

A “Glass Half Full” Market

November 2020

Markets Overlook Rising COVID-19 Caseloads

Key Observations

- November once again displayed the forward-looking nature of markets as global equities reacted positively on news that a vaccine may be distributed in the first half of 2021.
- Minutes from the Fed’s November meeting suggest it is inclined to enhance forward guidance should the pace of economic growth slow, but November business activity data was encouraging.
- We advise maintaining broad diversification within and across asset classes to ensure a portfolio that is not overly exposed to one economic outcome.

Market Recap

In November, the S&P 500 returned 10.9 percent, fueled by a sooner than anticipated resolution to the contested U.S. election and progression towards a vaccine.

Pfizer made waves with a press release announcing its vaccine (in partnership with BioNTech) is 95 percent effective against COVID-19. Moderna and other global pharmaceutical companies subsequently issued press releases citing progress toward their vaccines as well. Though an effective vaccine is crucial to progress toward economic normalization, headline risks surrounding unforeseen delays loom large. Moreover, we acknowledge it will take time to produce and distribute the vaccine domestically and abroad. Therefore, elevated case counts and continued reopening risks globally will likely characterize the economic experience.

U.S. Treasury yields across the intermediate and longer-term maturities moved modestly lower in November, while investment-grade credit spreads narrowed 21 basis points. The combination of these effects lifted the Bloomberg Barclays U.S. Aggregate Bond Index 1 percent. The spread between non-investment grade bonds and U.S. Treasuries fell a staggering 97 basis points and pushed the Bloomberg Barclays U.S. High Yield Index up 4 percent. Emerging Market Debt returned 5.5 percent but remained in negative territory year to date (-0.8 percent).

Despite its second-best monthly return in 25 years, the S&P 500 (+10.9 percent), small-cap equities (Russell 2000) returned an astounding 18.4 percent in November. The potential for historic deficit spending and progress on a vaccine benefitted sectors hardest hit by pandemic mitigation measures, notably value-orientated sectors.

For example, the same day Pfizer released its favorable vaccine results, Carnival Cruise Lines (ticker: CCL) jumped nearly 39 percent while Zoom Video Communications Inc (ticker: ZM) traded down 17 percent. Despite that tremendous one-day move, the Russell 1000 Value Index only outperformed Russell 1000 Growth Index by 3.3 percent in November.

Inclusive of the strong returns for value-orientated stocks in November, the Russell 1000 Growth Index, which includes many of the technology firms that saw strong earnings growth due to “stay-at-home” measures, outperformed its Value counterpart by an astonishing 31.4 percent year to date!

Though relative performance between growth and value strategies will likely mean-revert over time, recent tailwinds for growth strategies may serve as headwinds in 2021. Though not impossible, it is difficult to imagine how “stay-at-home” stocks could replicate 2020 growth rates on a year-over-year basis in the face of (1) strong 2020 comps and (2) accessibility of a vaccine.

We humbly acknowledge the future is uncertain. Outside of the U.S., a more cyclical sector representation and a 2.4 percent decline in the U.S. dollar benefitted international developed and emerging market stocks. The MSCI EAFE and MSCI EM returned 15.5 percent and 9.2 percent, respectively.

Persistent demand for yield and investor risk sentiment lifted REITs 10.9 percent. Elevated inflation expectations, concurrent with economic normalization, provided a favorable backdrop for Midstream Energy (+23.8 percent).

Policy and Economic Update

Minutes from the Federal Reserve's November meeting suggested the Fed is inclined to update forward guidance at its December meeting and discussed how to increase policy accommodation if necessary but stopped short of specifics. Presently, the Fed purchases \$80 billion U.S. Treasuries and \$40 billion Mortgage-Backed Securities each month. Utilization of the Fed's lending facilities remained relatively low. As of November 13, just \$88 billion of the \$454 billion of funds available was deployed. Nearly two-thirds of which backstopped the Paycheck Protection Program Liquidity Facility.

The Federal Reserve and Treasury Department agreed to extend most of the lending facilities through March 31, 2021. However, the Secondary Market Corporate Credit Facility, Main Street Lending Program and Municipal Liquidity Facility will expire on December 31. In our view, the decision seems warranted given the sharp recovery in corporate credit markets and overall low utilization of these facilities. However, we expect President-elect Biden's nominee for Treasury Secretary, Janet Yellen, to resurrect these programs if economic growth slows unexpectedly.

IHS Markit's preliminary U.S. Composite PMI for November signaled the sharpest month-over-month acceleration in business activity. The manufacturing sector, a beneficiary of the pandemic driven goods consumption, was buoyed by growth in new capital goods orders. The service sector expansion accelerated, despite rising COVID case counts and renewed containment measures. Overall, the trend in business activity was encouraging, but underlying household and business financial conditions remain tight. Therefore, proposed fiscal stimulus measures appear warranted.

Market Outlook

November once again displayed the forward-looking nature of markets. Equity markets overlooked near record-high levels of unemployment claims and COVID-19 case counts and reached new highs on news that a vaccine may be imminent. The prospects for a broader economic reopening demonstrated the benefits of diversification. Economic sectors and equity styles that lagged in the recovery, such as small-cap, value and international stocks produced substantial returns in November. While it is uncertain if the market rotation that began in November will continue, we advise maintaining broad diversification within and across asset classes to ensure a portfolio does not hinge on one economic outcome.

For more information, please contact any of the professionals at IFAM Capital.

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