



October 17, 2020

In this strategy briefing...

It was not all bad news for COVID-19 this week. The severity of this wave of cases seems less lethal than prior waves. 3Q2020 EPS seasons seem to be affirming we are indeed moving past the bottom. – Strategy – [Page 1](#)

While markets are likely to remain choppy in the very short-term, investors should stay focused on the improving longer-term cycle. Participation is again broadening with stocks such as AME, ROK and ADSK in the Automation space, buy ideas as they emerge from their summer trading ranges. – Technical – [Page 4](#)

A stimulus deal is still possible before the election. Getting a bill is a high priority for the President. While McConnell has opposed the big bill, it is hard to imagine him saying no to the President on the eve of the election. – Policy – [Page 8](#)

FS Insight Investment Views

Near Term View:	Health, Economic Data Point to Better 2H20 for Cyclical, Value
'20 Target:	3,525 (YE P/E 18.3x · 2021 EPS \$193)
Style:	High Quality
Granny shots⁽¹⁾:	GOOG, AAPL, CSCO, XLNX, GRMN, MSFT, MXIM, LEN, KLAC, MNST, OMC, GWW, INTC, LOW, AMZN, EBAY, TSLA, PYPL, AXP, BF/B, PM, NVDA, QCOM
Additions:	GWW, INTC, KLAC, OMC, QCOM
Deletions:	BKNG, BWA, CF, EMR, HPQ, PG

⁽¹⁾ The granny shots portfolio was rebalanced this week, additions/deletions are reflected above

The View from Thomas Lee (Equity Strategy)



Thomas J. Lee, CFA
Co-Founder & Head of Research
Previously Chief Equity Strategist at J.P. Morgan from 2007 to 2014, top ranked by Institutional Investor every year since 1998.

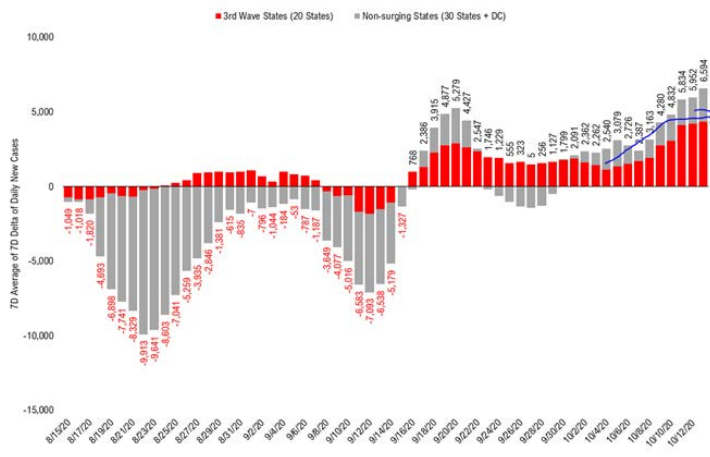
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In Choppy Week for Markets Stocks Finish up 0.2%

Equity markets were choppy over the past week. And while impacted by the stalemate in Washington over the fiscal stimulus and the surging COVID-19 cases in Europe and the US, the Standard and Poor's Index finished the week essentially flat; up 0.2%.

Unfortunately, COVID-19 is spreading at a faster rate in the US. While cases are spreading in nearly every state, this surge since early September is being driven by a new set of about 20 states. Wave 1 was NY tristate, wave 2 was FL, CA, AZ, TX, or F-CAT, and as the chart below shows, these other 20 or so states are driving wave 3.

Daily cases are spreading at such a high-speed in these states to hopefully cause their residents to take appropriate action. Similar to wave 1 and wave 2, I think it's possible that we see this third wave peak within the next 2 weeks. And if these states avoid a shutdown, this would be good news.



Source: COVID-19 Tracking Project

Nevertheless, it was not all bad news on the COVID-19 front this week. The severity of this wave of cases seems less lethal than prior waves with the US seeing 1% incremental hospitalizations vs 4% in July. And over the next 20 days, equity markets are primarily focused on Washington (election and fiscal stimulus) and the path of COVID-19. Importantly, the daily change in COVID-19 cases vs 7D ago has not shown an exponential rise, which I see as a positive.

