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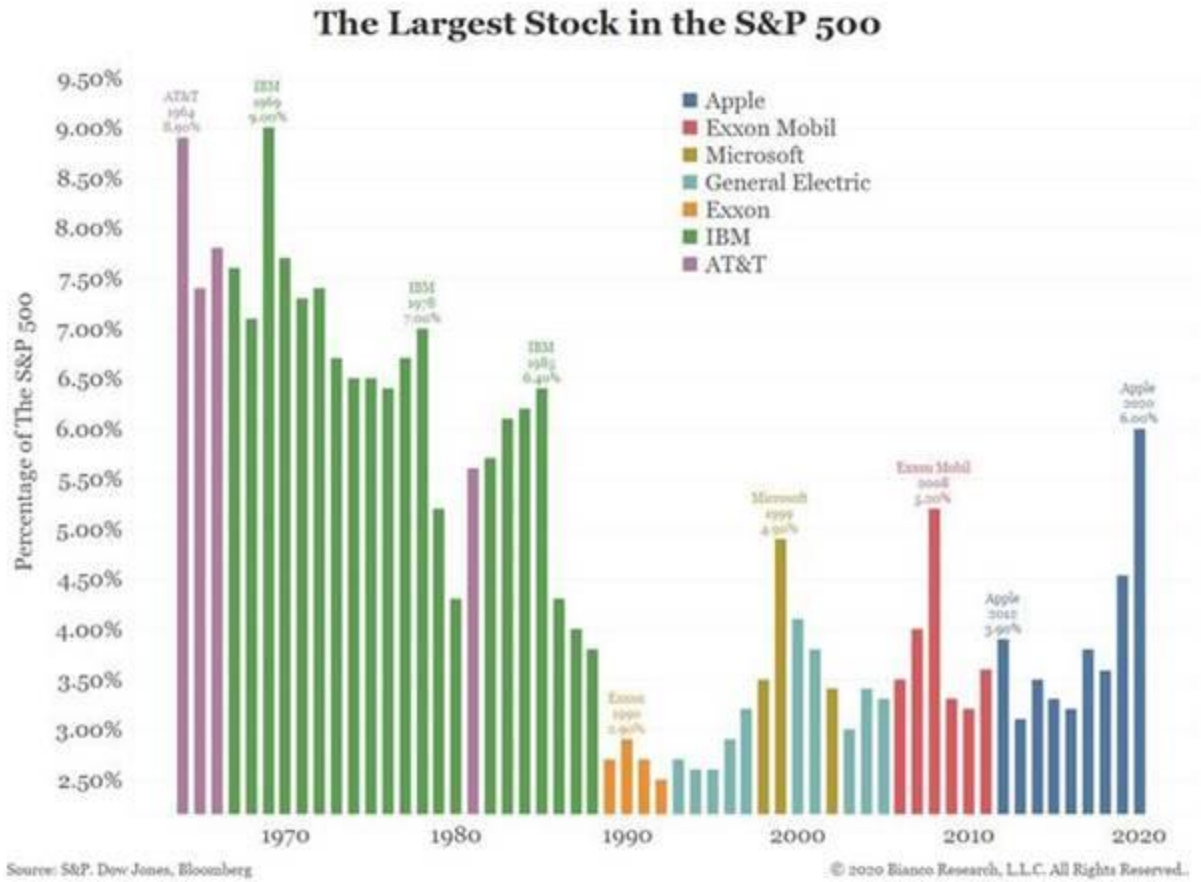
Markets Ebbs and Flows

Keeping perspective during the markets ebbs and flows is one of the harder skills to master for investors, and markets today are presenting another challenge, so here is our perspective.

One of the things we have been discussing over the last several weeks is the 'broadening of the market'. In simple terms, **a broader market, defined by how many stocks are participating in the rally, is a healthier market.** If the S&P 500 is performing well because 350 of the 500 stocks are performing well, that is a healthy market with broad participation. On the other hand, if the S&P 500 is performing well, but that performance is on the back of a handful of stocks, that is an unhealthy market. **Over the past month or so, there has been an ongoing battle for market leadership with small caps and value stocks briefly performing well, only to have the tech/growth stocks re-assert their dominance.** No clear trend was taking hold, which can be very frustrating. This week, **growth appears to have re-asserted itself one again. We take that as being a function of a gradually more negative view of the economy due to COVID.** In an economy that is starved for growth, true growth stocks will tend to shine. If the COVID trends begin to improve again and the positive economic trend does not run out of steam, we may well see the market broadening once again.

