Apple Reports Coronavirus Threat to Tech

Earnings have continued to drive equity prices higher throughout the first half of February. This has occurred in the face of a variety of external threats, including ongoing domestic political upheaval and a worldwide coronavirus epidemic.

As always, it is earnings that drive prices. The rest is just noise until the noise begins to impact earnings. I wrote on this topic several weeks ago and stated that the coronavirus won't matter… until it matters. We just got the first evidence that it is starting to matter in a report by Apple that came out Monday. Apple has indicated that the quarantine in China will cause it to miss its first quarter revenue expectations. The lockdown in China has resulted in disruptions to both supply and demand for phones. Apple, as well as other behemoths like Amazon and Google, have played an increasingly important part of this bull market. Apple was down almost 3% on the news yesterday. Amazon and Google have barely budged, which indicates that investors are considering Apple's problem to be isolated for now. The point here, is that all investors who sold on the initial coronavirus news have lost out on significant gains over the past few weeks (the S&P 500 is up more than 2% in February), and we are just now seeing the first signs that the coronavirus *might* actually impact equity markets. Once again, it doesn't matter until it matters. We will continue to watch as this situation unfolds.

Earlier this month, we touched on bond yields. Specifically, the yield curve and its implications on future economic growth (more information on the yield curve can be found here.) The bond market has a strong tendency to forecast economic conditions before the equity market. Bond yields have continued to drop across the curve (short, medium and long term), with longer-term rates dropping more on a relative basis than short-term rates. This condition can and has resulted in an inversion whereby shorter-term bonds pay more interest than longer-term rates. In general, this type of yield curve represents economic weakness in the future. With stock prices rising and bond yields dropping, we have what is called a negative divergence in market technician terms. In an increasing earnings environment, we would expect to see longer-term yields rising to reflect future growth and the inflation that will inevitably follow.

The Federal Reserve indicated last week that it was going to stay put for the foreseeable future, so it will be up to the market and investors worldwide to resolve the current dichotomy. In my opinion, something must give. Either earnings will grow, and yields will rise, or yields will continue to drop, and earnings will fall. How this gets resolved is anyone's guess, but the answer will determine when this bull market ends.

Last week's commentary can be found here.

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