This week, we looked at the “peak speed” of COVID-19 spread on a state by state basis. Similar to waves

Analysis not opinions



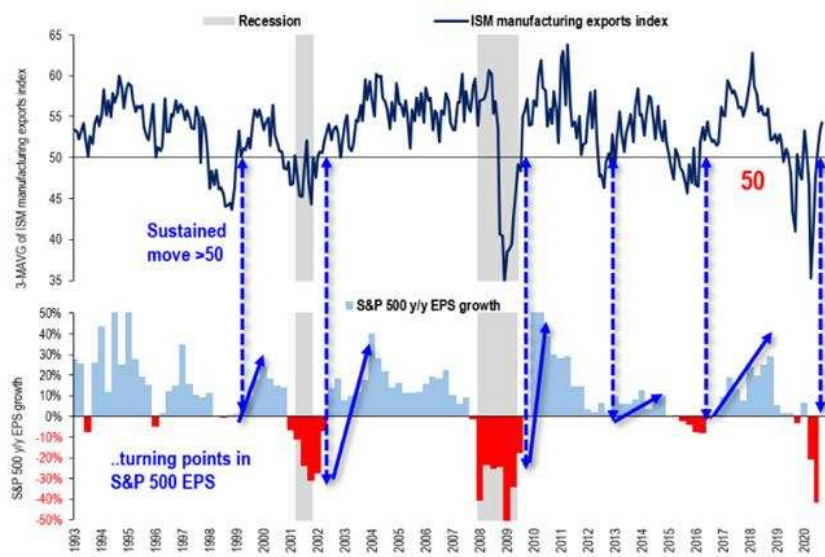
1 and 2, this recent spread also seems to have what I call a built-in "speed governor," in the sense that once cases reach a certain level of spread, there is a policy response as well as behavioral changes that mitigate further spread.

A simple example of this is the many anecdotes we received from those in Texas. Once COVID-19 reached a certain level of spread, many Texans donned masks and practiced other mitigation measures. On a state by state basis, we are seeing different levels of "peak daily cases per 1mm" and will be watching this closely. I expect these "peak" levels on a state by state basis to provide insight into the overall trajectory of this third wave

Strategy: 3Q2020 EPS season affirming we are moving past the bottom on EPS.

A simple guide to seeing this is to look at the relationship between ISM exports and EPS growth. As can be seen in the chart below, when ISM exports recover back above 50, this coincides with a turning point for EPS. Hence, the run-rate for EPS is now positive quarter over quarter. And overall, this EPS recovery is far stronger than we expected, and US corporates are more "unkillable" than we expected. Previously, we expected 3Q2020 EPS to be similarly bad to 2Q2020, so this is better than our expectations.

Figure: ISM manufacturing exports index and S&P 500 y/y EPS growth Since 1993



Source: FSInsight, Bloomberg, ISM

Accordingly, we are raising our 2020 EPS estimate from \$50 to \$100. Decomposing this growth into sectors, more than 50% of this increase is driven by EPS growth from the epicenter sectors (Discretionary, Financials, Industrials, Energy, Materials). A little less than 50% of the increase will be driven by Secular Growth (Technology, Communication Services, Healthcare) with little growth being driven by defensive sectors. We are keeping our 2021 EPS estimate at \$193.

This week we re-balanced our "Granny Shots" portfolio adding five new stocks and removing six stocks. On a year to date basis, the granny shots portfolio is outperforming the S&P 500 by 25.4%. We continue to view Granny Shots as a way to

construct a core portfolio as these stocks fall within our three thematic portfolios and three tactical portfolios and encourage you to refer to the updated list on page 1.

Bottom Line: The choppiness in equity markets over the last week is understandable given the focus on election outcomes, fiscal stimulus and rising COVID-19 cases. Nevertheless, I think stocks have made their pre-election lows and am encouraged by 3Q2020 earnings results.

