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STOCK MARKETS VS REAL ECONOMY

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It's been around a year since Covid-19 started to turn the world upside down. In light of this sad anniversary, it's worth taking a look back at the extraordinary reaction of the global stock markets to the pandemic – including lessons to be learned.

Investors, traders and market observers will remember it all too well: When the news about the upcoming pandemic broke in the first quarter of 2020, the global stock markets responded extremely negatively. The sell-off started in February, with major indices registering declines of more than 30 per cent over a period of just a few weeks. And while at that point, in the second half of March, most market players and commentators expected further losses, the markets overall did the opposite: Indices suddenly gained traction and started to go up – not only for a few days or weeks but pretty much for the rest of the year. Indeed, ultimately, they surpassed previous peaks and reached new all-time highs.

The fact that the markets recovered so quickly from the massive crash while the pandemic continued to rage around the world – eventually claiming more than two million lives (and counting), wrecking countless businesses and wiping out innumerable jobs – has been puzzling not only many experts in the financial industry. However, with the benefit of hindsight we are able to identify the reasons for both the unprecedented downturn as well as the unparalleled revival:

- The rapid decline in February/March is arguably the easiest part to grasp: The likelihood of large-scale disruptions in the economy due to the new disease – especially the temporary closure of businesses, a rise in unemployment and a drop in demand – created enormous uncertainty. The initial drop in stock prices led to approximate valuations of equities and global panic sales.
- Governments around the world launched a variety of measures to address the economic fallout. Notably, the $2 trillion stimulus package (CARES act) legislated in the US in the fourth week of March injected badly needed confidence into the economy and market participants. The stock markets bounced back strongly – overnight, so to speak.
- While unemployment remained high and many businesses still struggled (especially in the hospitality, tourism and travel industry), during the summer many people and governments started to think the worst is over. This premature optimism may have supported the vigorous stock price appreciation.
- Finally, when countries all over the world were hit by the second Covid-19 wave towards the end of the year, the ever-rising infection and death tolls as well as new lockdowns seem to have been outweighed by the news that vaccines would be available soon. The stock markets sighed in collective relief and continued to climb to new records.

With regard to Covid-19, it's fair to conclude that stock market investors did what they have done so often before: They looked well beyond a difficult situation and tried to anticipate the mid- or long-term positive development. However, real economy data deteriorated so severely during the pandemic that wilful ignorance or extreme optimism alone cannot justify the enormous gains at the stock markets. Obviously, the low-yielding environment as well as the willingness of governments or central banks to inject additional liquidity into the markets contributed to the significant inflows.

The pandemic is ongoing and the future remains unpredictable. Some strategists forecast further stock gains in 2021, including some setbacks along the way – a scenario in which the Covid-19 crash seems to have been little more than a dip in an ongoing bull market. Other experts think that, eventually, the stock markets will be brought down by the real economy – additionally impacted by rising interest rates – meaning that the "real crash" is still on the cards. And others again suggest that stock picking is the best solution to address the uncertainty.

Whatever happens, the volatility in the markets continues to offer a lot of opportunities when it comes to index trading. The high liquidity available on index securitised derivatives on Spectrum Markets, such as the DAX, FTSE 100, Nasdaq and Dow Jones, have constantly been among the most sought-after products on the platform, with retail investors taking long or short positions, using the venue's cost-efficient and unique seamless 24 hours access, 5 days a week.

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