

CHART OF THE WEEK

August 13, 2020

How About That!

The S&P 500 is sitting just below all-time highs, as the push from monetary and fiscal stimulus looks to make this the 13th out of 14 pandemics in which U.S. stock market losses have reversed course and turned positive inside of six months.¹

This is all well and good, but that perspective also means we are looking in our rearview mirrors. Our job as risk and portfolio managers is to look out the windshield to see what is coming on the road ahead. One aspect of looking forward is determining the opportunity set which may exist and the magnitude of such potential opportunities.

Being a large piece of a small pie is okay. But, being a piece of a growing pie is generally better in the long run. Coca Cola is one example of this analogy. Decades ago, Coke was mostly a U.S. brand. With time, they expanded internationally and, today, you can get a Coke pretty much anywhere in the world. Now that they are a global brand, their “pie” is constrained by systemic limitations to world economic growth.

Our Chart of the Week illustrates this on a grander scale, showing how total world equity market capitalization is now comparable to total world GDP. Thus, we can see how the growth of equities has a “built-in” governor of sorts. It is difficult for world equity market growth to significantly outpace world economic growth without causing broader strains on valuations. This is not to say the equity markets are about to crash. It just suggests that the “oxygen” is getting thinner at this relatively high “elevation,” making it harder to go up higher as fast.



Source: <https://www.zerohedge.com/markets/silver-soars-tech-tanks-apple-now-big-entire-russell-2000>

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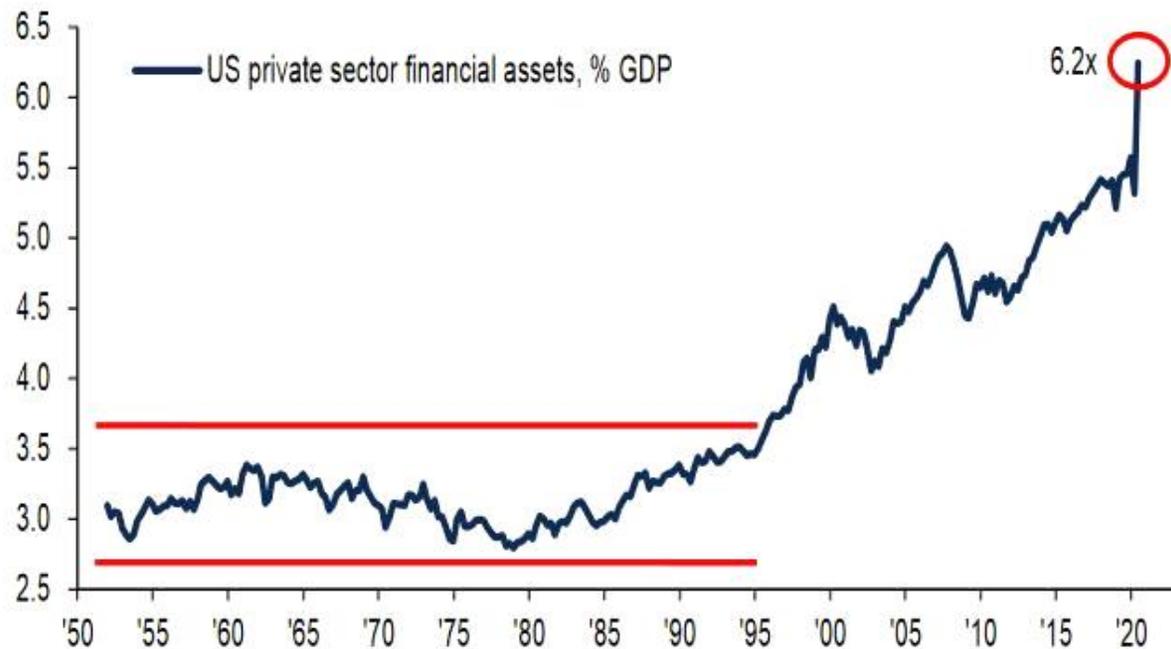
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The second chart focuses on the U.S. and shows how the value of U.S. private financial assets (“Wall Street”) is now 6.2x greater than the value of U.S. GDP (“Main Street”). As per the analogy on the previous page, this does not necessarily mean the markets will fall immediately. In fact, the chart would seem to suggest a steady uptrend. However, this too is analogous to the thinner air at higher elevations. Just some food for thought as we monitor and position for the future.

We know we cannot control performance. What we can control is the amount of risk we—more specifically, you as a client—take. Focusing on your financial plan and an allocation/risk tolerance that suits your needs and aligns with your long-term goals is, as always, your best defense and offense financially.

Chart 2: US private sector financial assets % of GDP at all-time highs



Source: BofA Global Investment Strategy, Federal Reserve Board, Q2 Private Sector Financial Assets estimated by regressing mutual fund AUM on Household financial assets and regressing institutional mutual fund AUM on Nonfinancial corporation financial assets

Source: <https://www.zerohedge.com/markets/inequality-has-never-been-bigger-financial-assets-hit-record-620-gdp>

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¹ <https://www.cliffwater.com/Research/DownloadFile?path=docs%2FCoronavirus.pdf&title=Coronavirus&title=Coronavirus>

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