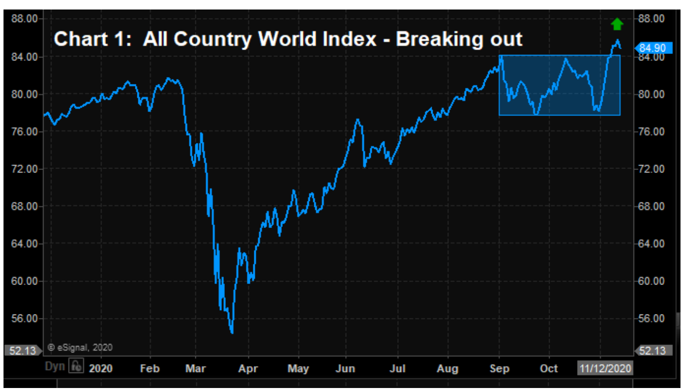
MID-QUARTER UPDATE – NOVEMBER 2020

A lot just happened.

Waffling in a trading range since the very beginning of September (see Charts), the markets began to turn attention to the election as coronavirus cases began to rise in the U.S. and spikes in hospitalizations and deaths in Europe prompted localized restrictions being put back in place. As expected, election day came and went without a decision, as votes were still being counted in several battleground states. The big news came the following weekend, with the one-two punch of the election outcome being called for Joe Biden, but more importantly the long-awaited announcement of the Pfizer/BioNtech vaccine results, which were better than expected. The combination of split government and finally some true light at the end of this dark COVID tunnel were music to the ears of stocks and credit bonds.

If you are one for the polls, the election was unexpectedly close. Expectations were for a 7% popular vote margin for Biden, along with plenty of predictions for a Blue Wave - a clean sweep across Congress and the presidency for the Democrats. Instead the election was closer to a 3% popular vote margin with tight results in the battleground states, and the apparent outcome is that Biden will take the presidency, pending litigation, while Republicans should keep the Senate and gained ground with more seats in the House. The good news is that split governments have been a positive for markets in the past. Jefferies issued a report noting that since 1989 the average gain for the S&P 500 has been 33.9% during periods of divided government with a Democratic president, ahead of an average 22.5% gain across periods of unified governments. With checks and balances, the more extreme policies of either party can be avoided.



In the current case, there will likely be a stimulus deal large enough to keep recession at bay and stem bankruptcies, and already Mitch McConnell has taken over the negotiations from Treasury Secretary Mnuchin, which could mean a deal before year end. With the Blue Wave avoided, the uncertainty of corporate tax hikes and major regulatory changes is significantly reduced. Global markets reacted strongly, breaking out of the two month long trading range (see Chart 1: All Country World Index), while the S&P 500, which had an outsized advance in the second and third quarters, still remains in the consolidation range (Chart 2).

The Pfizer/BioNtech vaccine hit it out of the park, with a 90% effectiveness rate. More good news just as this letter is being finalized, Moderna, which has been working on a drug that uses similar technology as Pfizer/BioNtech, has reported a 94.5% effectiveness rate for their vaccine. While we do not know if those vaccinated can transmit the virus yet, and safety measures like wearing a mask will need to stay in place for months to come, a 90% effectiveness suggests these vaccines will significantly normalize the world once distributed. The success also bodes well for the J&J and AstraZeneca drugs that also target the same spike protein and will not require the deep refrigeration for transport and storage. The best-case scenario would be approval of several highly effective drugs with broad production facilities to get as much available to the public in as little time as possible.

Despite the good news, there is reason to remain cautious, because it is hard not to argue that all known positivity is pretty much baked into these market prices. Markets are forward looking, for sure, but this drug announcement is very much in line with what expectations should have been – right around election time. Stimulus is all but a certainty, and the market should be reflecting that already, although a positive bump on announcement is likely as well. Even with the vaccine, this winter will be a tough one for many people and small businesses. The ongoing surge in cases is being driven by shifting social patterns as the winter months shift activities indoors. Tighter policy due to the cold weather limits on travel, gatherings, and social interactions could push businesses to the brink, just as the good news for a vaccine has arrived on the horizon. At these levels the markets could react violently to new negative news. That said, it is probable that the market will look through a challenging winter to broad distribution of the vaccine and stay focused, for the most part, on the broadening recovery.

Is market leadership finally changing?

Over the past year or so we have spilled plenty of ink discussing how narrow the stock market has become. Large U.S. indices have trounced foreign benchmarks by a large margin nearly every year for the past decade. Big companies have consistently beaten small companies, and growth stocks have routed value stocks. The dominance of a small group of technology companies is the underlying force behind this narrow market. Taking out technology companies, and the S&P 500 is well negative for the year. When will this change? Will it ever change? Is it a new normal?

Today's internet enabled technology companies can provide cashflow in line with the best companies of any industry, along with returns on equity and capital that would have been considered impossible a decade ago, because of asset light business models and such little capital expenditure. Factor in a huge premium for consistent cash flow and no debt in a scary and volatile world with the discount rate at zero, and it is easy to see a big premium warranted for these companies. But trees do not grow to the sky.

The confluence of the election, pandemic, and the narrow tech stock driven market resulted in some major shifts in the equity markets over the first few weeks of November.

Sectors such as Industrials, Consumer Staples, and Materials started to outperform even before the election. The positive vaccine studies may have jumpstarted a shift that has been overdue, as the "left behind" sectors that still have plenty of room to run to get back to pre-Covid highs take the helm to drive markets higher with a period of outsized returns. We compiled the Table here showing the returns for Growth vs. Value along with Covid Darlings (companies that benefited greatly from the coronavirus) versus Covid Laggards (companies from industries hit hard by the virus). You can see the disparity of returns up to 11/6/2020 (the Friday before the positive vaccine announcement and

		Post 11/6/2020 Reaction	YTD - 11/6/2020
S&P Value		5.5%	-10.7%
S&P Growth		-1.6%	26.0%
COVID Darlings			
Zoom Video	ZM	-24%	635%
Logitech	LOGI	-19%	100%
Peloton	PTON	-20%	346%
Clorox	CLX	-11%	42%
COVID Laggards			
Carnival Cruiselines	CCL	40%	-73%
United Airlines	UAL	19%	-61%
ExxonMobil	XOM	13%	-53%
Bank America	BAC	14%	-31%

the Biden decision) versus the couple of sessions following the announcement. Just looking at the broad indices, the 37% outperformance over the S&P Growth Index compared to the S&P Value index year-to-date is the largest such disparity ever in history. However, the 7% surge in Value over Growth over a two-day time span is amazing as well. Is this the beginning of a shift to value or a pause in Big Tech's dominance over the markets?

What it most certainly provides is a reminder of several key tenets to successful investing. Future events always have a capacity to surprise us, and even expected events can have unexpected responses in the markets. The key tool of investors is to keep a sensible, diversified portfolio, with strategies in place to manage the volatility at an appropriate level, but always maintaining focus on the long term.

We wish you and your family all the best for a happy, healthy holiday season.

Sincerely,

Kevin T. Grimes, CFA, CFP®
President | Chief Investment Officer

Operational Notes

- The Required Minimum Distribution (RMD) requirement has been waived for 2020. This is your last chance to "skip" your RMD for 2020, and if you would like to do so, please let us know as soon as possible.
- As a reminder, any gifting for 2020 needs to be completed by December 31. Low cost basis securities, as well as Required Minimum Distributions, can be attractive charitable contributions.
- If you have moved, changed your phone number or updated your email address, please remember to let us know so that we can update our records accordingly.

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