"Dare To Be Different"

Market Commentary – November 2020

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The advance estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 33.1% in the third quarter of 2020. This is by far the largest value in the records of the U.S. Bureau of Economic Analysis (BEA). From 1947 Q2 (the earliest date of quarterly GDP readings reported by the BEA) to 2020 Q2, there were only ten quarters where GDP grew by more than a 10% annual rate, with the largest being +16.7% in 1950 Q1. Annual data is provided by the BEA for 1930 to 1947, with the biggest reading as +18.9% in 1942 (during World War II). The growth in 2020 Q3 was truly historic. While we often look at the percent change in GDP, it is helpful to consider the actual GDP number. GDP peaked at $21.747 trillion in 2019 Q4 and plummeted to $19.520 trillion in 2020 Q2, before rebounding to $21.158 trillion in 2020 Q3. The economy has clawed back most, but not quite all, of what it lost in the Great Cessation (despite continued lockdowns in several key states). The National Bureau of Economic Research has yet to call an end to the recession which began in February 2020, but it may soon reveal the recession has already ended.

While Americans are caught up in the emotional politics of the election on November 3, investors can feel a degree of comfort that the Federal Reserve has their backs. There are material differences between the economic approaches of a conservative Trump administration and a progressive, "quasi-socialist" Biden administration. Investors applaud lower tax rates and less regulation. Importantly, though, the Federal Reserve has committed to extremely accommodative monetary policy for the next couple of years (federal funds rate at 0% to 0.25% through the end of 2023 and a $7.2 trillion balance sheet, growing by $120 billion per month). If the stock market becomes jittery after the election, we may see the Fed pull another rabbit out of its hat during its next scheduled monetary policy announcement on November 5.

Multi-cap value investors must endure extended periods of underperformance to eventually benefit from periods of outperformance that make it a superior long-term investment strategy. The October 2020 edition of the *AAII Journal* (American Association of Individual Investors) has an outstanding article titled "The Price We Pay For Being Different". The article highlights a comparison of two portfolios: S&P 500 index vs. multi-cap value. Interestingly, the 90-year analysis shows periods of underperformance of multi-cap value spanning from 8 to 20 years, with periods of outperformance lasting only 3 to 7 years. The outperformance during these periods was so significant, however, that value and small cap investing have earned a reputation as a superior long-term strategy (a sweet reward for patient value investors). The article cites the recent 14-year period of underperformance of multi-cap value through the end of 2019, which has certainly extended into a 15th year in 2020. Of course, there is no guarantee that the next 90 years will be as kind to multi-cap value investing, but 90 years of history should not be ignored, either.

Technical factors of the market are bullish (more demand than supply), while fundamentals are attractively priced – therefore, we are mildly bullish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) during 2021 is $164.30, which implies a price-to-earnings (P/E) ratio of 19.9 with the S&P 500 at 3,270. The earnings yield (E/P) of 5.02% represents attractive value relative to the 10-year U.S. Treasury note yield of 0.88%.

After a strong first half of October, the second half saw the S&P 500 correct on fears of COVID-19 and the upcoming election. Resistance exists near the October high (3,550), while there is support near the September low (3,237) and the 200-day moving average (3,130). Cracks in the technology bubble have begun to appear, as the spread between the Nasdaq 100 and S&P 600 Small Cap Value indexes (without dividends) has narrowed from 54.9% last month to 48.0% today. The stock market has been a blessing for patient value investors, as it has allowed us to accumulate stocks at bargain prices. In some cases, cheap prices for stocks have become even cheaper…in the short run. In the long run, multi-cap value investors have historically reaped the reward for daring to be different.