Keeping with the theme of a market dominated by relatively few companies, this week, we came across a chart that caused some discussion, and we thought it would be worthwhile to share. The chart (below) shows the largest stock (by value) in the S&P 500 for each year. **One of the things that really stand out is although concentration is considered high now, at least as measured by the largest company in the S&P 500, has been more concentrated historically.** That is information that can be taken two ways. **If you are a growth stock believer, you take confidence in the fact that concentration has been much higher in the past, which could imply that that there is plenty of room for growth stocks to continue to outperform.**

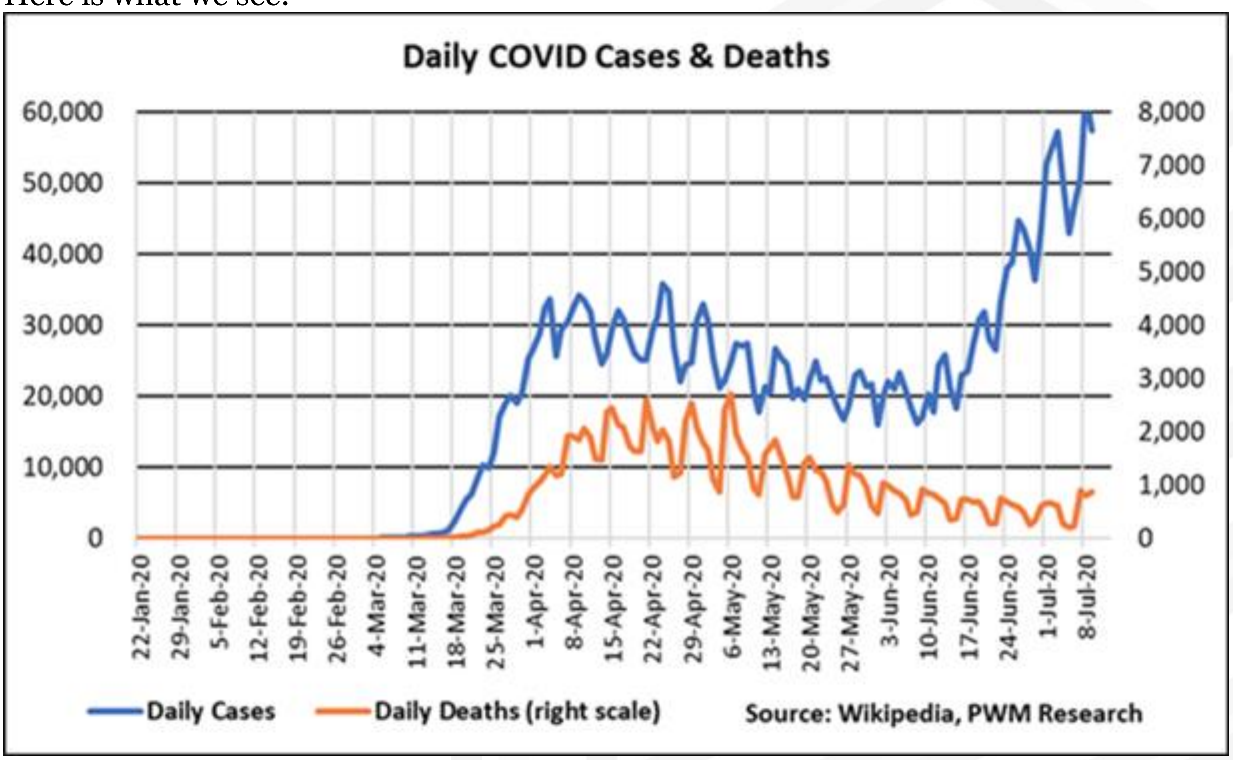


On the other hand, you can also look at this chart and conclude that each time a stock becomes 'too large' something happens to change things and the market leadership changes, which could imply that it is time to step away from growth. Just a quick look at the chart and the changing colors (market leaders) demonstrates that leadership is constantly changing. Is there any reason to believe that this time will be different? The period of the late 60'sand early 70's is the 'Nifty Fifty' era, when the market was dominated by a group of growth stocks. There is no list of the Nifty Fifty, but it included names like McDonalds, which was in a massive expansion phase, Polaroid, which was in the midst of 'instant photography', IBM still ruled the computer world, but Digital Equipment had a new way of computing and was growing like crazy. These stocks traded at some very high P/E multiples because Wall Street deemed them to be 'one decision' stocks. All you had to do was buy them and hold them. Selling the stock was something that did not need to be considered. That would have been a bad decision. **The 1973-74 market collapse that followed led to a malaise that lasted into the early 1980's. Although many of the stocks recovered, it was not without significant pain when the market leadership changed.** The Nifty Fifty era is great example of unrealistic investor expectations and how the market tends to draw people in at the top.

