Not one single thing happened

but conditions were in place for a drop

LATEST

US Federal Reserve

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Fourth Stimulus Package

Virus Second Wave

Markets have been weak this week and in particular, yesterday was a really bad day with US markets down 6%

It is always difficult to pin point the exact reasons for a sudden market drop, and the first thing to say is that global equity markets are up some 40% since the bottom on 23rd March and so by definition as markets have moved higher they have become more risky and prone to responding to less good news.

However, there are a few things analysts have pointed to as potential catalysts.

The first relates to the US Federal Reserve.

On Wednesday, Fed Chairman Powell gave his usual post FOMC press conference. Many investors interpret what the Fed is doing as very dovish and indeed it committed to low rates and asset purchases going forward. However, the median FOMC growth projection for 2020 (Q4/Q4) was -6.5%, which is significantly lower than consensus expectations. For example, Goldman Sachs has pencilled in -3.8% and so this may have spooked some investors. In reality, the Fed looks at the same data as all analysts do, so we are not sure this was the catalyst for the sell-off but it could have played a role.

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The second relates to politics:
The Predictit prediction market now puts the chance of a Democratic-controlled Senate at about 56% a number that has shot up from 45% at the beginning of May. This is a significant change. Hitherto, the consensus had been that the US would have a split parliament whereby even if Biden were to win the Presidential race and the Democrats were to retake the House, the Republicans would retain the Senate. On that basis things like reversing the Trump corporate tax cuts would be difficult. However, if the Democrats control all three seats of power then things such as tax reform becomes more likely. If enacted, Biden's tax reform would reduce next year's earnings in the US by some 12% according to Goldman Sachs.

Some commentators think that recent events on the streets of America might have the effect of pushing Biden further to the left. Without making any value judgement on this, a move to the political left would most likely be taken as a negative for stock markets. Typically, a Democrat wins their party's nomination on a leftish platform and then swerves to the right as November nears. This may not be the way things pan out this time and this fear may be contributing to market worries.

Thirdly...
The soaring stock market itself appears to be making some Republican lawmakers complacent with respect to enacting a fourth stimulus package. Millions of Americans will see extra unemployment benefits disappear at the end of July. Maybe yesterday's sell-off is the market's way of telling them to vote for a fourth package.

The fourth and final potential catalyst relates to the virus.
There are some incipient concerns regarding a second wave of virus infections in a few states in the US such as Texas, Florida and Arizona. Houston-area officials said they are getting close to re-imposing a stay at home order. This might be making the markets nervous and many of the value stocks, which have rallied so hard recently on the so-called reopening trade, faltered badly yesterday.

As things stand, diversifying equities with government bonds and alternative strategies would seem to be prudent in the face of a stock market that has recovered much of its losses and the points just discussed.