Weekly Capital Market Comments

May 22, 2020

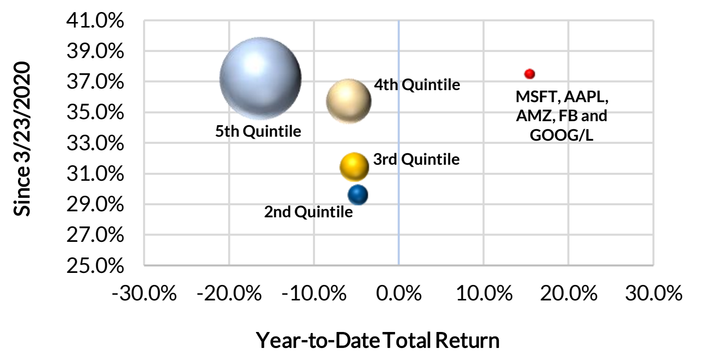
NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

When You Run With Bulls, You May Get The Horns

Every year, between July 6th and 14th, the town of Pamplona hosts the San Fermin Festival – a Spanish Mardi Gras if you will. And the cornerstone of this festival are the "encierros" (bull runs). Each morning, hundreds of participants line the route leading to the city's bullring, running alongside and in front of 12 bulls weighing more than 1,300 pounds. The ½ mile course through the streets of the Old City takes about 3 minutes. Last year, eight runners were gored, while it is typical that between 200-300 runners suffer other injuries. There have been 15 deaths since 1925, the most recent in 2009.

So while San Fermin officials in Pamplona, Spain, have canceled this year's Running of the Bulls amid the coronavirus pandemic, adrenalin junkies and risk-takers under global lock-down can find another fix; trading our own S&P 500.

Size Matters | S&P Quartiles by Market Cap



Source: NEPCG and FactSet

We continue to field calls from clients asking what is driving the market, especially given the 32% retracement from the March 23 lows. And this has occurred despite another [2.4 million unemployment claims] (bringing the seven-week total to almost 39 million), and continued softness in most, if not all, economic data. Further [tensions between the U.S. and China] continue to escalate. And while several biotech/pharma companies are optimistic about finding a vaccination or treatment for COVID19, our [economy continues to suffer]. With all of this, the notion that the U.S. economy will stage a "V" recovery is clearly on the back burner. Yet the S&P is trading at 21x '20 earnings and 20x '21 earnings, well above historical averages.

But as we continue to express to clients, not all companies are created equal, and **much of the upside in the S&P has been driven by only five companies**. These five companies are Microsoft (MSFT), Apple (AAPL), Amazon (AMZ), Facebook (FB), and GOOGLE (GOOG/L). **Collectively, they represent about 20% of the S&P's total weight**, hence the first [quintile] by market capitalization. Two of these five are Technology companies, two are Communication companies, and one is a Consumer Discretionary.

As we illustrate in the graph above, **these five names** have returned about 15% YTD, and almost 40% from the market lows of March 23, 2020, **but again – contribute over 20% to the index's overall total return**. When we compare these results to the second market cap quintile, which holds roughly 20 companies, we find the YTD return of negative 4.8% and a rebound from the March lows of about 30%. When we look at the result from the fifth market capitalization quintile (roughly 325+ companies), we find the weighted average return YTD is still negative 16%, with a retracement from the lows of about +37%. So while many investors may be lulled into the notion that the recovery in the equity market will be sustained, we need to see better performance from the 2nd, 3rd, 4th, and 5th market capitalization quintiles, before we adopt that view. Hence, we continue to suggest a "W" trend for the equity markets, as the reality of weak economic trends is not property discounted into current valuations. **We'd love to hear your thoughts.**