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Lessons from the Bull Market of 2020

Bruce D. Simon, CFA, CPWA®, Partner & Director of Research

As the results of the US election come into sharper relief, investors are scrambling to gauge the impact on the future direction of equity markets. To provide some insight, it may be instructive to review the drivers of the chaotic market performance so far in 2020 and consider their applicability to 2021 and beyond.

A quick recap: after a robust 31.5% gain in 2019, the S&P 500 drifted higher until mid-February 2020 until the mushrooming threat of the coronavirus pandemic became apparent. From its peak on February 19, the S&P 500 dropped 34% in just over a month, as a near-global lockdown on economic activity was imposed. With epidemiologists warning of a lengthy period before the development of a vaccine to control the spread of the pandemic, the economic outlook was grim. Unemployment rates in the US spiked to mid-teens levels as businesses reacted to the collapse in demand across many industries.

The swift decline in economic activity led to unprecedented actions by both the Federal Reserve and the US government to provide immediate support to the millions of consumers and businesses directly impacted by the lockdown. Congress quickly approved a series of support measures, including direct payments to individuals who had lost their jobs. The Fed instituted several measures to calm jittery financial markets, push interest rates down, and provide much-needed financing to revenue-starved companies.

Despite a steadily increasing count of COVID-19 deaths, more than 11 million people still out of work, and consensus forecasts calling for a full economic recovery to be delayed until sometime in 2022, the S&P 500 began an explosive rally that produced a 57% return from the low set on March 23 (through November 6).

In our view, there are several important lessons to be learned from this remarkable recovery:

- **Don't fight the Fed or the Congress** – This is standard lore among professional investors and its validity was never more apparent than in this situation. The fiscal and monetary response of the magnitude instituted in March was an unalloyed bullish signal for stock prices.
- **Markets hate uncertainty** – The steep crash in March was exacerbated by the lack of historical precedent by which to gauge the extent of the economic damage. The 1918 Spanish Flu pandemic provided little insight.
- **The stock market is not the economy** – The stellar performance of a handful of mega-cap technology companies who are well-positioned to benefit from the behaviors encouraged by the pandemic (and whose size creates an outsized influence on market averages) does not correlate with the hardship

inflicted on many consumers and small businesses. In other words, measuring the state of the economy by the value of the S&P 500 is a false equivalency.

- **Trend is more important than level** – Even with the spectacular 33% gain in third quarter GDP, the US economy is still about 3.5% smaller than it was in the fourth quarter of 2019. Nonetheless, the steady improvement since March has encouraged investors to bet on a continued recovery, irrespective of how long it takes.
- **Interest rates matter** – The plunge in interest rates as a result of the Fed's actions improved the outlook for stocks in two important ways: 1) providing a source of inexpensive funding for corporations that allowed them to weather near-term disruptions to their businesses; and 2) improving the relative attractiveness of stocks as high quality bonds plumbed new sub-1% yields.
- **Earnings matter** – As the impact of the pandemic expanded, analysts struggled to recalibrate earnings forecasts in light of the highly uncertain environment they were facing. Initial estimates called for year-on-year declines of 40% or more in S&P 500 earnings. While estimates are still expected to fall 18% in 2020 vs. 2019, they are coming in much better than original expectations, helping to support the market's recovery. Again, the trend is what matters.

Are there lessons to be learned about what lies ahead? We can't predict the future, and history can rhyme but rarely repeats. But setting aside the unpredictability of when the pandemic will be contained (which is highly dependent on people's willingness to embrace social distancing guidelines and when an effective vaccine can be widely distributed), acknowledging the following principles should be helpful in divining the stock market's future direction: 1) additional fiscal and monetary stimulus will bolster equity prices as long as they meet or exceed investor expectations; 2) markets can rise even as severe economic pain is being felt by small businesses and people on the lower end of the economic spectrum; 3) low interest rates are a powerful tonic for equity prices; and 4) as long as conditions appear to be improving, stocks are likely to respond positively.

Finally, the market's explosive reaction since Election Day underlines another important principle: markets prefer certainty and stability in their political system. If current trends hold, a Democratic president and a Republican senate ensures that policy changes are likely to be modest.

Bruce D. Simon, CFA, CPWA®, Partner and Director of Research

Bruce is a Partner and Director of Research at the firm. Bruce rejoined Ballentine Partners in June 2016 after more than 5 years as Chief Investment Officer of City National Rochdale, LLC, in Los Angeles. City National Rochdale, a wholly owned subsidiary of City National Bank, serves family clients across the United States with a staff of nearly 100 investment professionals. Before moving to Los Angeles, Bruce served as Chief Investment Officer of Ballentine in our Waltham office for three years. Prior to that, Bruce spent four years with Morgan Stanley Private Wealth Management in New York and eight years with Glenmede in Philadelphia as Chief Investment Officer and Portfolio Manager. In addition to working directly with a number of family clients, Bruce serves on Ballentine's Investment Management Committee, which is responsible for the oversight of all of the investment activities for the firm. Bruce received an MBA with a concentration in Applied Economics from George Washington University and a BS degree in Business Administration from Penn State University. Bruce holds the Chartered Financial Analyst (CFA) and the Certified Private Wealth Advisor (CPWA®) designations. He lives with his wife in Palm Beach Gardens, Florida.