹ It certainly makes you scratch your head. So how do we make sense of this seemingly twisted logic?

First, the market is blind. The political and societal strains we are facing are very real and I don’t believe they’ll get any better in the next four months. While I don’t want to get political with this letter, it’s easy to see how things will get worse. At the same time, the market just doesn’t care. It is a gathering of anonymous buyers and sellers that make economic decisions in their own self interests. While political and societal challenges can certainly affect the economy, the linkages tend to be subjective and uncertain.

Second, the market is forward looking. Investors buy stocks with the anticipation that the companies they represent will be more valuable down the road. They believe the companies will grow and some may share their increasing profits with investors in the form of higher dividends. Today, the market is looking past the pandemic and resulting economic effects. We often look at economically sensitive sectors of the economy like semiconductors and energy for confirmation. These two are up 43% and 67% respectively since March 23, both better than the overall market.²

A word of caution...the strong stock market is based upon several assumptions regarding the next 6-9 months. The pandemic will pass. The economy will continue its recovery. Companies will resume their growth. And the election will not result in higher taxes. That’s a lot to go right. Should any of these assumptions prove faulty, stock prices could decline.

¹ YCharts

² YCharts

Third, and most importantly, the Federal Reserve is providing tremendous support for the entire financial system. Their balance sheet has expanded from \$3.9 Trillion to \$6.1 Trillion.³ Simply put, this cash needs a place to go. The stock market is one of the destinations. When there's so much cash in the financial system, stocks are bound to benefit. As the saying goes, "Don't fight the Fed."

In conclusion, it's natural to question the twisted relationship between stocks and the world that surrounds us. Sometimes things don't make sense until we can view them far in the rearview mirror.



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³ [brookings.edu](https://www.brookings.edu)



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