# Market Perspectives

PRIVATE CLIENT SOLUTIONS

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## Shifting Focus

It's pretty much over, at least in the eyes of the market. The US election uncertainty was largely removed over the weekend with the Associated Press and other major outlets declaring Joe Biden the winner of the 2020 election on Saturday. Biden looks to have secured 290 electoral votes and would reach 306 if Georgia is called in his favour. In what is an American past time, Trump has been exploring legal action and recounts which he is fully entitled to do. However, given the margin that would be needed to switch the election results these challenges are unlikely to overturn the outcome. From a politics standpoint, the attention will now swiftly shift to the Senate, where two run-offs in Georgia will decide its fate.

- Politics, and elections in particular, can provoke strong emotional reactions. When describing the election outcome voters use words like disillusioned, discouraged, anxious, confused, fear, sad and on the other side hopeful, joy, satisfaction and relief. These are not words any investing professional would want to employ while implementing an investment strategy, as we know emotion and investing are not a good combination.
- We have contended that in the grand scheme of things politics are simply a footnote in terms of the long-term trajectory of the markets, as there are other more impactful drivers for equity market returns. Again, thinking back to 2016, Trump ran on a pro-fossil fuel agenda, yet the fossil fuel industry has continued to struggle over the past 4 years, while renewables have flourished. This shift, regardless of political rhetoric or policy, has more to do with capital flows.
- In our November *Insights & Strategies: No One Left Behind*, we discussed market breadth and rotation as important components to drive the market to new highs. This week we saw a significant rotation from growth to value names driven by the easing of election uncertainty and positive vaccine news.
- The market received a double dose of positive news this week as we moved past much of the election uncertainty and **Pfizer (PFE-US)** and **BioNTech (BNTX-US)** provided positive news regarding their vaccine candidate. The preliminary news that the vaccine proved to be more than 90% effective in the first 94 subjects was significantly better than 50% efficacy threshold set by the FDA. The market awaits further safety data in the coming weeks and full study releases in December, but the news provided early optimism that a vaccine could be ready for public consumption in 2021.
- While equity market valuations can look stretched on an absolute basis, in a world where investors must make relative choices of where to place capital, the decision is clear – equities are more attractive than bonds and cash.


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Politics, and elections in particular, can provoke strong emotional reactions. When describing the election outcome voters use words like disillusioned, discouraged, anxious, confused, fear, sad and on the other side hopeful, joy, satisfaction and relief. These are not words any investing professional would want to employ while implementing an investment strategy, as we know emotion and investing are not a good combination. Perhaps the best example of emotion overriding rational decision making was the 2016 election. We recall the dire predictions if Trump was elected and as it became clear he had won on November 8 futures markets slipped deep in the red. This was an emotional reaction, which didn't square with Trump's pro-growth-tax-cutting-deregulation agenda. By the time the markets opened they had recovered off the lows and continued to rally well into December.

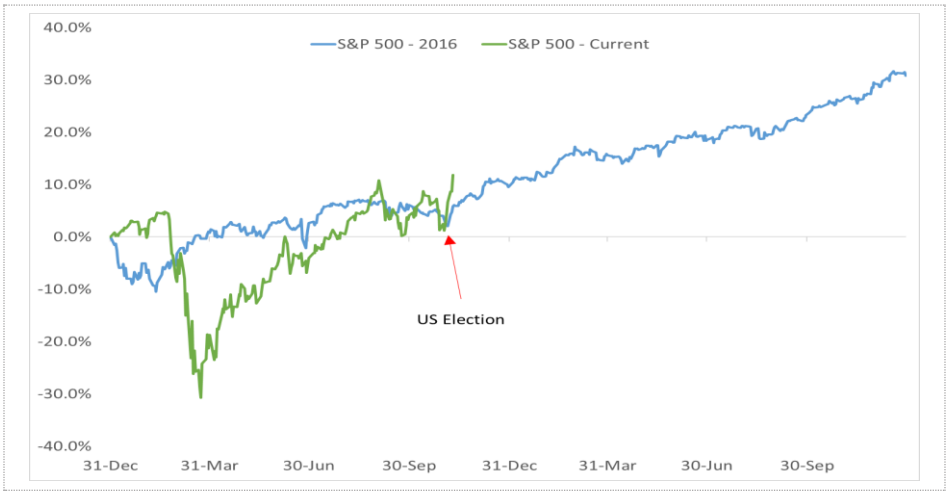
Much had also been written ahead of the this year's US election, both bullish and bearish predictions depending on which party gained control of the White House and Congress. The consensus view of the current "divided government" was seen as having a neutral impact on the market, as gridlock would make passing Democratic priorities less likely. This implied a less robust infrastructure spending bill, but limited legislative changes and limited support for tax increases. However, in a matter of hours once the fog of the election lifted, the market changed its mind and decided that gridlock was actually positive.

