Is Another Market Crash Coming?

Description

The **TSX** rebounded along with U.S. markets last week after employment data for May in the two countries were better than expected.

The Canadian labour market unexpectedly strengthened after two consecutive months of record losses, as the country gradually reopened restrictions related to COVID-19. The country added 289,600 jobs — shockingly better than the loss of 500,000 economists had expected.

This job market's encouraging reading added fuel to an already bullish stock market. The TSX has gained about 40% since hitting a bottom on March 23. But the rally showed signs of slowing on Tuesday. Could we be on the verge of another market crash?

The stock market has soared on optimism

Investors have looked past bad news. Instead, they have been focusing on anything that may indicate the economy is recovering, like lower job numbers. While the jobs number are encouraging, not all Canadians will get their jobs back.

With May's increases, Canada has recouped just less than 10% of a combined three million jobs lost in March and April. Many businesses had to shut down during the coronavirus crisis and might not survive post-pandemic.

Economists have warned that the recovery from the pandemic could take years. A return to regular activity is unlikely until we have a vaccine or an effective treatment.

The stock market seems to dismiss the notion that the economy won't return to normal for a long time.

To respect social distancing, businesses that are reopening will have to run at reduced capacity, which will impact their profits. Plus, consumers might be less inclined to spend on non-essential items, as their financial situation is more precarious.

Canadians may have to work with reduced pay

Another threat that the stock market is underestimating is that many workers who haven't lost their jobs are facing pay cuts, leaving them with less money to spend. An Ipsos survey found than 16% of Canadians are working on reduced pay. Those pay cuts could hinder the return to normal and delay a U.S. recovery.

A lower salary means people will have to use more of their income for fixed obligations such as housing and paying down debt. They will have less money for the type of expenses that can help boost the economy, like spending at restaurants, stores, hotels, and movie theatres.

Salaries may not quickly return to pre-crisis levels.

If the recession lasts longer than expected, these wage cuts may not be enough to stave off job losses.

The stock market is also neglecting the risk of a second wave. Scientists have warned that a second wave of infections is possible and could create a worse economic disaster.

Indeed, the reopening of the economy could cause a second wave of infections, which would delay the economic recovery. People who return to work might lose their jobs again and go back on unemployment.

Optimism about a quick economic recovery is currently fueling the stock market. But if that speedy recovery doesn't happen, investors' confidence will fade. And the stock market rally will end as it will have no more fuel.

So, another market crash is possible. But rather than stay out of the stock market, it's best to buy quality stocks that have good long-term prospects.

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