

SUMMER 2020

Split Screen

As we have been “working from home” since long before the pandemic we have dealt with the distractions common in this now widespread practice. Often the distraction is some important national or international crisis being discussed at great lengths by experts on the various cable news networks. While trying to keep abreast of important world and national events while also focusing on investment issues pertaining to our clients, we are, like many, caught in a torrent of information, misinformation and opinions to the point of distraction if not exhaustion.

Perhaps the Covid crisis has been the ultimate distracting event with its effect on our lives and the economy. The daily briefings of federal and state officials have given way to the ongoing saga of the successes and failures in dealing with the disease in various states and countries. As we move into summer, we are seeing glimpses of positive economic developments, but these glimmers of progress are overshadowed by ever increasing numbers of infections in many parts of the country.

Yet as bad as things seem to be while watching the troubling Covid news on television, we turn to our computer screens following the stock market and see what appears to be a quite different story. The red of increasing infections on one screen contrasts with the green of advancing stocks on another.

After plunging over 34% from the February high to a low of 2,237.4 on March 23rd, by the end of the second quarter the S&P 500 advanced by almost 40% off the low. For the year to date through June 30th, the total return of the S&P 500 Index is down only 3.1%¹. The NASDAQ Index, dominated by large technology stocks has done even better, advancing with a total return of 12.1 %, after rising 30.6% during the second quarter and is now at an all-time high. Is this evidence that the stock market has discounted the end of the Covid crisis and is predicting a rapid rebound in economic activity?

¹ All return data quoted in this newsletter is for the year-to-date through June 30th, 2020, and is derived from sources Black Diamond, Standard & Poor's, Morningstar, FTSE Russell, and CNBC.

Perhaps, but just as there seems to be a disconnect between the stock market and the grim Covid news there is a wide divergence of returns in stocks this year. The modest decline in the S&P 500 in 2020 masks the significant declines in many of the larger companies in the index. According to CNBC, the median return for stocks in the S&P 500 was minus 11.0%. A good illustration of this divergence is found in the year to date total returns through June 30th of the iShares Russell 1000 Growth Index ETF (Exchange Traded Fund) and the iShares Russell 1000 Value Index ETF. The growth index, dominated by Microsoft, Apple and Amazon was up over 11% through June 30th while for the same time period the value index, dominated by J.P. Morgan, Berkshire Hathaway, Verizon, and Johnson & Johnson, among others, declined by over 17%. Foreign stocks have diverged to the downside as well, with the year to date total return of the MSCI EAFE Developed Foreign Market Index and the MSCI Emerging Foreign Market Index down 11.3% and 10.7%, respectively.

While the advantages of growth companies like Apple, Microsoft and Amazon are more readily apparent in our new pandemic economy, many stocks we would consider stalwarts, both now and in the eventual economic recovery, remain well below their recent highs. From a valuation standpoint, the price/earnings ratio of the Russell 1000 Value ETF is 14.8x and the dividend yield is just over 3.0%. By contrast, the P/E ratio of the Russell 1000 Growth ETF is 31.6x with a dividend yield of just under 1.0%².

We believe in many of the growth stocks like Apple, Amazon, Alphabet and Microsoft but we also want to have good representation in value stocks such as J.P. Morgan, Johnson & Johnson and many others in the industrial, consumer discretionary, consumer staples and energy sectors. A diversified portfolio of both growth and value stocks may hinder returns relative to the S&P Index at times but we think it is a sound long-term strategy. We don't know just when, but we strongly believe that value stocks, smaller company stocks, and foreign stocks will at some time have a period of outperformance as compared with the large growth stocks. The higher dividends available from many value stocks also provide a better source of current income than the large growth stocks.

While there are more than enough conflicting predictions for the stock market in the short term, we would offer only that we would not be surprised to see more volatility

² FTSE Russell

in the market. There will be progress and setbacks in dealing with Covid and all its ramifications. It is difficult to ignore some of the dire warnings and sobering statistics being discussed by various medical experts and our economy may also have a long, uneven climb back. Add in a contentious national election and it is hard to think there will not be additional turmoil in the markets. However, we do remain confident that this crisis will pass. Doctors and scientists learn more about the disease every day and we believe we will have a successful vaccine and/or therapeutics before too long. Despite many well publicized lapses, most people are behaving responsibly and are working hard to resume a somewhat normal life as safely as possible.

We wish you and your families all the best as we make our way through this crisis.

John C. Knox, CFA

John C. Downing, CFA

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