This Month in the Markets

November 2020

EQUITY COMMENTARY

The Great Rotation

November 2020 marked a turning point with the announcement of three vaccines that appear very effective against the COVID-19 virus. These developments drove a risk-on mood in markets and added fuel to the post-US election rally.

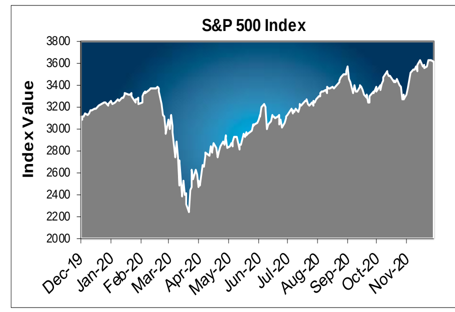
The MSCI All-World Net Total Return Index climbed 12.3%. The S&P 500 climbed 10.9%, making this its best November since 1928. The MSCI EAFE Net Total Return Index rose even more with a gain of 15.5%. Value outperformed growth, beginning what we believe to be the start of a rotation away from a narrow breadth and growth-focused rally earlier in the year. The MSCI All-World Value Net Total Return Index climbed 14.7%. In comparison, MSCI All-World Growth Net Total Return Index rallied 10.3%. The investor focus on a broad economic recovery was evident in the lead sectors. The MSCI ACWI Energy sector was the largest gainer for the month with an impressive 26.3% rise. The MSCI ACWI Financial Sector climbed 18.7%. The worst sector, the MSCI ACWI Utilities Sector, posted a 5.9% gain in the month. Our best performer in the month was TechnipFMC PLC, which jumped over 50% with the surge in the energy sector. Our biggest detractor in the quarter was Alibaba Group, which fell 13.6% after news that its Ant Financial initial public offering was canceled and the Chinese government began more oversight on monopolistic behaviors.

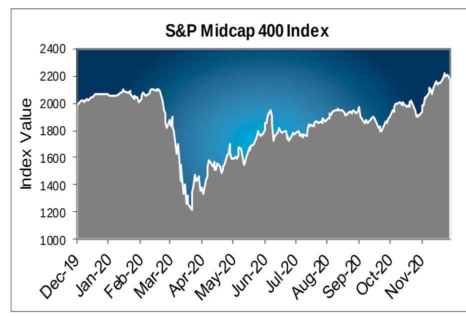
We believe the election results may be one of the best outcomes for the equity market. Assuming the Republicans win at least one seat in the January Senate run-off in Georgia, we will go into the next Presidential term with a split government. This is likely to prevent any "Blue Wave" from rolling back or eliminating the Trump tax cuts, which would undoubtedly weigh on corporate profits. It is also likely that an infrastructure plan develops, although maybe somewhat reduced from the original Biden plan. This combination of continuing lower taxes and additional fiscal spending may not help U.S. deficits but is likely to add fuel to corporate profits.

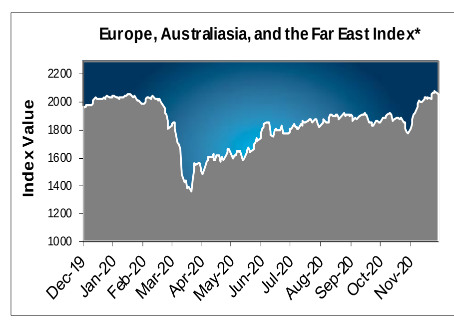
On the virus front, we seem to be getting nearer to the end of the war. Pfizer/BioNTech, Moderna, and AstraZeneca/Oxford vaccines were announced successively through the month, and all have shown to be very effective in reducing symptomatic cases of COVID-19. This is an impressive feat of development (the fastest vaccine development before this was the Mumps, which took four years). The distribution, manufacturing, and storage logistics seem daunting, but we already see exceptional mobilization globally for deployment. We remain optimistic that 2021 will see significant uptake and the containment of COVID-19 by the end of the 3rd quarter of 2021. Thus, we are likely to continue to see more "normalization" within the economy and, as a result, a rotation towards more value and cyclically focused companies, which will lessen the dominance of large tech and heavily weighted names in indexes.

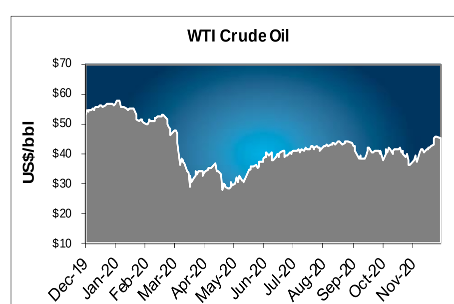
During the month of November, we decided to sell two names: TechnipFMC PLC ("FTI") and China Mobile ("CHL"). After FTI jumped over 50% in the month, we chose to use the rebound to reduce our energy exposure further. The sale of CHL also helped lower our considerable China exposure as we are getting increasingly concerned about the hostile rhetoric happening between the U.S. and China and felt it prudent to reduce a name focused solely on the domestic Chinese economy and majority controlled by the Chinese government.

We had two new buys in the month. Lumentum Holdings ("LITE") is an optical components company with a significant share in 3D sensing components, optical switching, and pump lasers. LITE should benefit from the healthy 5G phone upgrade cycle, the increasing use of face recognition 3D sensing technologies, and the deployment of 5G radio connectivity at the tower level. Its optical components and subsystems maximize bandwidth, enabling faster content delivery across the internet. Laboratory Corp of America ("LH") is a clinical laboratory company that provides routine testing, patient diagnosis, and specialty testing and has been at the forefront of the testing for COVID-19. Its Covance Drug development segment assists pharmaceutical companies with drug trials. This segment is likely to see a surge in activity as these trials return to normal from depressed levels from COVID-19 restrictions. We also like its undemanding valuation, trading at an enterprise to EBITDA ratio of only 8 times on 2021 estimates and forward price-earnings ratio of ~10 times.









