LSAM LIFESTYLE ASSET MANAGEMENT

# Market Commentary

## November 2020

### Equity and Bond Market Update

(as of November 17, 2020)

| Index | YTD | 1-Year |
|---|---|---|
| Dow Jones Industrial Average TR | +6.5% | +8.7% |
| S&P 500 Total Return Index | +13.6% | +17.8% |
| Russell 2000 Total Return Index | +8.7% | +14.1% |
| MSCI EAFE Index (net) | +2.0% | +5.3% |
| MSCI Emerging Markets Index (net) | +9.9% | +17.1% |
| Barclays US Aggregate Bond TR | +6.9% | +7.2% |

### Economic Indicators

| | Statistic | Data as of |
|---|---|---|
| Unemployment Rate | 6.9% | Oct 2020 |
| Gross Domestic Product (GDP) | +33.1% | Q3 2020 |
| Consumer Price Index (CPI) | +0.0% | Oct 2020 |
| Consumer Confidence (1985=100) | 100.9 | Oct 2020 |
| 30-year fixed mortgage rate | 3.02% | 11/18/2020 |
| Housing Starts (single family) | 1,179,000 | Oct 2020 |
| 10-Year Treasury Yield | 0.87% | 11/18/2020 |

We are now two weeks past the U.S. election, and equity markets globally have so far reacted positively to the results. We say "results" since there are a handful of states that are still being contested, are in re-counts, and/or are dealing with lawsuits filed. At this point, we have to analyze where markets are based on the information that we have, which is that we will end up with a Democratic administration and a split Congress. This could change over the course of the remainder of November and into December, as well as into 2021 with very important runoff Senate elections taking place in early January that could tip the scale of the Senate to the Democrats, giving them full control of both the Presidency and both houses of Congress. A 50-50 split of the Senate, with the Vice President casting final votes for split decisions, does give Democrats the edge, but with such a slim advantage it will be almost impossible for them to get their most ambitious legislation passed. This should result in smaller shifts in economic, fiscal and social policy, not large leaps.

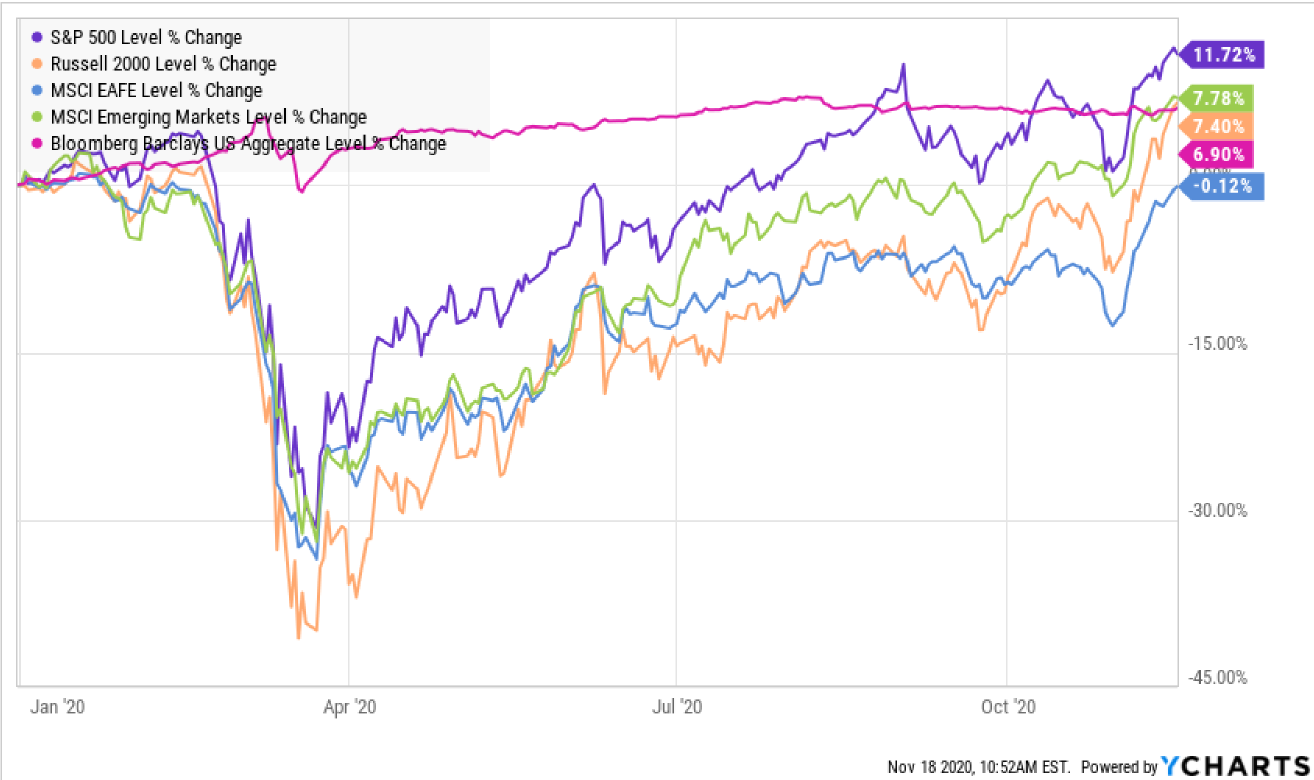
Since the election, U.S. small-cap stocks have performed best, returning +11% since November 3rd. Trailing small-caps are: developed foreign stocks up +8%, emerging markets up +6% and then U.S. large-cap stocks up +5%. In addition, we have seen a shift in style since the election, with large-cap value stocks outperforming large-cap growth by a differential of about +5.3 percentage points. Just a note that we are only two weeks off of election day, but these trends are exactly the opposite from what we have experienced for the preceding ten months this year, as well as going back prior to 2020. Whether or not these shifts stick, and we see a reversal of outperforming and underperforming assets classes remains to be seen, but some of the outperforming asset classes right now are due for some performance when comparing relative valuations.

