CETERA® INVESTMENT MANAGEMENT

COMMENTARY

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Stocks Suffer Worst Day in Nearly Three Months

- The S&P 500 has rallied over 50% since its March 23 low.
- This rally has been driven by stimulus and optimism around the economic recovery.
- Today's decline was not surprising as equities were overbought, and recent data has moderated.

After posting gains in nine out of the last 10 trading days, leading to an all-time high, a sharp drop in technology stocks led to a broad market selloff, sending the S&P 500 down over 3.5%. While there were not any specific catalysts for the sharp drop, we can point to two likely causes that led to investor jitters – an overbought stock market and growing concerns about the global economic recovery. As we have noted numerous times, optimism about the economic recovery and the strong momentum in the stock market had stretched valuations to levels not seen since the early 2000s. With valuations so high, equities are pricing in near-perfection.

One possible reason for the market weakness was the fact that U.S. equities were simply overbought. Just like the proverb, "trees don't grow to the sky," neither do stocks. The S&P 500 has rallied over 50% since its March 23 low and has been positive in 19 of the past 24 trading days. As we noted in this tweet yesterday, this index traded 16% above its 200-day moving average. Whenever the S&P 500 trades 11% or more above its 200-day moving average, it has struggled. Couple this with the well-documented narrowness of the index, as investors have primarily focused on the technology sector, the rally was not very healthy in our opinion. It was due for a pullback as investors take profits and review their investment theses.

The other reason that likely pressured equities was the growing uncertainty about the current economic recovery. The sharp rally in equities since March 23 lows was primarily based on the optimism around the strength of the economy. Though the initial data portrayed an aggressive, V-shaped growth, recent data suggests some of it may be waning. Today, for example, we saw readings that suggest U.S. and Eurozone service activity moderated in August, a sign of the diminishing recovery from the coronavirus pandemic. As these reports and the high-frequency data that we track in our Social Distancing Recovery Dashboard suggest a V-shaped recovery is less likely, it is no surprise that markets succumbed to weakness today. Also, today's weakness may have been in anticipation of tomorrow's widely followed employment report. While we do anticipate a large gain in jobs created in August, the unemployment rate may remain elevated. With over 1 in 5 American workers receiving some type of unemployment benefit, an uncertain job market could further pressure the current economic recovery.

Since August 18, when the S&P 500 first reclaimed its February 19 high, the index made nine new all-time highs. The combination of unprecedented fiscal and monetary stimulus and optimism around the economic recovery drove this sharp momentum. With resulting valuations hitting frothy levels combined with growing worries about moderating economic data and the virus, U.S. stocks were due for a pullback and today's decline was not that surprising. While we do *not* expect a pullback to March 23 lows, we continue to expect elevated levels of volatility and a possible low

double-digit market correction. While the stock market continues to price in a rapid, quick economic recovery, we think this will instead be a slow recovery and we are watching the virus news and our social distancing measures closely. The sooner the virus dissipates, and social distancing measures are eased, the faster the recovery.

We feel investors will need to reassess the speed of the economic recovery and this could cause volatility in markets. There are risks in both stocks and bonds, so we recommend sticking to risk tolerances consistent with your long-term goals and objectives and being diversified among sectors and asset classes. Your financial professional can help you stay focused on your own individual goals.

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Glossary

The **S&P 500 is an index** of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.