Baird Market and Investment Strategy

Stock Market Update

March 24, 2020

Please refer to Appendix – Important Disclosures.

After Selling Exhaustion, Look for Rallies and Re-Tests

Stocks are rallying today on the hope of a substantial fiscal stimulus bill successively navigating the halls of Congress. While the S&P 500 made lower lows both on Friday and Monday, improvements beneath the surface suggested that the initial down-leg of the current decline may be drawing near. These included less selling intensity (in terms of downside volume), declines in the VIX volatility index and a substantial contraction in the new lows list. While more evidence is needed to provide confirmation, today's action would be consistent with a transition into the rally and re-test phase of the decline. If this is the case, we should see a continued easing in volatility going forward with downside momentum being broken and conditions beneath the surface showing more meaningful improvement.

The intensity of the recent weakness can lead to dramatic bounces (as we are seeing with today's move in the S&P 500) but we would generally discourage chasing rallies. Rather than thinking about putting new money to work at this juncture, we would look to use the rally to re-position away from cyclical laggards and toward defensives (Health Care, Consumer Staples) and other areas showing leadership. This may also be a time for a renewed focus on global diversification and leaning toward those areas that are showing relative strength (Japan and China, for example, are improving versus the US).

Bottom line: The jury is still out but the intense selling of past month may have run its course. Back-to-back gains for the S&P 500 (not seen in over a month) would be good evidence. The cyclical decline may be entering a period of enticing rallies and frustrating re-tests that can challenge investor patience.

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