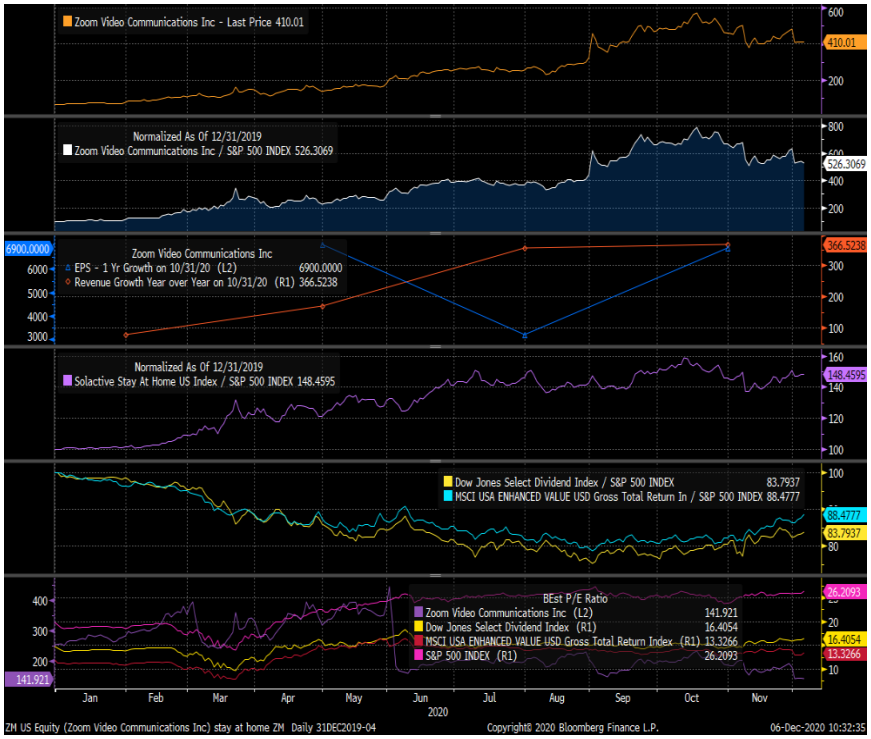
# STONE INVESTMENT PARTNERS LLC

# Weekly Market Guide | December 7, 2020

## CHART OF THE WEEK – HOME FOR THE HOLIDAYS




Source: Stone Investment Partners, Bloomberg as of 12/6/2020

Looking at the mobility, restaurant and airline readings from our **U.S. Reopening Monitor**, many in the U.S. are staying home for the holidays. "Stay at Home" stocks peaked in performance relative to the S&P 500 in mid-October despite the growing wave of infections (see chart, panel 4). Zoom Video (ZM) has been a beneficiary of the Stay at Home trade and reported earnings last week so it can provide some insights. Zoom's stock is up over 500% year-to-date while sales and earnings were just reported at a whopping 366% and 6900% higher year-over-year! Interestingly, Zoom fell -13% last week and has underperformed the S&P 500 since mid-October (see panel 1 & 2). Some of the reasons are likely Zoom specific with sales slowing to 17% quarter-over-quarter (Q/Q) and falling gross margins causing earnings to decelerate to 8% from 360% Q/Q the previous quarter. While investors covet growth numbers like these, Zoom was trading at 191 times forward earnings estimates prior to earnings so high growth was clearly priced into the stock (see panel 6). The current market environment is extremely challenging with companies like Zoom benefiting from the environment but priced for something near perfection. Meanwhile, more challenged businesses and those more impacted by economic growth, like value and high dividend stocks, trade at much more reasonable levels (see panel 6). Our thesis has been that the pandemic accelerated many trends already in place prior, like virtual meetings and online shopping, but is not likely to destroy the human need for physical interaction. Looking for companies that will survive this fallow time but benefit from the rebound in human activity once the vaccine begins to make an impact seems a prudent course. Markets are already starting to anticipate this eventuality with value and high dividend stocks outperforming since early September though a smooth ride is never guaranteed (panel 5).