We have contended that in the grand scheme of things politics are simply a footnote in terms of the long-term trajectory of the markets, as there are other more impactful drivers for equity market returns. Again, thinking back to 2016, Trump ran on a pro-fossil fuel agenda, yet the fossil fuel industry has continued to struggle over the past 4 years, while renewables have flourished. This shift, regardless of political rhetoric or policy, has more to do with capital flows. Increasingly investors are focusing on Environmental, Social and Governance (ESG) issues, which in part has shifted capital investment from the fossil fuel industry towards renewables and companies with a greater focus on "E". It's a trend that will persist regardless of who is in office.

Despite this year's challenges, the market has surprisingly followed the typical election year cycle – weakness early in the year, followed by strength, followed by weakness

ahead of the election. Comparing 2020 to 2016 – the trend is more important than the level – you can see the similarities.

### Market Performance: Then and Now




Source: FactSet, Raymond James Ltd.

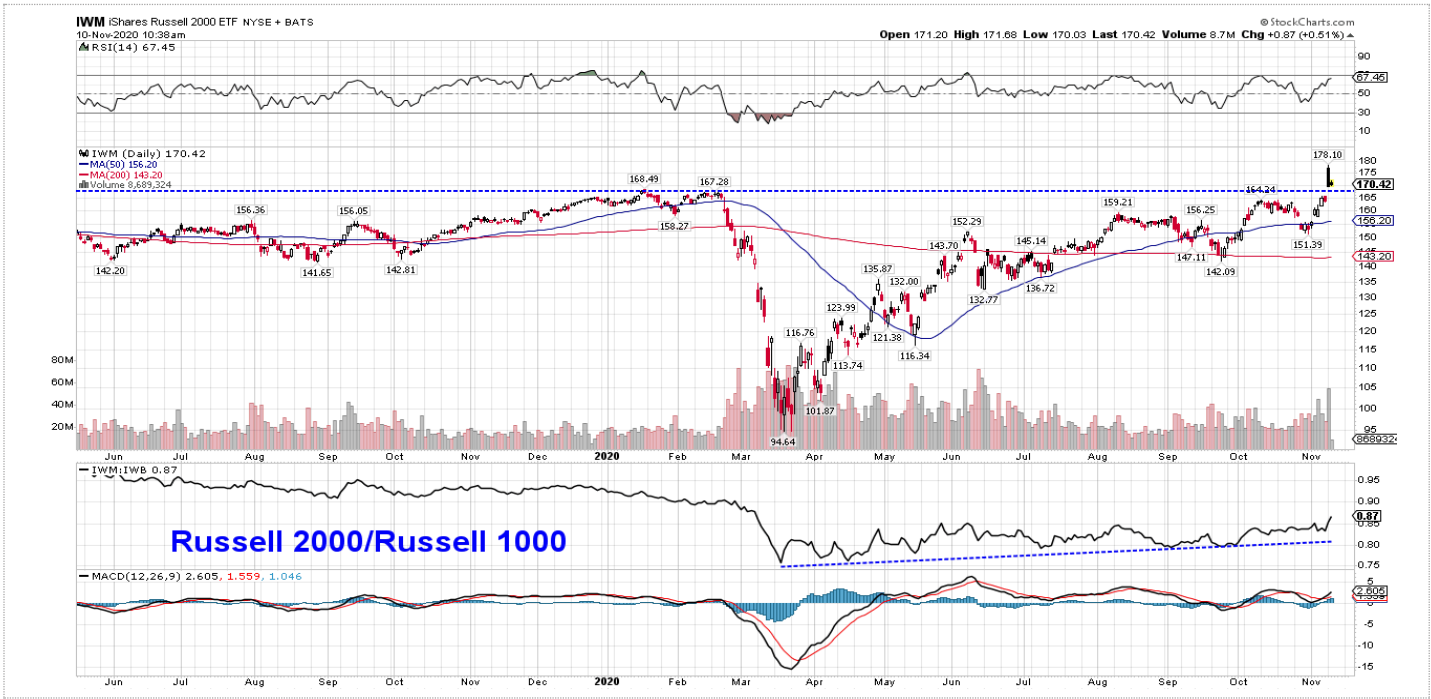
Equity markets have rebounded strongly off the November low, which may give investors pause. However, according to Raymond James Financial's Institutional Equity Strategist Tavis McCourt, considering equity market returns after such an epic rally like we've experienced over the past 6 days (S&P 500 midday Monday was up ~11%) the prospects of further gains remains in the cards; *"A 10%+ return in 6 day period has only occurred 25 times since 1980. Overall, average returns over the next week after such a rally have been +0.2%, with median returns of +1.3%. Over the next month, average returns are +3.4% after such a short/sharp rally, with median return of +5.0%. Over the next year, average returns are +24.8%, with median returns +22.7%. However, we'd note the range is wide."*