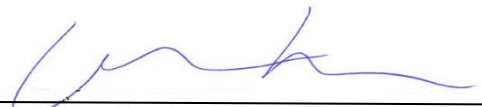

Thomas Lee, Co-Founder & Head of Research

Figure Comparative matrix of risk/reward drivers in 2020

Per FSInsight

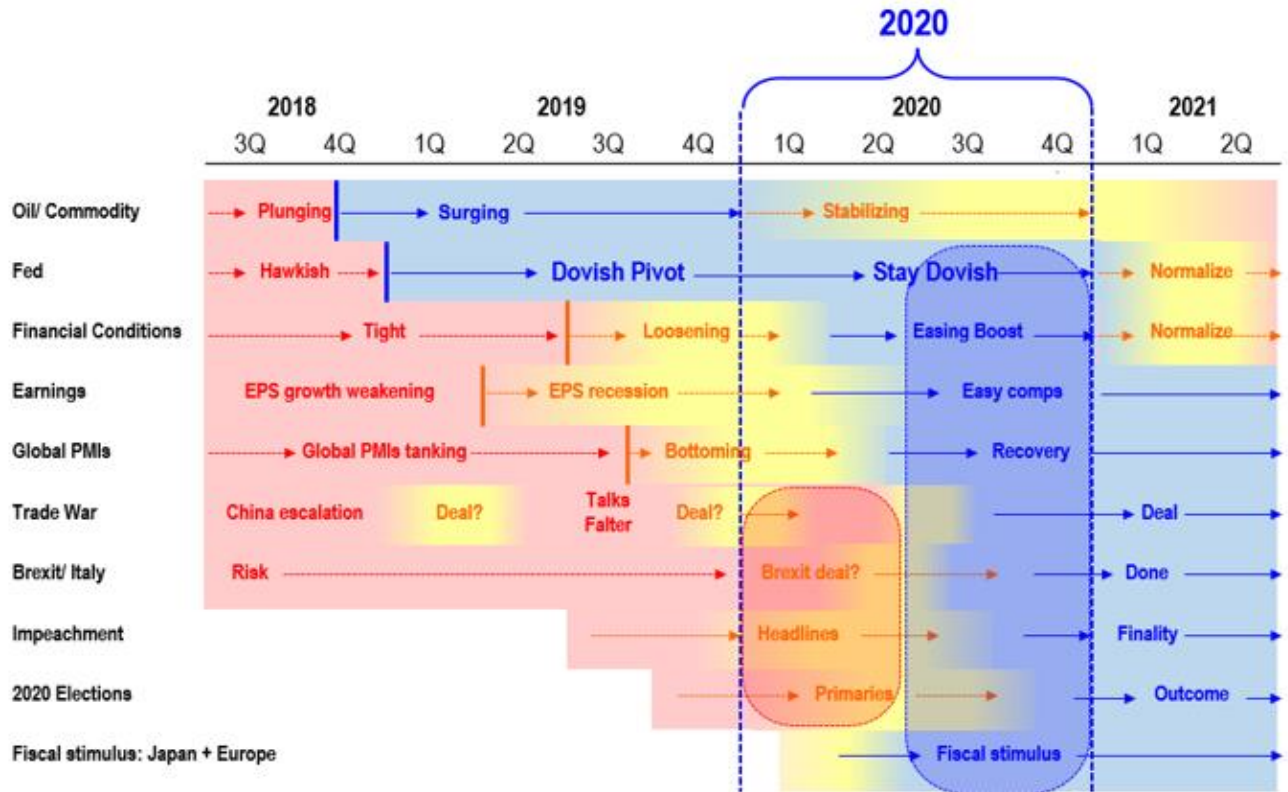


Figure: FSInsight Portfolio Strategy Summary - Relative to S&P 500

** Performance is calculated since strategy introduction, 1/10/2019

Fundstrat Theme	Execution of Strategy	Date Added	Last 3 Months			FY19					Since Inception Rel.Return
			Aug	Sep	Oct	(since 1/10)	1Q20	2Q20	3Q20	4Q20	
S&P 500	S&P 500 Price Index		7.0%	-3.9%	3.6%	24.4%	-20.0%	20.0%	8.5%	3.6%	34.1%
Performance relative to S&P 500...											
Granny Shot	Intersect of below investment strategy	1/10/19	2.9%	-0.4%	0.8%	8.8%	1.6%	14.6%	7.8%	0.8%	43.3%
Tactical — 6-12M											
1 Value / Growth Tilt	Market re-discovered valuation risk. • Quality Cyclical • Value Quality	1/10/19	-0.6%	1.8%	2.0%	4.3%	2.9%	4.8%	5.6%	2.0%	26.2%
2 Seasons the NEW Seasonality	Overweight groups with good seasonal. CURRENT: Advt., Online Retail, Cable, Home Improv., Semis, Homebuilder, Managed Health Care, System Software	1/10/19	0.2%	0.8%	0.8%	1.2%	-13.0%	8.0%	6.2%	0.8%	-5.1%
3 PMI Recovery*	Sectors and style that benefit from PMI recovers above 50. • Tech, Industrials, Financials, Energy + Value	12/13/19	-3.9%	-1.4%	1.5%	0.4%	-9.0%	28.1%	2.0%	5.1%	-10.2%
Thematic — 3-5 years											
4 Millennials prime years	Millennials driving >50% GDP growth. • Millennial transformation. • Millennial accelerates growth.	1/10/19	8.8%	-0.2%	0.6%	0.5%	0.1%	8.5%	13.1%	0.6%	28.6%
5 Labor shortage— AI/ automation	World is short 78 million workers. • Automation/ AI suppliers. • Beneficiaries of Automation/ AI	1/10/19	6.0%	-0.6%	3.3%	3.4%	-5.5%	11.0%	7.4%	3.3%	20.1%
6 Higher inflation— Assets vs OpEx	Inflation trending higher long term. • Assets over OpEx.	1/10/19	-3.2%	-1.2%	1.2%	-0.6%	-1.5%	5.2%	-5.5%	1.2%	-2.8%

