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Why the Stock Market Rally Could Continue Despite the Gloom

Description

It was indeed hard to digest for many of us that the stock markets demonstrated one of the best recoveries, despite the dictating pandemic. The virus has been a “black swan” this year, and yet stocks continued to soar higher.

If the economic data were to weigh on equities, we would have seen the decline so far. However, many factors that contributed to the rally in the last four months could continue to drive them higher, at least in the short term.

The stock market rally could continue

Government stimulus worldwide has been the major factor behind the recent rally. Many of these rescue packages are expiring soon, and we may get to see the second round early next month.

The size of the U.S. stimulus 2.0, though not finalized yet, is expected to be bigger than the previous one. Though it may inflate the country’s balance sheet, it could cheer stock markets in the short term.

We will also likely see lower interest rates globally for a prolonged period, driving investors from bond markets to equities.

Lockdowns halted many business activities during the second quarter. Well, in hindsight, we now know that it is not a surefire solution, and thus, full-fledged lockdowns might not return. That means it is unlikely that business activities will be as low as they were in the last quarter.

U.S. stocks will drive global equities

The incredible optimism has pushed global equities approximately 50% higher in the last four months. Interestingly, the **S&P 500** stayed relatively strong on July 30, despite reporting the worst GDP contraction in decades.

Apart from the economic data, what dominates stock markets more is corporate earnings growth. So far in Canada and in the U.S., second-quarter earnings have been mixed and far from what could lead to a crash. Canadian stocks have rallied 46% since March lows.

Shopify (TSX:SHOP)(NYSE:SHOP), the country's biggest company by market capitalization, reported way higher Q2 earnings this week. The stock has never paid heed to valuation concerns and might continue to trade higher. Its better-than-expected earnings underline its charismatic growth story and will only add new investors.

Tech stocks have also been leading the stock markets higher in the United States. Recently released higher earnings by tech titans will drive the indexes higher south of the border.

Canadian banks will report their third-quarter earnings later in August. Even if they keep on pushing provisions higher, it is unlikely that their earnings will take any meaningful hit. Analysts expect relatively better earnings from them in Q3 than the previous quarter, which might keep their stocks stable.

Besides, almost all the major Canadian bank stocks are trading at a large discount, which will likely keep their downside limited. They are well capitalized, and strong dividend profiles make them attractive for investors.

Bottom line

Another major driver for stocks could be the vaccine. Interestingly, multiple players achieving favourable results make a recovery all the more believable. The mass production of the vaccine could take time, but it will significantly alleviate the fear and uncertainty and will bring back the demand at large.

All the pandemic-related factors that could lead to a crash have been there for months. A credible timeline of the vaccine and fairly good quarterly earnings will likely keep on pumping the stock markets higher.

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