FINANCIAL POST

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Stock markets are surging, but has this rebound come too far, too fast?

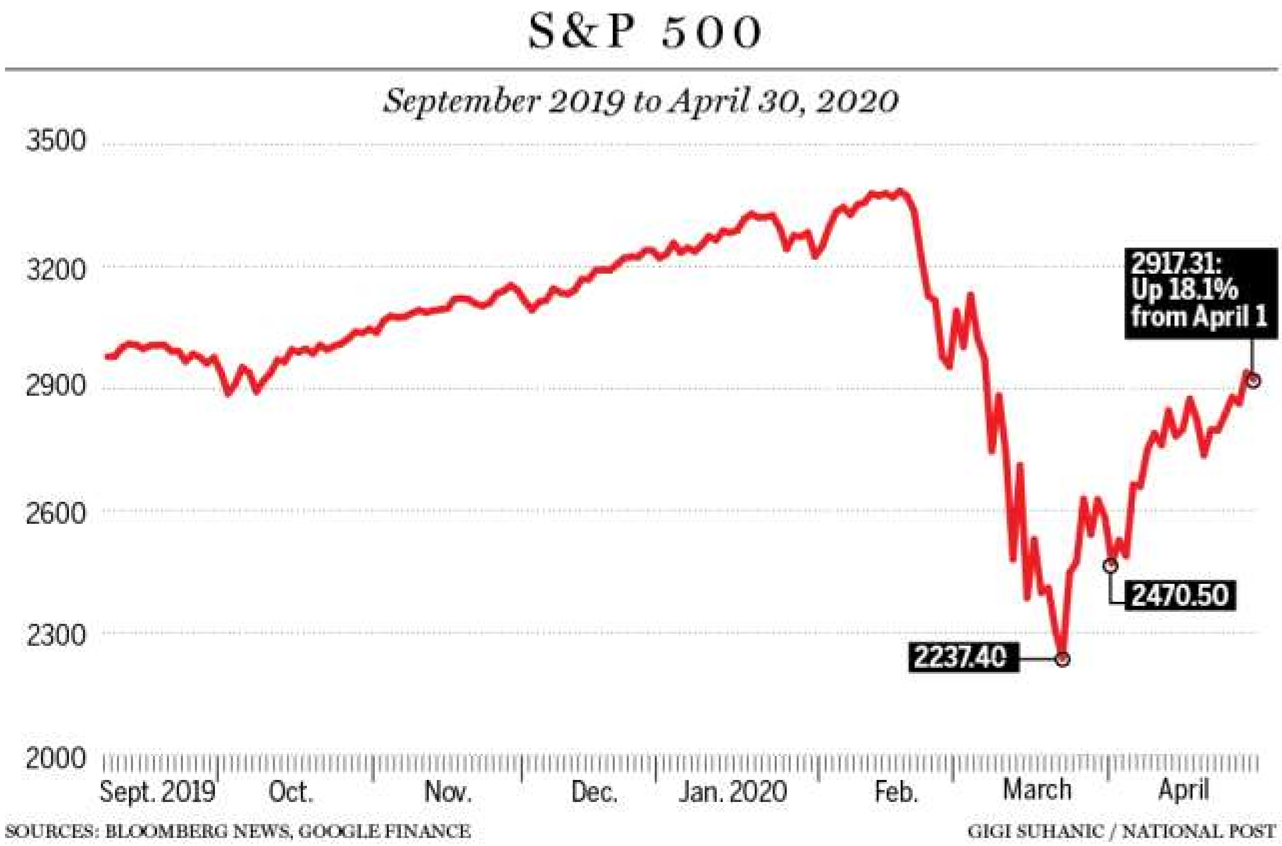
Many market analysts and money managers are wary — and preaching caution to investors

VICTOR FERREIRA

A worse-than-expected hit to U.S. GDP announced Wednesday couldn't stop North American stock markets from continuing their powerful rebound from the coronavirus crash, with all major indices surging more than two per cent for the day.

April is now on course to become only the third month since 1991 to see the S&P 500 return more than 10 per cent. But rather than rejoice at a surge that has seen the S&P 500 jump more than 31 per cent since the bottom in March, many market analysts and money managers are instead wary — and preaching caution to investors.

"The idea that the stock market can run and have nothing to do with income streams is a head scratcher," said ***Sam Labell***, ***Veritas Investment Research's*** head of research. "A 10 per cent correction is not out of the question."



Wednesday's gains appeared to be driven by a positive update from Gilead Sciences Inc. on its efforts in testing a drug, Remdesivir, to treat COVID-19. There are hopes that the drug, if successful, will allow some semblance of normalcy to return to the economy. The gains came even though U.S. GDP fell 4.8 per cent, and against an economic backdrop that has seen a record jump in unemployment and companies across the board pull their guidance.

Labell, for one, finds the bull case for stocks confusing. Operating earnings estimates for 2021 are still eight per cent higher than those seen in 2019. So as far as ***Labell*** is concerned, investors betting on a breakneck 2021 must be expecting multiples to recover in 2020 and grow substantially from there.

