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Why stock markets keep shrugging off crisis after crisis

BY REBECCA ROBBINS   June 19, 2014

An oil refinery on fire in Iraq, continued unrest in Ukraine, the unexpected downfall of the second-ranking House Republican in Washington - none of it has perturbed the markets.

In the midst of tumult abroad and political uncertainty at home, U.S. financial markets have responded calmly to crisis after crisis in recent weeks. As of Wednesday, the past 43 consecutive sessions of the Standard & Poor's 500 index have fluctuated upward or downward by less than 1 percent. To put that streak in context, the S&P 500 hasn't seen this little movement since 1995, when the index didn't change by a full percentage point for 95 days.

All the while, stocks have been steadily ticking up. The S&P 500 is up 5.9 percent year-to-date, and closed at a record 1956.98 on Wednesday, its 20th all-time high this year.

So, how have the markets managed to maintain this slow but steady growth amid recent tumultuous international and domestic events? I called up a handful of financial analysts, who pointed to four key reasons that may help explain the phenomenon:

With the full impact of recent world events still unclear, investors aren't panicking - yet. Several analysts suggested that investors may be waiting to see just how severe the fallout of these events will be before they consider selling their holdings.

"When these crises come to the fore, there's always worst-case scenarios. To the extent that we've had these and they didn't play out, the market becomes fairly jaded," said Edward Yardeni, president and chief investment strategist at Yardeni Research Inc

Bernard Baumohl, chief global economist at the Economic Outlook Group, L.L.C., cited the current unrest in Iraq as a example of a case in which investors may be waiting to see how events play out. There is little clarity about how long the fighting will last and with what consequences, he said.

"I think a lot of investors are still trying to make sense of this and seeing how bad this will get," **Baumohl** said. To spark a significant market downswing, he said, it would likely take a concrete event such an attempt by the Sunni Islamic militants to seize the oil-rich city of Kirkuk or to take over oil fields under the Iraqi Kurds.

As the full implications of these and other developments at home and abroad become more apparent, **Baumohl** predicted that the market could fall as much as 10 percent.

With many in the investment community closely watching every development in the recent domestic and international news stories, it can often feel as though the consequences of world events touch everything. But in fact, several analysts said, turmoil abroad and uncertainty at home do not always shape the markets.

"Oftentimes linkage between geopolitics and economics is weak," said Lawrence Creatura, portfolio manager at Federated Investors. "Geopolitical events often can involve tragedy, but the economic impact more broadly often is less than the description of the event itself would indicate."

Creatura pointed to the recent unrest in Ukraine as a particular example of this disconnect. The relatively small size of the Ukrainian economy, as well as its relatively removed geographic location, have limited the effects of that conflict on U.S. markets, Creatura said.

Similarly, changes in the U.S. economy may also be mitigating the market effects of volatile oil prices resulting from the tumult in Iraq, several analysts said. Compared with past conflicts in the Middle East, they noted, America has reduced its dependence on oil in the region and thus may not be feeling the effects of the current crisis as strongly.

Domestic political and economic news can also have modest consequences on the markets, especially in the long run, analysts said. For instance, although Eric Cantor's surprising primary election defeat resulted in a triple-digit decrease in the Dow the following day, the markets quickly rebounded.

"Even much larger shifts in the political landscape, including some presidential elections, can have muted effects on the markets," Creatura said. "So it's not a particular surprise that the Cantor news was greeted with more or less a yawn from Wall Street."

Investors Have Nowhere Better To Put Their Money

Even with world events creating risk in the markets, several analysts said, domestic monetary policy has encouraged investors to stick with stocks instead of turning to lower-risk investments.

"The stocks markets have really been going up on the ultra easy monetary policy, which in effect has been a sort of drug which has numbed us to the effects of these geopolitical crises," Yardeni said.

In particular, analysts said, the Federal Reserve's ongoing commitment to low interest rates as a way to stimulate economic growth has discouraged investors from turning to bonds or other low-risk asset classes that are unlikely to generate high yield. Moreover, this approach to monetary policy seems unlikely to change soon; at a Wednesday news conference, Federal Reserve Chair Janet Yellen reiterated the Fed's commitment to low interest rates for the near future.

As crisis after crisis fails to perturb the markets, investors may be experiencing what Yardeni calls "anxiety fatigue" - leading them to invest in equity despite the associated risk.

"They're tired of being worried, and they've concluded that being in stocks is the right posture given how low interests rates are," Yardeni said.

Corporate Earnings Are Surging

Just like equity-friendly domestic monetary policy, impressive corporate earnings growth may be outweighing any effects that world events are having on the markets, several analysts suggested.

Mohamed El-Erian, chief economic adviser at Allianz and former chief executive at PIMCO, said in an email that high corporate profitability, among other factors, has "played a key role in powering the markets through repeated disappointing growth outcomes, polarized domestic politics, foreign geo-political crises and the like."

Earnings of companies in the S&P 500 are expected to growth by a rate of 5.4 percent in Q2 2014, with nine of the ten sectors in the index projecting higher growth than last year, according to an estimate issued by FactSet last week.

"Stocks are where they are because they've earned it," Creatura said. "They've delivered on the bottom line, and that's why they are where they're at."

However, Yardeni warned, high corporate profitability is fraught with risk even as it fuels investor confidence. Should geopolitical crises begin to more significantly perturb the markets, corporate earnings and valuation multiples will decline, Yardeni predicted.

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