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Vaccine Hopes and a Split Congress Fuel Market Rally and Sector Rotation

Positive COVID-19 vaccine developments and fading political uncertainty sparked a strong rally in equity markets with many major indices hitting record highs. The S&P 500 advanced 10.95% over the month, while the Dow gained 12.14%, crossing over the 30,000 mark. For many equity indices, November was the best month on record.

The first day of trading after Biden was named president-elect, Pfizer and BioNTech reported that their joint vaccine for COVID-19 vaccine was 90% effective in preventing the Virus and could potentially be rolled out to the public as early as December, sparking a rally in equity markets and outperformance in cyclicals and COVID-sensitive industries. Cruise line stocks – Norwegian, Carnival and Royal Caribbean - widely considered to be the most sensitive to COVID, rallied 40.98% on average. Positive vaccine developments from Moderna and AstraZeneca further propelled markets and accelerated underlying sector rotation during the month. Crude prices gained on vaccine hopes and a report containing a larger than expected drop in U.S. Crude supplies, sending energy sector shares higher. The two worst performing sectors year-to-date, energy and financials, were the top performers in November with the S&P 500 Energy Sector Index up 28.04% for the month and the S&P 500 Financials Index up 16.90%. From a style perspective, value - which has meaningfully underperformed growth YTD – posted outperformance in November with the S&P 500 Value Index gaining 12.88% compared to

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9.70% for the S&P 500 Growth Index. In another reversal, small caps out-performed large caps with the Russell 2000 Index gaining 18.42%. Big-Tech shares – Facebook, Amazon, Apple, Microsoft and Alphabet/Google – the beneficiaries of the "stay-at-home" trade, advanced with broad risk-on mentality but trailed the broader market with an average return of 6.75% as money flowed more heavily into cyclicals.

On the political front, markets appear to be viewing election results with a sigh of relief as a divided Congress will stall liberal policy goals, preventing large changes to the tax code which would erode corporate earnings. Historical data suggest that markets tend to perform better when Congress is split as it provides a balance of power and prevents either party from enacting radical policy changes. Going back to 1950, the return for the S&P 500 when Congress is split was 17.2% on average, compared to 13.4% when Republicans held control and 10.7% when Democrats controlled Congress. Expectations that President-elect Biden will pursue energy re-regulation and rejoin the Paris Climate Accord, combined with improving cost/efficiency of clean energy, led the MSCI World Alternative Energy Index to a gain of 16.56% in November, up 80.73% year to date.

From an economic perspective, continued support from the Federal Reserve and commitment to keep interest rates low for an extended period of time provided further support for equity and corporate credit markets. Manufacturing PMI and Nonfarm Payrolls data points came in better than expected while employment data points were mostly negative, stirring some potential concern about the strength of the recovery and possible impacts from reimposition of restrictions in areas where COVID cases are resurging. Markets reacted favorably to Biden's plans to nominate former Federal Reserve Chair Janet Yellen for the position of Treasury Secretary as she is widely known to be dovish on inflation and interest rates. Markets gave back some gains in the final trading sessions of the month as consumer confidence and sentiment numbers came in weaker than expected, but many

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major benchmarks remain near all-time highs.

It's surprising to see major indices trading to new highs despite the economic damage that has been caused and remaining risks. However, much of the positive year to date performance in major equity indices has been attributable to big tech companies. Headline benchmark numbers mask the lack of breadth that the market rally has had this year and as a result, major indices have become much more concentrated in large tech companies that trade at lofty valuations. At the end of August, the five largest tech companies – Apple, Microsoft, Amazon, Alphabet/Google, and Facebook – made up 26% of the S&P 500 compared to 14% for the top five holdings just three years earlier. The rotation that occurred in November from Technology to cyclicals may continue given the large spread in relative valuations however risks remain, including recent spikes in COVID cases, hurdles to developing and distributing vaccines, as well as the timing and scale of much needed COVID fiscal stimulus.

With indices more heavily concentrated in companies that generally trade at higher valuations, the road ahead provides potential opportunities as well as risks for active strategies to generate relative outperformance by tilting toward more discounted segments of the market that continue to trade at attractive valuations.

With equity benchmarks trading at higher valuations and interest rates artificially low, many Wall Street firms are revising their long-term capital markets assumptions with a view toward lower long term returns across both equity and fixed income markets, providing a headwind for traditional stock and bond portfolios and potential for diminishing diversification benefits. Stocks can always go higher, yet today's rich valuations in certain sectors/industries that have become more concentrated in market-capitalization weighted indices, may suggest investors would be well-served by adjusting expectations and possibly their portfolios to account for possible long-term headwinds.

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