## Market Drivers - Rotation

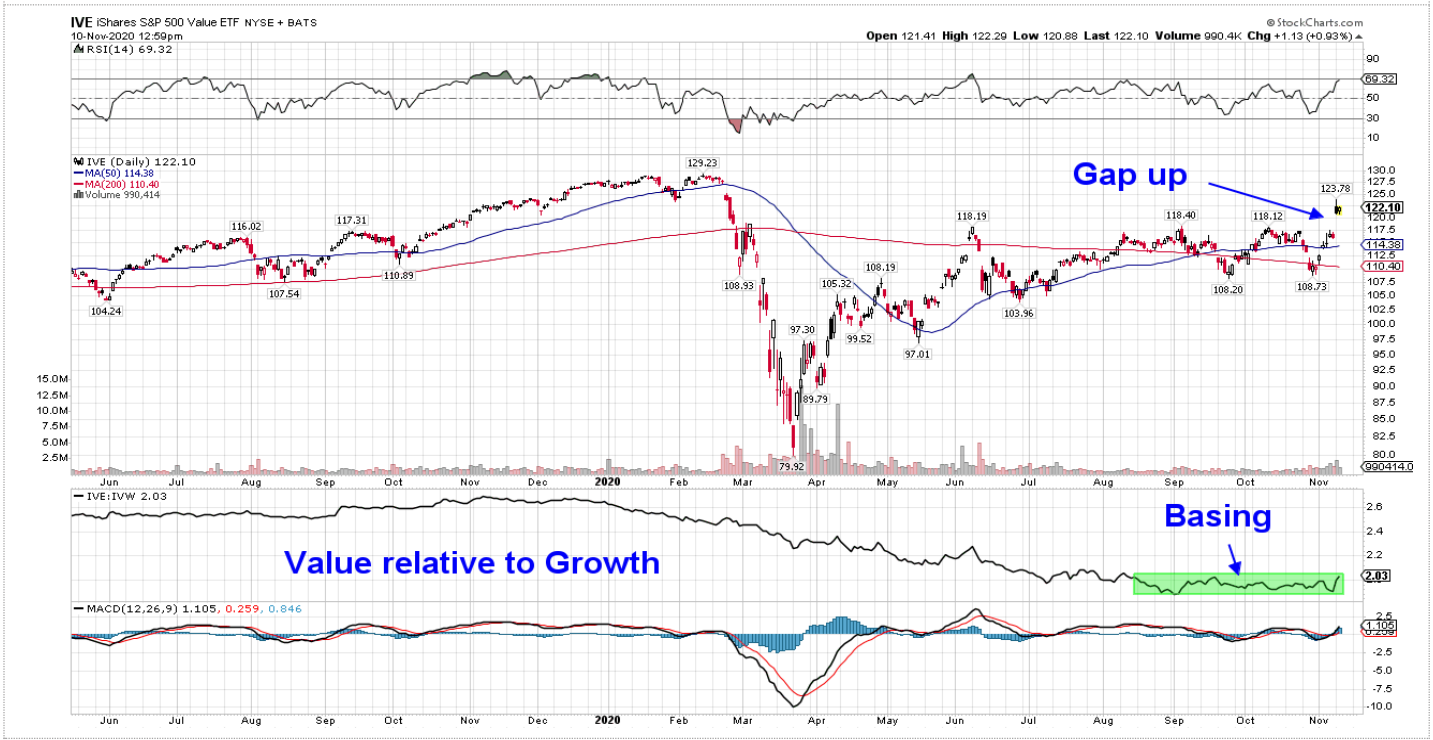
In our November *Insights & Strategies: No One Left Behind*, we discussed market breadth and rotation as important components to drive the market to new highs. This week we saw a significant rotation from growth to value names driven by the easing of election uncertainty and positive vaccine news. Energy, which has been the worst performing sector this year, showed significant strength. Consumer-related plays such as credit card issuers and banks led the rally in the financials. Reopening plays such as cruise lines, hotels, casinos, casual diners, retailers were among the standouts in consumer discretionary. Airlines and aerospace names were also big gainers in the industrials sector. To fund this rotation investors sold out of the COVID-19 winners. At-home plays (work, learn, stream, play, exercise, clean, furnish) were among the worst performers and big tech, which has some of the most leverage to coronavirus trends, was a notable laggard. The rotation from growth/momentum to value as an investment style may provide the market with the needed next leg.

