



Update

The Imbalance of Growth vs. Value

During this advance from the March lows, we've focused on the market's disconnect from an underlying economy in recession. We've also noted the bifurcation between winners and losers among stocks as evidenced by the NASDAQ's lone return to a bull market while the other indexes still tread below their February highs. That bifurcation was seemingly drawn along the line between stocks categorized as Growth or Value. The former being generally described as higher multiple/volatility issues while the latter is viewed as defensive, lower multiple, dividend-paying issues. We're now seeing signs of the beginning of a reallocation of capital from a number of the winners (Tech, Consumer Discretionary, Healthcare) to a few of the more neglected sectors such as Financials and Staples.

The line between Growth and Value is being blurred as the divergence in their valuations becomes difficult to rationalize. This rotation is symptomatic of the reversion to the mean that inevitably occurs when the pendulum swings too far towards Growth in an uncertain economic environment such as we have. Traders, with their short-term investment horizon, have created this imbalance. As diversified investors playing the long game, we've benefitted from that. We believe this week could mark a change of direction for the pendulum.

We've talked about opportunities presenting themselves. The banks, airlines, pharma, industrials, and healthcare are sectors that will thrive *after* a vaccine is developed and human behavior adapts to the virus being controlled, though not eradicated. This rotation is a sign that it's time for us to look among those market laggards for the next group of winners. That means using our outsized cash reserves to buy stocks with, for lack of a better term, a little hair on them. Our search includes a few new names as well as some familiar names we already hold.

Economic data points to a rebound in both manufacturing and consumption. The recovery is underway, but the awakening of cyclical stocks that validates a sustained recovery has yet to appear. We think the reallocation towards Value is a step in that direction, but is likely to increase the chances of the market settling into a trading range until there's a credible vaccine announcement. That announcement could send stocks higher briefly but might also hasten the move away from the winners toward companies that we'll be adding in the weeks to come. While the market may enter into a malaise as earnings catch up to stock prices, it's hard for us to entertain any revisit to the March lows while the Fed and the world's central banks remain intent on priming the pump.

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