Far outperforming all sectors since the election is Energy, which has almost doubled the performance of the second-best sector, Financials. It is important to note that most of the energy sector's advance has come since November 9th, the day that Pfizer announced it's results from late-trial tests of the effectiveness of it's COVID vaccine at over 90% effective. Just a week later, Moderna announced similar results with their vaccine clocking 95% effectiveness. As of today, these companies are seeking emergency-use authorizations to get the medications out as soon as possible. Since these announcements, many of the hardest hit industries in the U.S. economy from lockdowns have rallied nicely, from oil & gas companies, airlines, travel & leisure, aerospace & defense, and banks, among others. These industries have seen a nice bump over the last week, but they have all long way to go to reclaim pre-COVID valuations.

If we do see rotations in different asset classes, equity styles or sectors, we can take a look now at which are ripe for a reversal. The most prominent reversal, mentioned previously, would be growth to value. Over the last ten years, growth stocks represented in the S&P 500 index outperformed their value counterparts by a whopping 172 percentage points over the entire period. By using relative forward P/E ratio comparisons between growth and value stocks, value has been "cheap" in comparison to growth for close to three years now, and just this year has been the most undervalued since the great "growth" stock runup during the dot.com bubble.

Looking at sectors of the U.S. economy and their valuations relative to the last twenty years, the four sectors that are most "undervalued" relative to their average forward P/E ratios are (1) energy, (2) healthcare, (3) financial services, and (4) communications services. Those sectors most "overvalued" relative to their historical forward P/E ratios are (1) consumer discretionary, (2) industrials, (3) materials and (4) technology.

**Major Market Indices Price Return (YTD as of November 17, 2020)**




Another longstanding trend we have experienced that is hinting a possible reversal over the last couple of weeks is the outperformance of domestic (U.S.) stocks over foreign stocks. We have discussed in the past the undervalued status of stocks from countries domiciled outside the U.S. for some time. This outperformance has been working against geographically-diversified portfolios since around 2012. Currently, not only are foreign stocks (as represented by the MSCI ACWI ex-US index) trading at 76% of the valuation of the U.S.-based S&P 500 Index (based on forward P/E ratios), but they normally trade at a discount based on this metric of 87%. Looking at the returns table at the top of this commentary and breaking out emerging markets (mostly an aggregate of China, Taiwan, South Korea, India and Brazil), these markets together are up almost the same as the S&P 500 Index over the last twelve months, and are the second-best performing asset class this year.

Always keep in mind that fear, panic, and optimism are not investment strategies, but rather emotions that drive short-term markets.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Sources:

- S&P Dow Jones Indices website (us.spindices.com)
- MSCI Barra website (http://www.mscibarra.com)
- The Conference Board (www.conference-board.org)
- Bureau of Economic Analysis (www.bea.gov)
- JP Morgan Guide to the Markets
- FTSE Russell (www.ftserussell.com)
- Bankrate.com (www.bankrate.com)
- Bureau of Labor Statistics (www.bls.gov)
- United States Census Bureau website (www.census.gov)