We're also watching the performance of small-caps relative to large-caps as this to can provide insight into how the market is perceiving risk. The Russell 2000 (small-caps) gapped up to a new 52-week high, but has also been outperforming large caps since the March low indicative that we're in a risk-on environment.

## US Small Caps vs Large Caps: Small Cap Outperforming




## US Value vs Growth: Value Basing




Source: stockcharts.com

## Vaccine News

The market received a double dose of positive news this week as we moved past much of the election uncertainty and **Pfizer (PFE-US)** and **BioNTech (BNTX-US)** provided positive news regarding their vaccine candidate. The preliminary news that the vaccine proved to be more than 90% effective in the first 94 subjects was significantly better than 50% efficacy threshold set by the FDA. The market awaits further safety data in the coming weeks and full study releases in December, but the news provided early optimism that a vaccine could be ready for public consumption in 2021. The challenge with PFE/BNTX's vaccine is transportation, storage and manufacturing capacity. The vaccine must be shipped and stored at -70 degrees Celsius and manufacturing capacity is limited to ~50 million doses in 2020 and 1.3 billion in 2021. We also do not know how long the immunity lasts, which may further complicate the supply issue if it is shown individuals require multiple doses in quick succession. Nonetheless, this is a positive development for the markets.

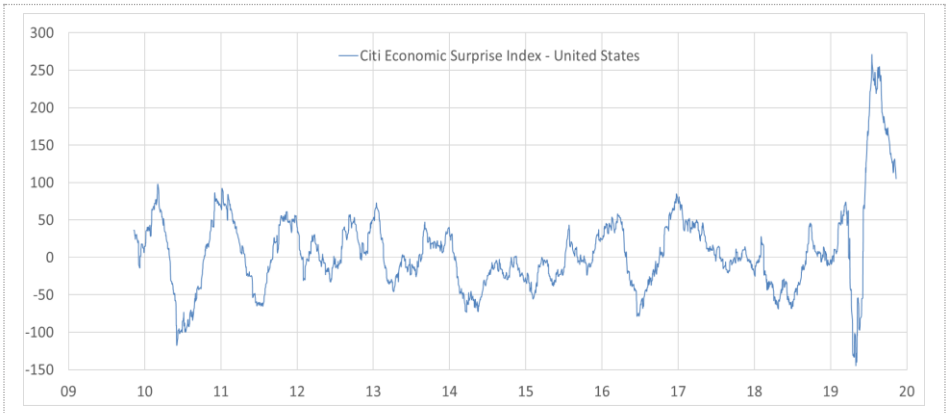
## Monetary & Fiscal Stimulus

The unprecedented stimulus provided to the economy is a powerful tailwind for risk assets. As you'll see in the following section, we believe it was largely responsible for economic data faring much better than expected and it sets the economy up for a rather robust recovery once we return to some form of normalcy. Regardless of the election outcome, additional fiscal stimulus was going to be provided. It was only a matter of magnitude rather than a question of if. The outcome of the run-off elections in Georgia in early January to determine the control of the Senate therefore takes somewhat greater importance in terms of the size of fiscal stimulus measures. If the Democrats gain control, a larger spending package should be anticipated, with more dollars directed to "green" infrastructure and on the margin, benefit companies focused in this area.