Source: FSInsight, FactSet

* Portfolio strategy introduced in December '19 rebalance, replacing 2019 portfolio recommendation — "FANG in odd years"



Technical: Robert Sluymmer



Robert Sluymmer, CFA
Head of Technical Analysis Strategy
Former Managing Director leading RBC's U.S. Technical Research team with over 26 years of expertise in investment research and technical analysis.

@rsluymmer

AME, ROK, ADSK – Automation Ideas Emerging from Ranges

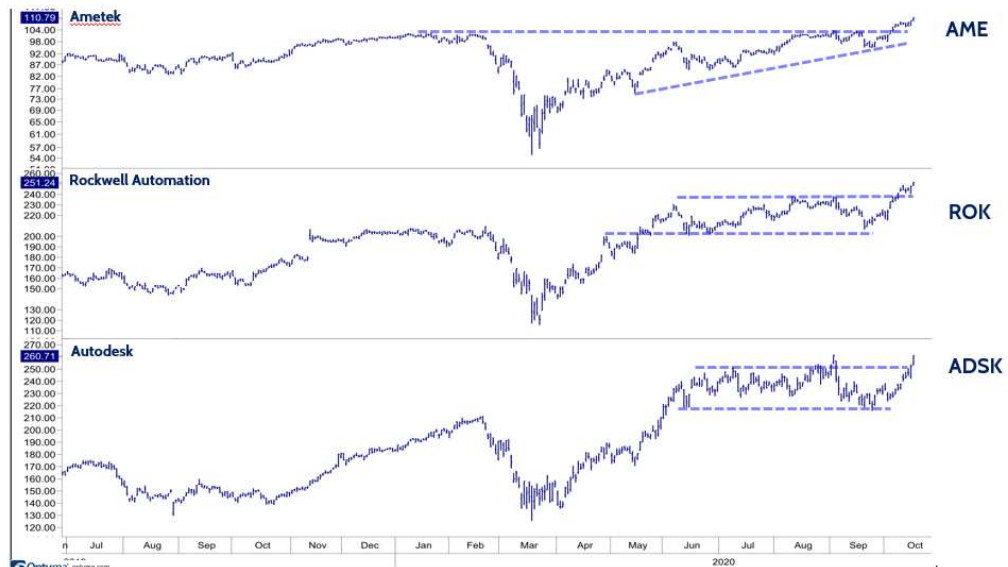
Near-term choppiness but the long-term cycle backdrop remains bullish - I continue to expect equity markets to remain in a choppy range near-term but would encourage readers to not lose sight of the bullish long-term cycle backdrop. Our market indicators, tracking 2-4 year moves, continue to build to the upside from deeply oversold levels and are unlikely to show evidence of peaking until well into 2021 and likely not until 2022. For reference, the average 4-year cycle return, during secular bull markets, is 100-110%. Obviously, there is no guarantee this will develop, but if history is any guide, then a rally to S&P 4400-4600 (+25-30%) is not unreasonable before a cycle peak develops. In addition, the relative performance of the S&P 500 versus one of the most widely tracked bond indices, the Barclay's Aggregate Bond Index, recently broke above its 2018-2020 trading range. I view this event as a long-term bullish technical signal that is likely to impact passive and active fund flows well into 2021. Trend following CTA accounts are just one example of the type of funds that will allocate more capital to equities away at the expense of funds.