*MSCI EAFE Index

FIXED INCOME COMMENTARY

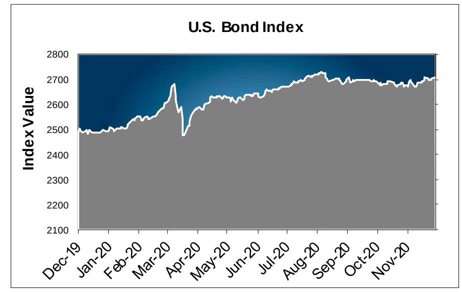
Rally in November

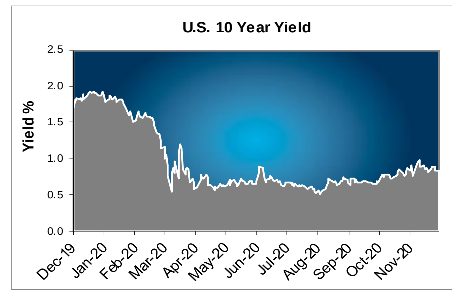
Risk assets rallied strongly in November on the back of successful vaccine trials and the belief that fiscal stimulus package in the U.S. is (eventually) on the way despite split control of the House of Representatives and Senate. Corporate credit rallied, led by the lowest-rated, most risky cohort of the credit market as the reach for yield environment we have previously cited became even more enflamed. While our fixed income portfolios have benefitted from the rally in corporate credit through our overweight position versus our neutral allocation, we are hesitant of extending ourselves further into higher risk credit at this point given the rally of the last 6 months. We are cognizant of the risk-reward trade-off and prefer to maintain a disciplined approach to adding credit risk.

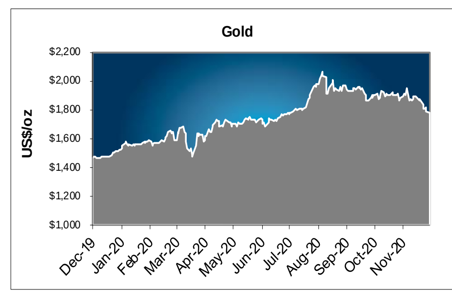
In November Treasury Secretary Mnuchin announced the Treasury Department would redeem the $195 billion funding it provided the Fed for a variety of market support programs funded by the Coronavirus Aid, Relief and Economic Security (CARES) Act, including the Primary Market Corporate Credit Facility, the Secondary Market Corporate Credit Facility, the Term Asset-Backed Loan Facility, the Municipal Liquidity Facility and the Main Street Lending Program. Mnuchin insisted the programs are no longer required to facilitate the smooth functioning of financial markets, while Fed Chair Powell disagreed – a rare public spat between the institutions. Powell's view is out of caution as he has been vocal about the risks to the economy without additional fiscal spending; a fiscal spending package is unlikely before Biden officially becomes president in February. Credit spreads were marginally wider on the news, however quickly resumed the tightening trend that characterized November.

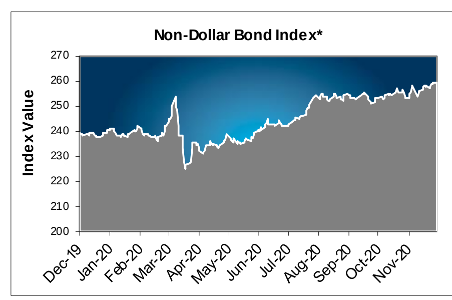
The Fed's Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility programs were announced on March 23rd at a time when the new issue market had dried up and credit spreads were relentlessly gapping wider. This was the first time the Fed committed to buying corporate credit (which the Bank of Japan and European Central Bank had been doing for years) – previously only Treasuries and agency mortgage-backed securities (MBS). The announcement had the desired effect as it marked the wide for credit spreads (widening credit spreads are bad for corporate bonds), and the new issue market swiftly opened. In fact, this has been a record year for corporate credit issuance. As of the end of November there has been $1.4 trillion of U.S. investment grade issuance (+54% YoY) and $337 billion in U.S. high yield (+70% YoY), according to Refinitiv. Ironically, the Primary Market Corporate Credit Facility was never actually tapped, and the Secondary Market Corporate Credit Facility spent only $13.3 billion, ~5% of the stated maximum capacity.

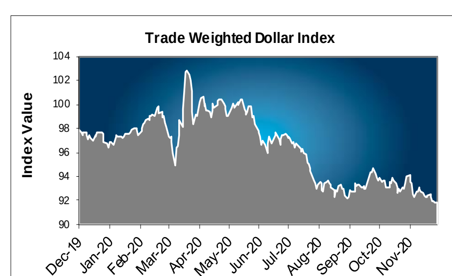
The US dollar continued to decline in November, as proxied by the -2.3% decline in the DXY index. The best developed market currencies in November were the Norwegian Krone (NOK) (+8.2%), New Zealand Dollar (NZD) (6.4%), Australian Dollar (AUD) (4.9%), and the Swedish Krone (SEK)(+4.8%). These are higher beta currencies that benefit from an increase in global growth (or expectations thereof). The NOK was also bolstered by higher oil prices. Adding currency exposure is a difficult decision at present, given the $17.17 trillion USD-equivalent of negative yielding debt globally (UK, France, Germany, Netherlands, Switzerland, Japan). As such, in most cases it is purely a currency call as there is virtually no yield buffer if you get the currency call wrong. It is a situation we continue to monitor, but for now are comfortable with our exposure to the Norwegian krone and Singapore dollar.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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