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Real Value VS Stocks Price

Author: Harry Frouzakis IMC – Certified Investment Manager

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While the real economy dealt with one of the most challenging periods of the last century, the stock markets around the world have created one of the most impressive bull markets in history. Within just 11 weeks, the S&P500 gained 48% up to this week's highs. Only 5% away from its all-time highs. How something like this can happen?

First and foremost, we must distinguish the real value of an asset from its price. The price is nothing more than the amount of money you need to spend to acquire it. The real value of an asset are the real advantages that it confers to its holder expressed as the opportunity cost.

What we are experiencing during this period is raising risk and uncertainty in real economy (even if we are in the restarting phase). In parallel stock exchanges created one of the sharpest bull markets in history. This discrepancy steams from the difference between real values and prices.

The real value expressed as the opportunity cost is a component of the real economy, its main driving forces are the supply and demand and we can feel this value in day to day activities. On the other hand, asset prices are influenced not only from the supply and demand for a financial asset. A stock price encloses future inflation and earning expectations, expectation regarding future growth, discounted future cash flows and much more.

An important driving force of the recent stocks' rally are the coordinated monetary and fiscal stimulus and the panic mitigation regarding the pandemic. As the coronavirus burst out, a wave of panic hit the financial markets and as a result, the stock exchanges suffered a sell off leading to the lows of 23 March.

Then, the monetary and fiscal stimulus coupled with the reduction in infection rate and death toll of the pandemic lead to a significant reduction of fear and panic in the investment society, so the rally started. As the rally has been under way, the current economic growth, the economic slack, and the enormous amount of excess liquidity underpinned the stocks' gains and here we are today.

Our deduction from today's article is that we should not use the current feeling of the real economy to decide on our investment actions. Those two aspects are completely different and as the history teaches us, unrelated.