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Reopening Economy, Dovish Fed = Strong 3Q Stock Market

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HIGHLIGHTS

- *November's presidential election will likely increase volatility.*
- *First Fiduciary initiates positions in Coca-Cola, the world's largest beverage company.*

The US stock market continued its advance in the third quarter of 2020. Sentiment toward stocks reached near-euphoric levels when Apple and Tesla executed share splits on the same day in August. Shortly after, the mega-cap technology stocks that have led the market higher experienced significant drawdowns, but still remain big winners year-to-date. Uncertainty in the market is elevated as investors prepare for what promises to be an unsettling presidential election while still dealing with the second- and third-order effects of the coronavirus pandemic. First Fiduciary's portfolio of high-quality industry leaders outperformed the value index. We continue to be surprised at the duration of growth stock outperformance. Nonetheless, we remain committed to our investment process, quality focus, and valuation discipline. In our view, chasing past winners is not worth the increased risk of large investment losses.

US states are at various stages of reopening, with some, specifically in the south, much further along than others. The jobless rate remains elevated, and the expiration of the weekly $600 unemployment bonus will reduce consumer spending for a swath of the population. Congress continues to debate additional stimulus; but, reaching an agreement before the election is uncertain. For its part, the Federal Reserve continues to be very accommodative. In September, the Fed announced its intention to leave interest rates near zero through at least 2023. The rate on 10-year Treasurys rose modestly in the quarter to 0.69%. These very low rates imply a slow economic recovery.

During the quarter, First Fiduciary initiated positions in Coca-Cola Company (KO) and exited positions in Walgreens Boots Alliance (WBA) and Wells Fargo (WFC). Coke is the world's largest beverage company. As the leading supplier of beverages to restaurants, shutdowns related to coronavirus have been a big headwind. However, revenues should recover over time. We are also optimistic about Coke's focus on new products. We sold positions in Walgreens Boots Alliance due to a loss of confidence in the company's business model. The company's nearly 10,000 brick and mortar locations increasingly appear to be stranded assets as business shifts to the internet, limiting WBA's importance in the health care value chain. Wells Fargo had been acquired with the thesis that a new CEO could restore the company's reputation as a high quality bank. The coronavirus-triggered recession has made that task considerably more difficult, and we chose to reallocate funds to a higher quality bank.

The spread (as measured by price-to-earnings ratios) between growth and value stocks is approaching 20-year highs. With interest rates near zero around the world, investors are comfortable paying ever-higher multiples for expected growth. At current prices, a few of these hyper-growth companies may provide good returns in the future; but, many more will experience disappointing growth rates and the repercussions for investors may be severe. We continue to prefer the more attractively valued equities of established, industry leaders that can still grow, albeit at a slower pace than those currently in vogue. The combination of favorable prices and strong balance sheets adds a margin of safety that expensive growth companies lack.