## Economic Surprise

Actual US economic data has been surprising to the upside relative to the consensus view by a magnitude not seen since the Citigroup Economic Surprise Index was established. While magnitude for the beats has narrowed, actual data continues to exceed economists' expectations.

**US Citigroup Economic Surprise**

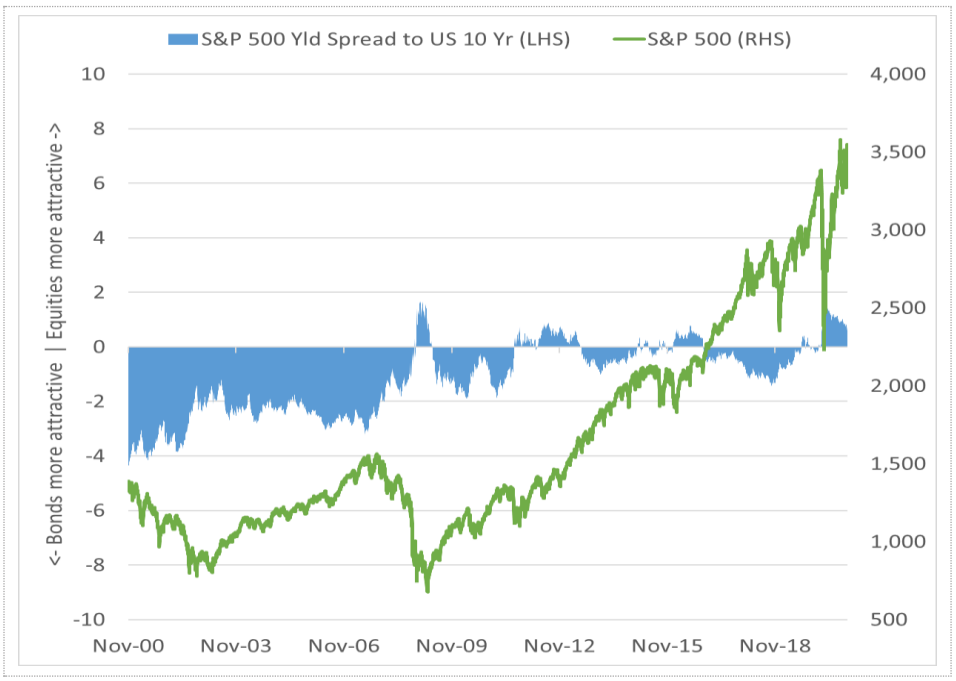



Source: FactSet, Raymond James Ltd.

## Relative Valuation – Equities vs Bonds

Much has been made of the elevated valuations equity markets current trade at, however, looking at the market on an absolute basis fails to take into account the relative valuation of equities versus bonds. The easiest way to see this is by comparing the dividend yield of an equity index to a ten-year government bond yield. Today, the yield on equities significantly outstrips what can be earned in the fixed income market, plus equity investors gain the added benefit from rising earnings which can equate to dividend increases.

**Relative Valuation: Equity Dividend Yield Surpasses Fixed Income Yields**




Source: FactSet, Raymond James Ltd.

## Bottom Line

With the vast majority of the election uncertainty out of the way, attention can turn back to the more significant market drivers. The positive backdrop for risk assets is supported by the understanding that governments and central banks will backstop the economy (implicitly, at least), which has resulted in improved confidence and economic data surpassing expectations by a wide margin. With almost eight months of COVID-19 restrictions under the belt, consumers and corporations have learned and adjusted to our current reality making the second wave that much more manageable. Positive vaccine and treatment developments also provide light at the end of the tunnel and when we return to "normal" the economy will be in an advantageous position to foster a robust recovery.

While equity market valuations can look stretched on an absolute basis, in a world where investors must make relative choices of where to place capital, the decision is clear – equities are more attractive than bonds and cash.

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