Philequity Corner (August 24, 2020)
By Wilson Sy

A new bull

Last week, the S&P 500 and the Nasdaq both made new all-time highs. The S&P 500 closed the week at 3,397, eclipsing its previous record of 3,386 reached last February 19. The breach of the previous high is important because it signifies that we are now witnessing the start of a new bull market. Some may find this surprising because the global economy is in recession and COVID-19 cases are still rising.

Disconnect between stock market and economy

The remarkable rally of the US market since its March bottom does not paint an accurate picture of current economic conditions. The US economy shrank 33% in 2Q20 while unemployment rate has climbed to double-digit levels. Total number of coronavirus cases has reached 23 million resulting in more than 800,000 deaths, with 5.8 million cases and 180,000 deaths coming from the US.

More losers than winners

Though US indices have performed strongly since March, a closer look into the index constituents would show that there are actually more losers than winners. The narrow leadership of the stock market focused on big-tech companies may be obscuring the general weakness of the broad market. Only 1/3 of the S&P 500 constituents are above their February highs. The US energy sector is still down 41% from its previous high. Meanwhile, financials are 35% lower and industrials are down 11%.

We note that US indices are the only ones that notched fresh record highs. Almost all equity markets are trading way below their highs while many are still down year-to-date. In US dollar terms, the PSEi is down 19% for the year, largely tracking the 23%, 22%, and 21% drop of markets in Singapore, Thailand, and Indonesia. And despite rallying 49% from its low, the PSEi is still 34% away from its previous high. In our article last week, we explained that the Philippine market, like its Asean neighbors, does not have many major tech companies and is heavily weighted towards banking, property, and retail stocks (see *Race for a vaccine*, August 17, 2020.

The shortest bear and a young bull

The shortest bear market on record took place when the S&P 500 plunged 34% in just five weeks. The S&P 500 fell from its previous all-time high of 3,386 on February 19 to its low of 2,237 on March 23. A bear market is deemed to have ended only when the market recovers back to a new closing high. Thus, the birth of the new bull was heralded by the ascent of the S&P 500 to its new all-time closing high of 3,397 last Friday.

Sharpest recovery on record

The new bull market which started on March 23 has so far produced an amazing return of 52% in five months. Despite an ongoing global recession and a continued rise in the number of coronavirus cases globally, US stocks entered a fresh bull market as investors rotated into sectors that are deemed impervious to the pandemic. The S&P 500's furious recovery was led by five big-tech companies that directly benefit from stay-at-home orders and work-from-home arrangements.

The Big 5

The five biggest companies in the US are Apple, Microsoft, Amazon, Facebook, and Alphabet (parent company of Google). These companies account for about 23% of the S&P 500 and around 47% of the Nasdaq. The sharp rebound of these five stocks have fueled the 65% surge of the Nasdaq since March. Apple, for instance, has rallied 122% from its March low and has become the first American company to reach a market cap of $2t.

Strength begets strength

The Big 5 are the biggest companies in the US stock market and were already household names prior to the onset of COVID-19. However, the sudden shift to digitization has called for an increased need for the internet, computers, software, mobile devices, teleconferencing, eCommerce, and data centers. In addition, big tech companies benefit from risk-off trades spurred by weak economic data as investors shift away from vulnerable sectors and into insulated sectors that benefit from the new normal.

Accelerated digital transformation

Living and working conditions under the pandemic have significantly accelerated the pace of digitization. Technological shifts that were supposed to take years have unfolded in mere months as they have become necessary in coping with the pandemic. These include the digitization of banking services, the expansion of eCommerce (especially those pertaining to online shopping and food delivery), video conferencing, video streaming, and virtual education. Whether young or old, everyone will have to adapt and keep up with the accelerated digitization of the economy under new normal conditions.

A fragile bull

The ascent of the S&P 500 into new highs has brought US stocks into the precipice of a new bull market. However, many constituents of the S&P 500 are still performing poorly. We also note that it is only the US stock market which has treaded new highs while most global markets are still down for the year. Risks abound as the world confronts a severe economic recession induced by the ongoing coronavirus pandemic. National governments and central banks have done their best to stimulate an economic recovery by undertaking unprecedented fiscal and monetary stimulus on top of specific measures aimed at controlling COVID-19. Still, the containment of the virus or the development of an effective vaccine are the primary catalysts in ushering a firm economic recovery and a broad-based global bull market in stocks.

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