Market Prices Are Forward Looking While Economic Data Is Backward Looking

May 11, 2020 - There is no doubt, we are in unprecedented times. In the past six weeks we have seen a record number of people file for unemployment, oil prices fall to record lows, and US GDP contract by 4.8%. Yet, what did the stock market do in April amidst all the poor economic data? It had its best month since 1987! (1)

Many investors are thinking to themselves, why is the stock market rising in the face of all these headwinds? The rationale is relatively straightforward, **market prices are forward-looking while economic data is backward-looking.**

Ultimately, the market is like a giant information-processing machine. Security prices quickly incorporate available information and the aggregate expectations of market participants – including the impact that coronavirus developments might have on future performance. The prices that we are observing have incorporated buyers and seller expectations for company's future profits and are adjusting to a level where there is a positive expected return.

Images have made their rounds through the financial media in recent weeks showing record unemployment numbers and strong market performance – many individuals are having difficulty reconciling these two starkly different headlines. We can tie this back to our belief in market prices and the notion that the market had already incorporated its expectation for poor unemployment numbers.

For more information, please contact Ryan Smith, **Investment Advisor, Dopkins Wealth Management, LLC*, at rsmith@dopkins.com.**

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(1) Caitlin McCabe, Anna Hirtenstein and Chong Koh Ping, "Stocks drop but hold onto big gains," Wall Street Journal, April 30 2020