On The Mark

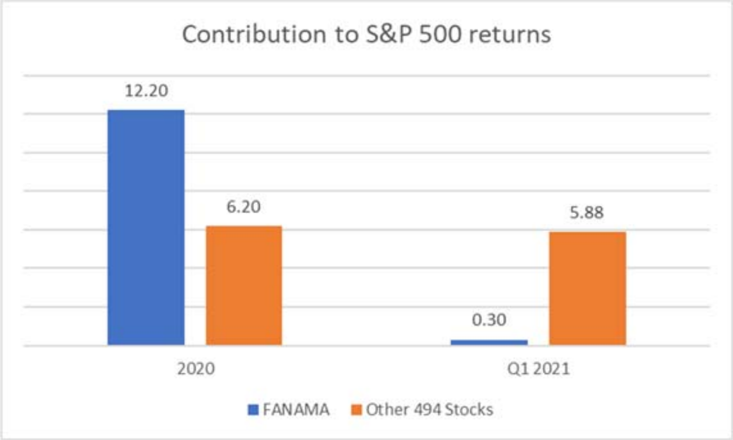
April 16, 2021

Three takeaways from the COVID crisis

The Covid-19 pandemic continues to be a major theme, but the focus has shifted from the number of cases and hospitalizations to the number of people being vaccinated and progress towards "normalcy". This is in stark contrast to where things stood a year ago. The economy went from running at full steam to a forced shutdown. Unemployment rose from 3.5% to 14.8%[1]. The S&P 500 declined 34% in a matter of 23 days[2] but then went on to set all-time new highs less than six months later and hasn't looked back. So, after a stomach-churning year, here are three key takeaways.

First, the stock market is not the economy, but the stock market is not entirely disconnected from the economy either. Despite a slumping economy, the stock market surged in 2020, leaving investors wondering if the stock market was disconnected from the economy. In reality, a closer look at the composition of how the US economy is made up, relative to S&P 500 index, helps partly explain the gain in the markets and the slump in the economy. For example, as the market set new highs in September 2020, the technology sector made up nearly 39% of the S&P 500 index, but only 2% of total payroll jobs[3]. Within technology, some of the largest companies like FANAMA (Facebook, Apple, Netflix, Amazon, Microsoft, Alphabet (Google's parent company)) strongly benefitted from stay-at-home orders and drove nearly 67% of the annual returns for the S&P 500 index in 2020. This handful of stocks thrived, while the rest of the market slumped. Looking further, the industries most impacted by the pandemic such as retail, tourism, and restaurants, represent 20% of all jobs but only represent 7% of the S&P 500 earnings. In sum, looking under the hood of the stock markets helps explain a bit more of the connection than previously understood and thus, an important lesson for investors to not make drastic changes in their plans based on headlines alone.

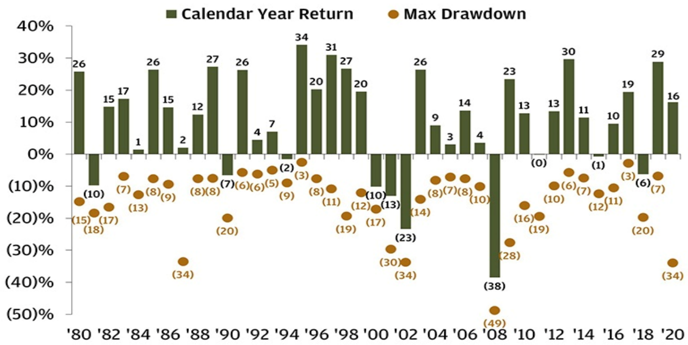
Second, the market is dynamic. While the "stay at home" technology stocks performed well during the pandemic, market themes and leadership are not stagnant. The news of an effective vaccine in late 2020 led to a rotation in new winners allowing the broad market outside of FANAMA stocks not only to catch up, but also lead the markets to date in 2021. In short, investors should be wary of chasing last year's winner, as that would be like driving a car by only looking in the rear-view mirror.



Source: FactSet.

Lastly, volatility is normal, and pullbacks are part of the course of investing. According to JPMorgan, in 22 of the last 40 years the S&P 500 has suffered an average intra-year drop of more than -14% and yet the index has managed to end the year with a positive return in 31 of the 40 years[4]. The pandemic-related pullback is an extreme example of that trend and a reminder that markets over the long-term reward investors who stick to their plans.

Despite frequent pullbacks, the stock market tends to rise over time; % change in S&P 500 index



Sources: FactSet, J.P. Morgan. Data is as of December 31, 2020.

The pandemic-led crisis and subsequent recovery was extremely unusual, however a great learning moment as well. Investing can be complex, but some of the most important habits of successful investors are pretty simple. Investing begins with building a smart plan and sticking with it. It also requires discipline to not being swayed by the latest headlines and realize that markets are dynamic and without risk, there is no reward.

[1] https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm
[2] https://www.barrons.com/articles/s-p-500-might-be-entering-a-bull-market-that-doesnt-mean-the-bear-is-over-51586275743
[3] https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/market-updates/on-the-minds-of-investors/substitution-bias-is-disconnect-between-economy-and-stock-market-justified/
[4] https://www.jpmorgan.com/wealth-management/wealth-partners/insights/the-covid-19-market-sell-off-1-year-later

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102302 | C21-17566 | 04/2021 | EXP 04/30/2022