MARKET INSIGHTS

from Ziegler Capital Management

The Medicine Might be Working... But What are the Side Effects?

Some quick market observations on recent data

The stock market (S&P 500 Index) has come a long way since March 23rd with an over 30% return through May 15th. While the market is still down 10.7% in 2020, it is actually positive 2.5% over the past year. Volatility, as measured by the VIX, is now 31.9 versus the cyclical peak of 82.7 on March 16th. While still somewhat elevated, the market gyrations of +/- 3% swings have subsided for now.

The Federal Reserve's unprecedented levels of market support coupled with $3 trillion in government stimulus (there are active talks for more) appear to have had a stabilizing effect on the markets. While the daily headlines are not all positive, it appears that the stock market (a leading future indicator) may have priced some of the bad news into prices already.

Earnings season is winding down with 91.9% of the S&P's market capitalization having reported first quarter results. Earnings ex-financials are surpassing expectations by 8.2% with 67% of companies exceeding their lower projections. Companies beating both revenues and earnings per share have outperformed the market by 1.7% versus a historical average of 1.6% while companies missing both have only lagged -1.7% versus the historical average of -3.2%.

There are more than a few questions going forward. Let us begin with share buybacks and dividends, 164 companies have discussed suspending buybacks and or dividends with the greatest concentrations in Financials (21%), Industrials (20%), and Consumer Discretionary (12%). This number far exceeds the typical first quarter statistics of no more than 25 companies considering suspending since 2010. If companies are not buying their own stock, who steps up and when? Monetary conditions are very good, stocks are arguably attractive from a valuation standpoint and there are high levels of cash on the sidelines. The spread between the U.S. 10-year treasury bond and the S&P 500 dividend yield is at an all time tight spread showcasing the attractiveness to current dividend levels.

There is much discussion on the shape of the recovery. Do we recover in a U, V, the dreaded W, or the "Nike Swoosh" and who leads out of it? While none of this will be seen for some time, current market conditions are showing some extremes. For example,

WRITTEN: MAY 21, 2020

ABOUT ZCM MARKET INSIGHTS

A series that provides a glimpse of our internal thought process through current topics affecting our clients and colleagues.

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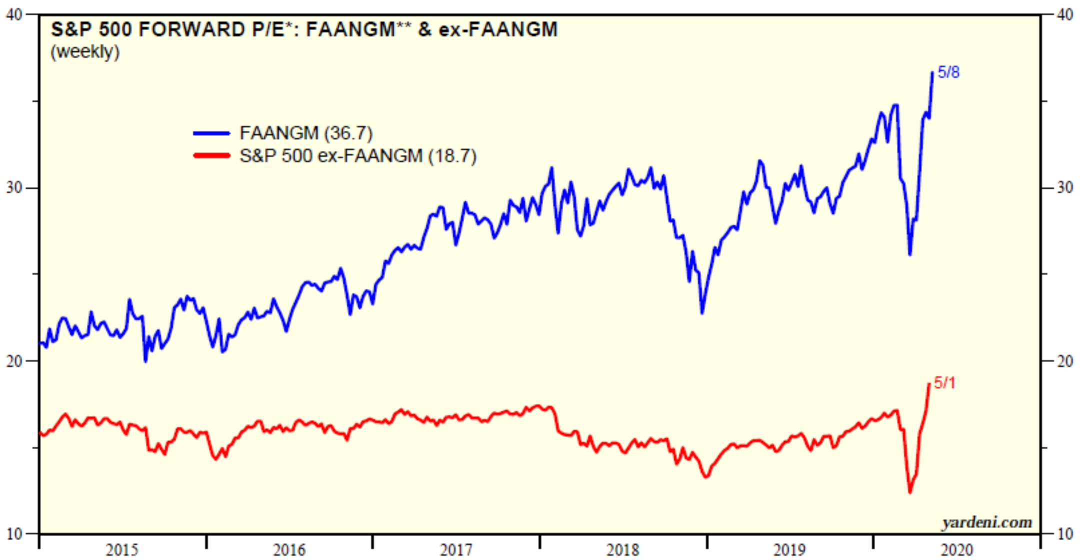
year-to-date through May 14th, the Russell 1000 Growth and Russell 1000 Value Price-to-Earnings ratio differential is the highest in ten years (28.3x versus 15.1x), but so are the differences in long-term earnings growth expectations (9.65% versus -4.1%). We clearly see that in the indices' year-to-date performance with a spread of 22.3% between growth and value, with the latter underperforming.

As we have stated before, there will also be winners and losers in specific companies and industries. For the same time period, it is likely no surprise that the Software and Services industry of the S&P 500 has the second highest return in the S&P 500 at a positive 4.49%, the best performing industry is actually Retailing with a return of 8.25%. You may find that hard to believe with so many retail operations closed and or under capacity. However, when Amazon represents half the weight and is up 29% this year the picture becomes clearer. The losers so far? Banks with a return of -41.77% with Automobiles & Components just ahead at -39.92% and the well-publicized Energy sector returning -38.93%.

The FAANGM stocks (Facebook, Amazon, Apple, Netflix, Google, and Microsoft) have continued on an upward trend as illustrated in the chart below. The question remains can these technology names continue to carry U.S. equity returns and remain decoupled from other sectors.



* Market cap divided by aggregate forward consensus expected operating earnings.
** FAANGM stocks include Facebook, Amazon, Apple, Netflix, Google (Alphabet), and Microsoft. Both classes of Alphabet are included.
Source: I/B/E/S data by Refinitiv.

Through May 15, West Texas Intermediate is down 51% this year at $29.65 a barrel. Oil has had a crazy run this year, strongly driven by the Saudi Arabia/Russia price war. While this has been punishing to the Energy sector, businesses and consumers will benefit from lower gas prices as the economy gradually re-opens.

The stock market has come a long way since the March 23rd lows. While the selloff was extremely fast (24 days), the recovery so far has been equally as impressive. Market pundits have published a wide variety of views – from this is the beginning of a 2009 recovery to more doom and gloom. There remains uncertainty as the economy is beginning to reopen and time will tell how successful the return to the “new” normal is. We remain vigilant in managing our client portfolios and have taken advantage of some of these dislocations successfully. We remind our clients to stick to their long-term goals.

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20-02001
Printed Internally