Weekly Capital Market Comments

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NORTHEAST SEQUOIA PRIVATE CLIENT GROUP

Value: The Bayonne Bleeder, or Rocky

My in-laws were born and bred in Bayonne, NJ. So I have heard stories of Chuck Wepner for decades; and my father-in-law is a great story teller. For those who don't know about Chuck Wepner, he was a heavy weight contender and fell just seconds short of a full fifteen rounds with heavyweight champion Muhammad Ali in a 1975 title fight. Shortly after the fight, Sylvester Stallone wrote the script for Rocky, which was released in 1976. Like Wepner's bout with Ali, Rocky Balboa's opportunity at the title was expected to be nothing more than an outsized payday for the Champion, as both contenders get bludgeoned. However, unlike Wepner, Rocky lasted all 15 rounds, and later aspires to be champion. While Stallone repeatedly denied a connection/basis with Wepner for years following the successful release of Rocky, the matter was put to rest in 2006, for an undisclosed settlement amount to Wepner.

Much like Wepner and Rocky, Value stocks have been bludgeoned by Growth for the last 10+ rounds, I mean years. During this time Growth has outperformed Value by over **400bps or 4% per year**. Over the last one, three and five year-periods, the outperformance has been even more lopsided, with Growth outperforming Value by 19.4%, 8.1% and 5.8% per year, respectively. And year-to-date, the Russell 1000 Growth Index has returned 17.2%, while the Russell 1000 Value Index is up only 1.0%; and all of this as the S&P 500 is up only 0.6% on a total return basis.

However, over the last few days, equity market leadership has shifted from Growth to Value, resurrecting hopes for Graham and Buffett zealots that Value investing is on a comeback, much the same way Rocky did. And while it is still early in the second quarter earnings season, NFLX only added fuel to the fire, for "pulling forward" demand from out quarters and sending shares reeling in after-hours trading, despite having a knock-out 2Q20 print. In addition, we have an emerging economic back drop, whereby data is pointing to a bottom in several trends, and in some cases hooking up. This is another constructive signal for Value sectors, as the country attempts to mend from a self-imposed economic shut down.

But recent bank earnings reports are proving to be a headwind to the tectonic shift required to level the performance playing field. And why? Because yields (and inflation prospects) remain stubbornly low. This helps support equities (especially cyclical growth/technology), as now roughly 70% of the S&P stocks have dividend yields greater than the current yield on the US 10Yr. Even the S&P Information/Technology sector carries a dividend yield averaging 1.18%, versus only 0.62% for the 10Yr Treasury Note. So it is easy to see why some investors may still bid-up dividend yielding technology-oriented names, as they are rewarded with a dividend (bird in the hand), as well as the potential for future capital appreciation. Then there is the argument that disruption and technological innovation has forever lopsided the Growth v. Value tug-of-war, but we lean more toward the former as the reasoning behind the unprecedented recovery in equities from the March 23rd lows.

Still, we think Value is the true Rocky, and not the Bayonne Bleeder. Inflation break-evens continue a slow and steady upward trend, and at some point, the massive amount of central bank stimulus should take hold, pushing rates higher. Alas, this is when banks will witness their NIMs (net interest margin) improve, alongside with a steepening yield curve. And as we emerge from a COVID Depression, value sectors and stocks will once again shine, even for only a short time, before Rocky III is released and Clubber "Growth" Lang steps into the ring.

We'd love to hear your thoughts.

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