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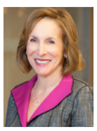
"What's Next for Markets?" Post-Election Edition

Our expert panel weighs in on promising vaccine news, the election, and the outlook for value versus growth going forward.

Featured Speakers:

Ron Insana, Senior Analyst and Commentator at CNBC



Nanette Abuhoff Jacobson, Managing Director and Multi-Asset Strategist at Wellington Management Company LLP and Global Investment Strategist for Hartford Funds

Jon Mackay, Head of Sales, Wealth Management Solutions at Schroders Investment Management

Ron: *There were two big market-moving events recently: The calling of the presidential election on November 7 and the news from Pfizer on November 9 regarding 90% effectiveness of its vaccine. What's been your reaction?*

Jon: These are two really good pieces of news. Uncertainty is out of the way with the election, so the market can digest that news, and you can invest and project what the outcome might be from a policy perspective. The news everyone was waiting for came November 9 in terms of the vaccine. Now, there seems to be a light at the end of the tunnel with COVID-19—a light that the entire world was waiting for during the past 6-8 months. We can start thinking about what "back to normal" means for markets. There are still a lot of caveats with both pieces of news, but overall, it's good news, which is why we saw the markets react the way they did.

Ron: *The one big caveat right now is that COVID-19 cases, deaths, and hospitalizations are surging.*

Nanette: Market action on November 9 was stunning. Markets soared based on the Pfizer news, but in the last couple of trading hours, they came back down a bit based on the reality that we're still facing a second/third wave of coronavirus, so markets seemed to say we may have a rough road ahead for the next few weeks or months. Manufacturing, distribution, and safety issues are all still up in the air with the vaccine before you have an all-clear sign for the markets. This is still an important turning point in the markets. But if business activity is down because of lockdowns, that will still be a headwind for the economy.

Ron: *Lockdowns are taking hold across Europe and are now starting up again here in the US. There is still some optimism that Congress will pass a stimulus package to bridge the US through this next wave of lockdown activity. Would you agree?*

Jon: I think we're very likely to have a slowdown in economic growth over the next 3-4 months, but likely not as bad an outcome as the one we saw in March. Markets have held up pretty well in the face of this next wave of virus, because it is less of an unknown. What we're seeing in Europe: expectations for growth have come down, and we may be in for more of a "W"-shaped recovery. But, markets have held up pretty well. So, it is something the markets can get through. From a stimulus perspective in the US, we're likely to see a reactive approach—meaning, markets or economies will cry for help, and Congress will respond to it. Or, we get something small from a proactive approach.

Nanette: The reality is, we're living in parallel universes. There's the real economy, where people have lost jobs or seen diminished incomes, where there are millions of sick people. The other universe is the markets. The

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markets are doing well due to policy support. Even though the timeline for vaccine distribution and manufacturing is still summer 2021, markets are looking through and past the lockdowns.

Ron: *The Federal Reserve (Fed) can't do things that fiscal stimulus programs can. The Fed can only do so much, since this is no longer a financial crisis. It is incumbent upon the federal government to provide the next bridge.*

Nanette: The Fed has impacted markets a lot. With the Fed's new inflation-targeting program, it has committed to low rates for at least the next three years, which is what has buoyed the markets. An infrastructure package would have bipartisan support and would provide meaningful recovery, especially in more cyclical sectors.

Ron: *It has been suggested we may have a double-dip recession before a full recovery. There will be a 6- to 8-month period where the economy could soften considerably.*

Jon: Small-business owners may have to close up shop again. Individual incomes may also take a hit. But Pfizer's vaccine is in the works and Moderna is not far behind. So, by the end of this year, we could have two vaccines. Vaccine distribution will be targeted; 75% of fatalities have been in the age-65-or-older group. This group will be part of the first wave of vaccinations. The vaccine rollout will allow us to return to some level of normalcy sooner than originally expected.

Nanette: Let me throw this curveball: I'm looking at the willingness of people to take the vaccine. An estimated 30-45% of people have said they will not take the vaccine, even if it's safe and effective. So there is still a sizable portion of the population that will not take the vaccine, so recovery will not be a straight line.

Ron: *I think we're starting to see the beginnings of a rotation from large-cap growth to cyclical/value stocks. It appears that this may be an environment where this rotation may be stickier.*

Jon: When markets started rallying after the lows on March 23, the initial rally—which lasted until early June—was led by value, small cap, and international. Then, the stay-at-home tech stocks took the lead again as coronavirus cases rose in Sun Belt areas. Cyclical areas of the market started struggling again. International and cyclical stocks and small-cap US stocks are highly levered to early-cycle dynamics, so value outperformance may be stickier now.