Looking at the chart. Microsoft topped the list in 1999 at the top of the tech bubble, Exxon led at the top of the housing boom, and Apple has taken the leadership mantle, with the rest of that story still to be written. **For us, this chart says always respect the trend, but also strive to maintain a balanced view, because nothing lasts forever. It's a great lesson for all investors.**

The Changing Face of COVID

We've said from the beginning, there is no playbook for dealing with COVID, we are flying by the seat of our pants. Mistakes are being made, as would naturally be expected. We're not taking sides here, but **dealing with COVID is a fluid situation. We learn more every day, we get better at dealing with it every day, and we are more educated about it every day.** Although this information is distributed widely, it is often and unfortunately distributed in a politicized manner, so rather than learn what is actually happening with this disease, we tend to see it through a political lens. Here is an example.
The chart below shows a rather intriguing trend. While hospitalizations are way up, the number of deaths as not followed suit as it did back in March and April. Of course, there is a lag, but looking back in March, when hospitalizations began to pick up, deaths followed fairly quickly, roughly 'one block' on the chart. Hospitalization really started to regain momentum in mid-June, but deaths are only now just starting to show any signs of an uptick. **Why this is happening?** Unfortunately, this question is not being discussed as it is too easy to politicize the data. Here is what we see:



1) **Infections are moving down in age.** Older people are naturally more concerned about infection and have not participated in the re-opening as aggressively as the young. As a result, infections are moving toward a younger group and as we know, the young generally do better with this disease, so this should limit the death toll.
2) **We are getting smarter about protecting those with the greatest risk.** Back in March and April, when New York was getting hit very hard, nursing home patients were a large portion of fatalities. Nursing homes and other institutions are now much better at protecting their residents from infection, with declining deaths as the result.
3) **Our treatment techniques are improving and we believe will be the key to watch for until there is a vaccine.** We don't have a vaccine nor do we have a truly effective treatment, but the medical system is comprised of a group of fast learners. **Gilead's Remdesivir drug revealed positive new data that shows it reduced the risk of death for severely sick coronavirus patients by 62%.** Therapies and techniques that work (or don't work) are quickly shared and best practices move seamlessly through the healthcare system. The result is better outcomes, i.e. fewer deaths. Until we have a vaccine, we can hope and believe that this trend will continue.

One other thing we have learned is that economic collapse is also dangerous to the population. As we said last week, until we have a vaccine, we need to find a way to coexist with COVID. Decisions to re-open, or re-close, are a delicate balance. **There are no easy solutions. Whatever decisions are made, somebody is going to be very unhappy about them. Mistakes will be made.** It is unreasonable to expect perfection in this effort, which means that **we will need to take more personal responsibility on how we handle this pandemic.**

One final note on COVID developments: We came across a rather disturbing item this week from the journal *Brain* and reported by *The Guardian*, a U.K. newspaper. **Neurologists in the U.K. have found that a small number of recovering COVID-19 patients may suffer 'mild to potentially fatal brain disorders' triggered by the virus.** Quoting from the Guardian: "What we've seen with some of these Adem patients, and in other patients, is you can have severe neurology, you can be quite sick, but actually have trivial lung disease... Biologically, Adem has some similarities with multiple sclerosis, but it is more severe and usually happens as a one-off. Some patients are left with long-term disability, others can make a good recovery." **There is still so much we don't know about this disease.**

A Divided Government Can Have Difficulty Responding to Crisis

We have already enacted extraordinary measures to offset the impact of the pandemic, but as emergency measures, nothing can be calibrated carefully, nothing can be organized effectively, and there are numerous and some very large gaps in the solution to date. **Monetary policy from the FED will be there. There is little question of that, but fiscal policy is potentially a real problem because it requires a divided Congress to act.** With nary a hint of cooperation over the last three years, there is little reason to expect it now. Republicans want more money with no strings attached, which of course serves their political purpose in getting Trump re-elected. Meantime, the Democrats attempt to push their agenda in a time of emergency, knowing that they can make good use of the pressure of a crisis. It's just politics. At its core, it is nothing really new, but with this President, the heels are dug in to an extent I cannot recall and that threatens the fiscal actions that are pending to get us through the pandemic. **Maybe the most important of these is the economic impact on state and local governments as their taxation revenue streams have dried up, especially sales taxes, and expenses have ratcheted up to address the pandemic.** Unlike the Federal government, states and municipalities can't print money and many are facing dire straits. **Congress needs to act. The question is, can they?** A failure to act would be an economic and financial disaster. **There appears to be an assumption that Congress will eventually act, but as the election approaches. everything is increasingly viewed from a political, not economic, perspective.** We can't lose site of the importance of the next round of fiscal stimulus for the economy as well as financial markets.