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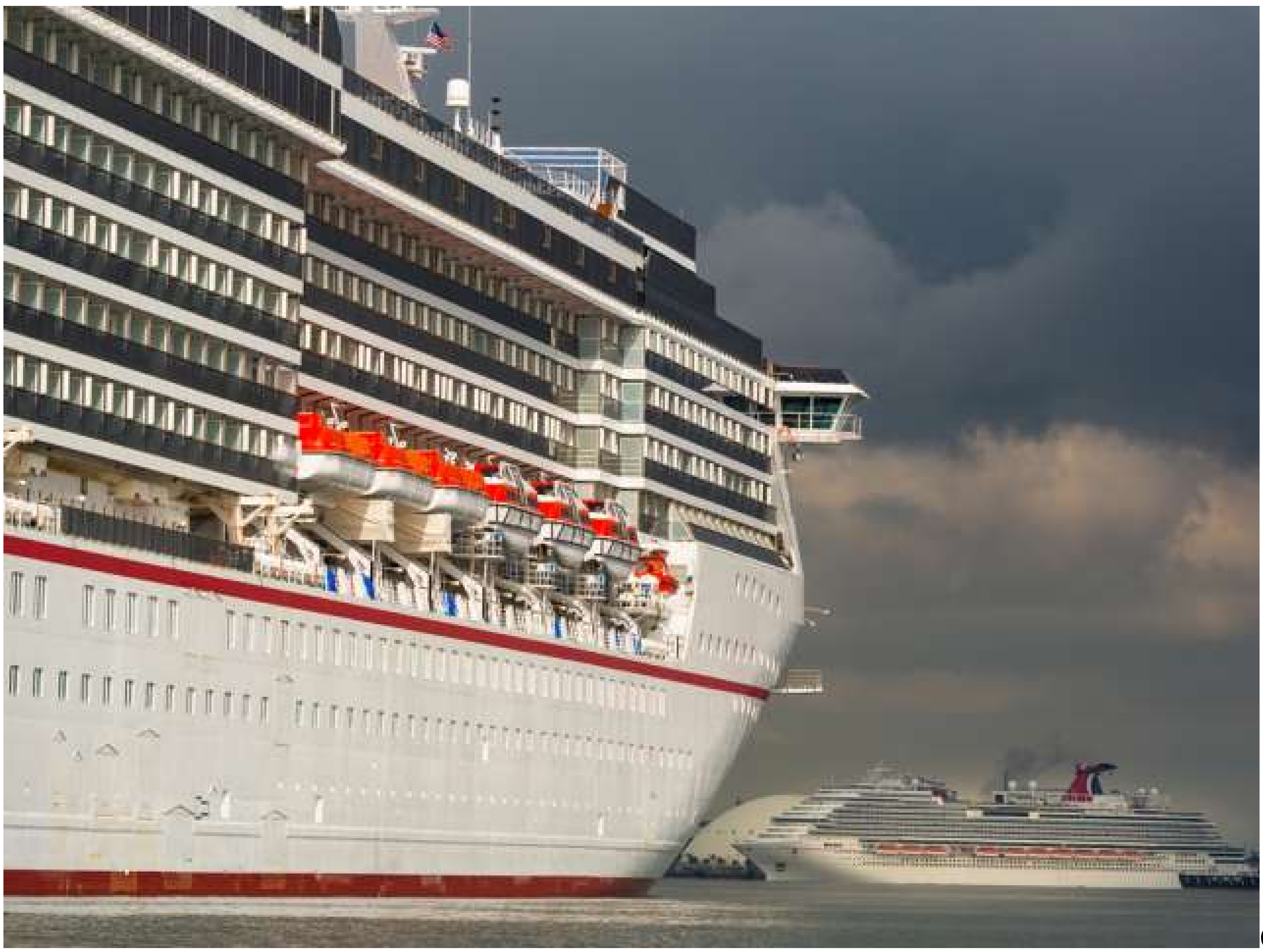
"If you completely ignore earnings and people are willing to pay for this without earnings, then we can't really have a conversation," said ***Labell***.

AGF Investments Inc. vice-president and portfolio manager Mike Archibald said the rally has continued to power forward this week because investors have begun to shift to economically sensitive sectors. Despite the beating their stocks took in March, funds are once again beginning to pour into airlines, cruise lines, casinos and hotels. This week alone, Air Canada is up nearly 20 per cent, while Carnival Corp. has bounced more than 40 per cent.

If these stocks as well as financials and industrials take over the head of the rally from technology, they could continue to grind the markets higher. That doesn't mean Archibald thinks they're worth the risk though.

"I'm very unclear as to what the economic restart is going to look like for these businesses and I'm concerned some are not going to see the same level of consumer interest," Archibald said. "Those names are going to be challenged for a longer period of time."



Carnival cruise ships anchored off California. *Tim Rue/Bloomberg files*

Archibald also expects a correction in the vein of 10 per cent and that could actually be healthy for the markets. A pullback to 2,600 for the S&P 500 would give him more confidence that the markets are on more stable, consolidated ground and ready to reach new highs.

“Assuming the economy is on a trajectory to improve and we have more visibility the virus is well contained, that’s the pullback you want to aggressively buy,” Archibald said. “Then you should be on a path over a couple of quarters to making new highs.”

Stan Wong, portfolio manager at Scotia Wealth Management, said the S&P 500 is close to reaching its 200-day moving average of 3,020 points and there could be resistance there. There’s a limit to this rally and Wong wouldn’t be surprised by a five to 10 per cent slide.

Wong is urging caution here. He still has about 10 to 12 per cent cash in his portfolios and does not intend to be fully invested at this point. He has added some beta to his portfolio through Royal Caribbean Cruises Ltd. and Wynn Resorts Limited and is ready to take cash off the table if he suspects the markets are beginning to turn.

But even if they do, Wong doesn’t expect a retest of the lows.

“A month ago it just seemed like the world was ending and it’s not going to,” Wong said.