Nanette: Valuations of growth-versus-value show that value is cheap and growth is expensive. This has been more of a value trap rather than real value in the past 17 years. You need a catalyst to make the mean-reversion in value work sustainably. Development of a vaccine—and getting past the pandemic—could be that catalyst, if it's sustainable.

Ron: *Growth versus value, big versus small, US versus international. All three of those are aligned, and the US dollar (USD) may go lower.*

Jon: There can still be value traps in the value space, and there can still be growth stocks that do well regardless of economic activity. If we're early-cycle, if we see continued earnings growth, and if we see a continuation of USD decline, you may see natural resources doing well (e.g., value, energy); we should be seeing a lot of emerging markets (EM) doing well (e.g., international); global trade and manufacturing could be picking up; a lot of international markets are skewed to that. This leaves a lot of the US market behind. So, international, small- over large-cap, and value over growth, could have a pretty good run for the next three to five years.

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Ron: *If this rotation from growth to value takes place, given the market-cap weightings of the biggest tech stocks, it might look like a "stealth bull market" for value and small caps.*

Nanette: The dominance of tech in the US market could mask what's going on underneath that sector in the US. There is much more exposure to cyclicals in international. When talking about value, we're not talking about an "index" trade. It is important to note that this rally could happen in a couple of phases. What happened on November 9 was more of a "junk" rally. Companies that did the worst in March and April were the ones to recover. In the last couple of hours of trading, there was some sorting out which companies are better positioned. Best-quality companies within the cyclicals may be those that lead in the next round.

Ron: *Was the pop in Pfizer stock, and other pharmaceuticals, too much, or is there more room to run?*

Jon: There are going to be some that are under-owned but are highly levered to this recovery. Pfizer is still flat on the year, because they do many different things. They're not solely levered to the coronavirus. It all comes back to active management. There will be some real winners, but some losers as well.

Ron: *When you look at value, airlines, cruise lines, etc., they all rallied hard on November 9. Do you need to be more discerning when looking at these value stocks?*

Nanette: Yes. Look at hotels. Some have reconfigured themselves to be more competitive and more resilient, and some have created better digital platforms. So, investors need to pick the winners, and that takes deep research. Investors need active management to wade through these issues.

Ron: *The CEO of Southwest Airlines has said it will take five years, if not longer, to get both leisure and business travel back to normal. Making a straight-line bet that travel will recover is risky, wouldn't you agree?*

Jon: We are still in an economic downturn. It is unlikely we'll get back to the level of economic growth we were at until the end of 2021. A lot of companies are still being forced to cut costs. People have been laid off to save costs. Other cost savings would include business travel, so business travel is not likely to come back for some time.

Ron: *Joe Biden has been declared the president-elect. How would markets respond to the unlikely event of a successful Trump challenge to that outcome?*

Nanette: A successful challenge by Trump would be incredibly unsettling. It would lead to maximum uncertainty. The market has already moved on. We think it's probably more important to focus on US Senate outcomes at this point. Policy and economic fundamentals are the important things the market is now focusing on.

Ron: *The speed of technological advancement increased dramatically because of the pandemic. Do you look for cyclical companies that are using tech better?*

Jon: Companies that are taking advantage of technological change to make their operations more efficient and cost-effective are poised to gain. Depending on the company, investors are asking themselves what multiple they're willing to pay now that they're back on a more normal path to growth.

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Nanette: One sector that has been overlooked and is very cheap, in terms of price-to-book ratios, is financials. Payments, fintech, even mega-cap banks have been beneficiaries of technology improvement. There is a possibility of higher 10-year Treasury rates, which would be a benefit to the banks. Even without higher rates, the outlook for the best-quality banks is good.

Ron: *Last week, the rate on the 10-year Treasury approached 1%. The Fed's plan is to anchor short-term rates, not inflation expectations. If the long end were to start to rise, would the Fed cap yields along the curve?*

Jon: If it was a runaway move higher, the Fed probably would engage in yield-curve control. But this is self-limiting. Rates in Europe are still incredibly low. And at 1% versus the 50-60 basis points[1] of earlier this year, long-term rates are starting to look more attractive, and we may see some capital move back into that space, which would cap those rates somewhat.

Ron: *If the two US Senate runoffs in Georgia go Democratic, what would the market reaction be?*

Nanette: The market is expecting more moderate policy in both taxes and spending, so that would be a negative surprise for the market—although a full Democratic Senate would lead to higher fiscal stimulus.

Ron: *What's the one thing you're keeping the closest eye on?*

Jon: I'm paying close attention to the path of the coronavirus and the government's response to it. There's a possibility the government may go too far with heavy lockdowns, which could be economically damaging.

Nanette: I'm looking at how to position oneself the best way in "value." I believe you would want to increase weight to international equities and try to find the best growth within value across regions.

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[1] A basis point a unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security.

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