CONWAY• JARVIS LLC
Investment Outlook

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Update

Stocks Surge Along with the Virus

This week we saw the NASDAQ extend its lead in performance over the other major averages as it breached the 11000 level. That leaves it as the sole bull market among the major averages while the "market", defined as the S&P 500, is closing in on its record high of February. So, why are the indexes advancing against bearish sentiment surrounding the virus? The construct of these indexes could distort the connection of the "market" to the economy. That distortion could be explained by the growing disparity in valuation between a few mega-cap stocks and the many lower-weighted issues included in these cap-weighted indexes. This is symptomatic of the bifurcation among market winners and losers that we've been discussing.

Currently, the five largest stocks (AAPL, AMZN, MSFT, GOOG, FB) represent roughly 20% of the capitalization weight of the S&P 500. Including the next largest five brings that total up to 27% of the index. The top ten have notched significant returns for shareholders (almost 10% through June) and are valued at the higher end of their P/E range at an average of 31.4, compared to the index multiple of 22.8. While the top 50 *averaged* positive year-to-date returns, the remaining 450 stocks within the index posted an *average* negative return. This indicates that investors are succumbing to the herd instinct and piling into a few big-name "winners". This is driving indexes higher even as it appears the virus is surging in the US and could be with us for an extended period.

If these two indexes were client portfolios, this would be a reason to slowly rebalance between Growth and Value as discussed in our recent CJ Update. The historic market advance that began on March 23 has been driven by the expectation of the country controlling the spread of the virus and seeing a robust recovery of the economy. So far, that expectation is one of speculation rather than fact. Yes, economic data points to a rebound in manufacturing and consumption while Q2 earnings have exceeded estimates. However, the longer-term outlook for normalcy returning to the economy is clouded by uncertainty as to *when* actual control over the virus will be attained.

The short-term outlook will likely be defined by a second stimulus package being rolled out by Congress. Further ahead, any speculation pointing to a dramatic shift in fiscal or regulatory policy following the election might set the stage for a pullback in the market. Ironically, any good news regarding control of the virus could serve as the catalyst for a partial rotation of capital from some of the highly valued mega-cap Growth issues. That capital would likely find a home in rationally priced Cyclicals and Value stocks that should perform well in a post-COVID environment.

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