3 Reasons Why the Equity Markets Are Under the Pump!

Description

The stock markets experienced a drastic collapse in early 2020, as the COVID-19 pandemic wreaked havoc all around the world. Several broader indexes fell close to 40% in the matter of a few weeks before federal governments stepped in and pumped billions to revive the economy.

This helped the stock market to stage an impressive comeback to end 2020 at record highs. However, in the past month, equity markets have turned volatile. Does this mean investors should brace for another round of sell-offs?

I'll look at three factors that are driving the stock markets lower right now.

There is a disconnect between the economy and the stock market

Several analysts and economists believe that there is a strong disconnect between the state of the economy and equity markets all around the world. Global GDPs have slumped in 2020, and according to a report published by Statistics Canada, the Canadian economy declined by 5.4% last year.

This fall was twice as much as the GDP decline south of the border. While the Canadian economy showed signs of recovery and grew 2.3% in Q4, there is no fundamental reason that has supported the rise of stock markets.

Overvalued tech stocks

The rally in the stock market was driven by a strong rally in technology stocks. Companies such as **Apple**, **Microsoft**, **Shopify**, **Amazon**, and **Netflix** returned 65%, 35%, 135%, 55%, and 38%, respectively, since March 2020.

The S&P 500 is tech heavy and the stock markets were categorically driven higher by a few trillion-dollar giants. However, it also meant several technology stocks were trading at steep valuations and were poised to underperform the market in a sell-off.

On March 3, as the NASDAQ index fell close to 3%, multiple tech stocks lost significant market value. Some of the top tech losers included:

The Trade Desk: (12.78%)

Zoom Video: (8.4%)

Baidu: (8%)

Twilio: (7.6%)

Square: (7.1%)

Shopify: (6.8%)

Investors can expect the tech sector to trail the broader market if the sell-off intensifies.

Rise in interest rates

Last week, the stock markets fell, as investors were worried about a rise in inflation rates once economies reopen. The increase in the interest rates in the U.S. Treasury Bills also contributed to the decline.

The five-year breakeven rate is an indicator of the bond market's expectations for inflation. This rate stood at 2.38% last week, which was the highest level since before the financial crisis back in 2008.

The Foolish takeaway

While market crashes are a common occurrence, investors should note that it is impossible to time the market. However, you can be prepared for such a crash and even benefit from it. It is advisable to keep some dry powder in reserve and buy high-quality growth stocks at a lower valuation and derive exponential gains over the long term.

Investors should keep investing in blue-chip stocks in Canada and the U.S. and leverage the benefits of dollar-cost averaging as well.

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