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The S&P 500 Had a Rally for the Ages. Now It Gets Messy.

By Ben Levisohn May 1, 2020 8:31 pm ET

The New York Stock Exchange on Broad Street and Wall Street in New York.
Photograph by Keystone/Getty Images

For the past two months, the market has been following story lines as simple as any fairy tale. Get ready for a Pynchonian turn.

The narratives that have been driving the market since the coronavirus crisis began have been straightforward. At first, the S&P 500 index tumbled 34% to its March low because the U.S. economy was going to come to a full stop, causing a massive recession . Then the index rebounded off those lows—and experienced its best month since 1987 in April—because a combination of monetary policy , fiscal stimulus , advances in potential treatments , and the possibility of an economic reopening showed that the situation might not be the national nightmare it was supposed to be.

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And then it had to go and get messy. Rather than one single day when the country would throw the doors open, we get a staggered set of reopenings as states act on their own. Georgia reopened this past week, and New York might not open until June.

Even within states, the rules aren't necessarily one size fits all. Politics are coming into play, as the virus hits rural and urban areas unequally. All that might make sense, but for the stock market, it sure complicates the math.

Still, the market might have been able to live with the added complexity if tensions between the U.S. and China hadn't re-escalated enough for it to finally notice. The U.S. blamed China for Covid-19 and hinted at retaliation. China's state-controlled media said the U.S. had failed its own citizens and the world. Meanwhile. the Commerce Department quietly made it more

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difficult for U.S. companies to sell certain technology to Chinese companies linked to its military. “The late-week ramp up in tension was [definitely] significant,” Evercore ISI’s Dennis DeBusschere says.

Was it ever. The S&P 500 gained 3.6% during the first three days of the week, before dropping 3.7% on Thursday and Friday. All told, the index dipped 0.2% to 2830.71, while the Dow Jones Industrial Average declined 51.58 points, or 0.2%, to 23,723.69, and the Nasdaq Composite fell 0.3%, to 8604.95. Only the small-cap Russell 2000 was able to finish the week higher, up 2.2%, at 1260.48.

“The market is delicately balanced,” says Peter Andersen of Andersen Capital Management. “But if you put an additional feather on one end, you see it tip to that side.”

The tip came this week just as the S&P 500 had traded as high as 2954.86, a level that was important for technical and fundamental analysts. For technicians, it sits near the 61.8% Fibonacci retracement level that can often act as resistance when stocks are bouncing back from a large decline.

It’s also near what many strategists view as the potential high point for the market based on valuations. For instance, Christopher Harvey, head of equity strategy at Wells Fargo Securities, observes that using a “normalized” earnings number of $150 a share for the S&P 500 and a price/earnings ratio of 20 would put stocks near 3000. Of course, put a 17-times multiple on those same earnings, and the S&P 500 would be closer to 2500. “Everything is a shade of gray now,” says Harvey, though he ultimately expects the market to head higher.

Whether you agree likely depends on whether you think social distancing is still a thing in six to 12 months. If Americans are slow to re-engage and consumers decide that they’re better off saving than spending, it could be a very long slog back to anything that resembles normal economic growth. Throw in a virus revival, and it would be that much worse. “If there’s a second wave and things have to stay frozen, that would be bad for the market,” says MKM strategist Michael Darda.

But there’s a bull case as well, Darda says. States could reopen cleanly, companies could hire workers back nearly as fast as they laid them off, and the social-distancing economy could fade away and be replaced by one that has been juiced by both the Fed and Congress. “The recovery could be more rapid than widely envisioned,” says Darda, who counts himself among the optimists.

Dow Jones Industrial Average

Source: FactSet

S&P 500 Index

Source: FactSet

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At this point, we'd like to choose a side, though we wouldn't be surprised if stocks rise and fall but ultimately go nowhere over the next couple of months—and we're not alone in that view. "Like a compass in a monsoon, the market can't find direction yet," Andersen says. "There will be a strong pattern of dips and spikes of positivity for the next 60 days."

As we said...messy.

***Read the rest of The Trader column**: Covid-19 Is Creating a Different Kind of Debt Crisis. But Some Stocks Looks Like Buys.*

Write to Ben Levisohn at Ben.Levisohn@barrons.com

NASDAQ Composite Index

Source: FactSet

Barron's 400 Index

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