## WEEK IN PREVIEW

- Geopolitical: Brexit negotiations between the European Union (E.U.) and U.K. regarding their future trade relationship should be coming to a head to complete the legislative process by year-end with a narrow trade deal the most likely outcome. Increased restrictions continue in many parts of the globe to combat the resurgence in COVID infections, and the impact on economic activity will be closely monitored but revisiting the economic collapse of wholesale lockdowns during Lockdown 2.0 remains unlikely. After being approved in the U.K. last week, the Pfizer/BioNTech vaccine for COVID-19 will be reviewed by the U.S. Food and Drug Administration (FDA) on Thursday with distribution beginning the next day if approved.
- U.S.: After the busy and important economic calendar with a disappointing monthly jobs report last week, this week's releases hold little of long-term interest. Focus will instead be on the FDA's vaccine approval and a possible fiscal stimulus deal before year-end. November consumer (CPI) and producer (PPI) inflation data should continue to be muted at 1.1% and 0.7% year-over-year (Y/Y) from 1.2% and 0.5% in October. 3Q household net worth is almost certain to reach a new peak despite the COVID recession, primarily due to rising stock and real estate prices. The Atlanta and New York Fed's estimate of 4Q GDP growth is currently 11.2% and 2.5%, respectively. Readings for our **U.S. Reopening Monitor** moderated with tightening restrictions under Lockdown 2.0 as COVID cases and deaths rose. Underlying high frequency economic data showed only retail sales improving while consumer sentiment, airline travel, mobility, dining and public transit softening.
- S&P 500 Earnings: 7 S&P 500 companies are scheduled to report earnings. Two "stay at home" favorites are reporting earnings this week: Costco Wholesale (COST) and lululemon athletica (LULU). 4Q 2020 earnings and sales estimates are now -10.2% and 0.2% Y/Y, respectively. 2020 calendar year earnings are expected to be -13.8% Y/Y, while sales are -1.8%. A strong rebound is forecast for 2021 with earning 21.7% and sales 7.7% Y/Y. Consensus earnings estimates for 2020 and 2021 increased last week.
- Europe: The rate of growth in Eurozone COVID cases has retreated to less than half of peak levels. Restrictions across much of the globe continue to impact dining with a -55% decline from the global baseline. France, Italy and Spain saw a decline in the weekly infection pace. The German December ZEW expectations survey should reflect an increase in sentiment from peaking infections and the coming vaccines. The European Central Bank (ECB) is almost certain to ease policy, which is likely to be accomplished via increasing asset purchases (PEPP) and additional bank lending programs (TLTRO). The U.K. pace of infections has declined to almost half of peak. England moved to tiered restrictions last week, which helped lift U.K. dining to -38.1% Y/Y versus baseline. U.K. October industrial and manufacturing production are expected to weaken to -6.5% and -8.4% Y/Y, respectively. Please see our **U.S. Reopening Monitor** for international COVID charts.
- Asia: November China trade data continued to recover which reflects domestic and global economic growth. Exports rose to 21.1% from 11.4% Y/Y, while imports declined to 4.5% from 4.7%. China CPI and PPI data for November should remain tame at 0.0% and -1.8% Y/Y, respectively. Japan COVID cases rose, but the weekly pace of infections fell after nine straight weeks of acceleration. Japan October economic data should show some improvement this week with household spending, labor cash earnings and core machine orders all expected to have better Y/Y readings.
- Central Banks: In addition to the ECB which will almost certainly keep rates unchanged though ease further via unconventional policy actions, the central banks of Chile, Canada, Namibia, Brazil, Georgia, Serbia, Ukraine and Peru are scheduled to meet with no major banks expected to change their policy rate.

## WEEK IN REVIEW

- Stocks rose by 1.7% for the S&P 500 with nine of eleven sectors higher for the week. Despite a worse than expected monthly jobs report, the rising probability of stimulus and pending vaccine approval powered risk assets higher. Energy (4.5%), healthcare (2.8%) and technology (2.8%) outperformed the S&P 500, while utilities (-2.2%), consumer discretionary (-0.4%) and materials (0.0%) were the biggest laggards. WTI (1.6%) and Brent (2.2%) oil were higher with MLPs (9.0%) and the energy sector (4.5%) outperforming.
- Large cap value as measured by the Russell 1000 Value outperformed at 1.8%. Banks outperformed as well with the Invesco KBW Bank ETF (KBWB) higher by 2.8%. High dividend strategies outperformed the S&P 500 with the iShares Select Dividend ETF (DVY) rising 2.0%. Momentum underperformed with the iShares MSCI Momentum ETF (MTUM) by increasing 0.9% for the week. Small-cap stocks outperformed relative to the S&P 500 with the Russell 2000 higher by 2.0% and small-cap value stocks outperforming at 2.5%. The 10-year and 30-year U.S. Treasury yields were higher at 0.97% and 1.73%, respectively.
- High yield credit spreads narrowed reflecting increased risk appetite. AAA municipal bond yields as a percentage of Treasuries fell, causing municipal bonds to outperform. The negative revenue impacts of the economic lockdown on local governments and talk of state bankruptcy have driven municipal bond valuations to low levels relative to Treasuries. Between the strong 3Q economic rebound and Federal support so far, states declaring bankruptcy remains an unlikely outcome. Additional support for the states is likely to come in any future stimulus bills, but one of the sticking points to a new deal is the size and distribution of Federal government aid.
- The U.S. dollar was weaker against both developed and emerging market currencies. Developed international stocks as measured by MSCI EAFE underperformed the S&P 500 returns in U.S. dollar terms (1.0%) and on a hedged-currency basis (0.2%). MSCI Japan underperformed the S&P 500 returns in U.S. dollar terms (-0.6%) and on a hedged-currency basis (-0.5%). Emerging market stocks kept pace with the S&P 500 with a non-hedged return of 1.7% for MSCI EM.
- The 10-2 yield curve widened to +82 basis points. Another curve measure of three-month yield six quarters forward minus the current three-month yield increased to +13 basis points. The yield curve has historically provided an accurate forecast of future recessions when the difference in these measures turns negative, also known as inversion. Yield curves are one of the major indicators that we monitor to judge recession risk, but these inversions typically happen more than a year in advance of an economic recession. External shocks like the current coronavirus-induced recession might not be accompanied by inversion. Stocks have historically had significant advances post-inversion.

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### Disclosures



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