Bullish: Advance-decline lines for the S&P and NYSE are making new cycle highs. While I expect equity markets to remain choppy in the near-term, I would stress it is unlikely to disrupt the ongoing uptrend for equities. Here again I would encourage readers to stay focused on improving market internals. For example, the advance-decline lines for the NYSE and S&P 500 made new all-time cycle highs in the past week indicating more stocks are moving higher not lower. As a general rule of thumb, new A-D line highs is bullish for stocks and suggests new highs are pending for those indices.



AI and Automation ideas

AME, ROK and ADSK: 3 cyclical automation ideas breaking out of 4-month trading ranges



Source: FSInsight, Bloomberg, Optima



What to do? AME, ROK and ADSK – 3 Automation ideas emerging from their summer trading ranges.

With participation expanding, I continue to encourage investors to broaden exposure within portfolios to more cyclical stocks to complement core positions in growth



stocks. AME, ROK and ADSK, are noteworthy timely long ideas within Tom Lee's list of recommended AI/Automation ideas. These stocks look like the ideal mix of both growth stocks in uptrends but have plenty of exposure to an improving economy in 2021. Similar to most cyclicals, all three stocks paused in June and have traded in broad trading range since. Since September 22-24 however, they are all showing signs of accelerating to the upside and are beginning to break-out to new cycle highs. I recommend using near-term weakness to add to these stocks to broaden portfolio exposure to more cyclical ideas.

Figure: Weekly Sector Review
Source: FSInsight, FactSet

- Discretionary and technology uptrends intact with industrials and materials again strengthening above 50-dma moving averages of their relative performance trends.
- Energy and Financials are showing early evidence of bottoming intermediate-term but have yet to show any meaningful improvement in their relative performance trends.

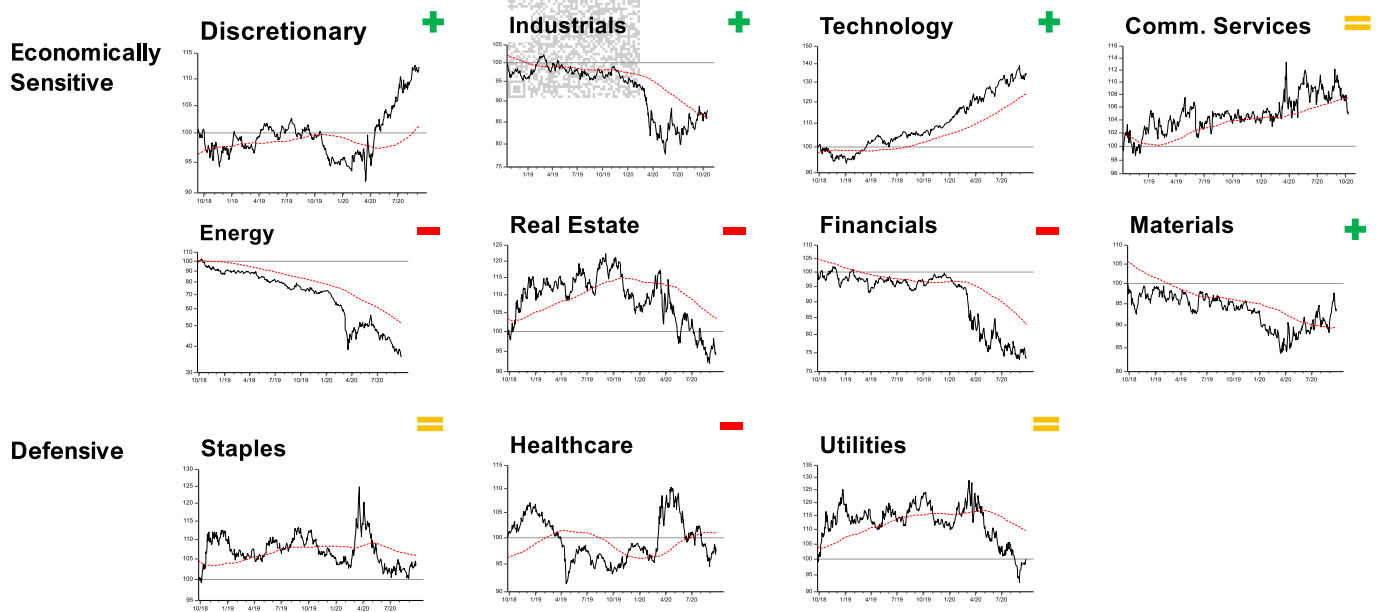
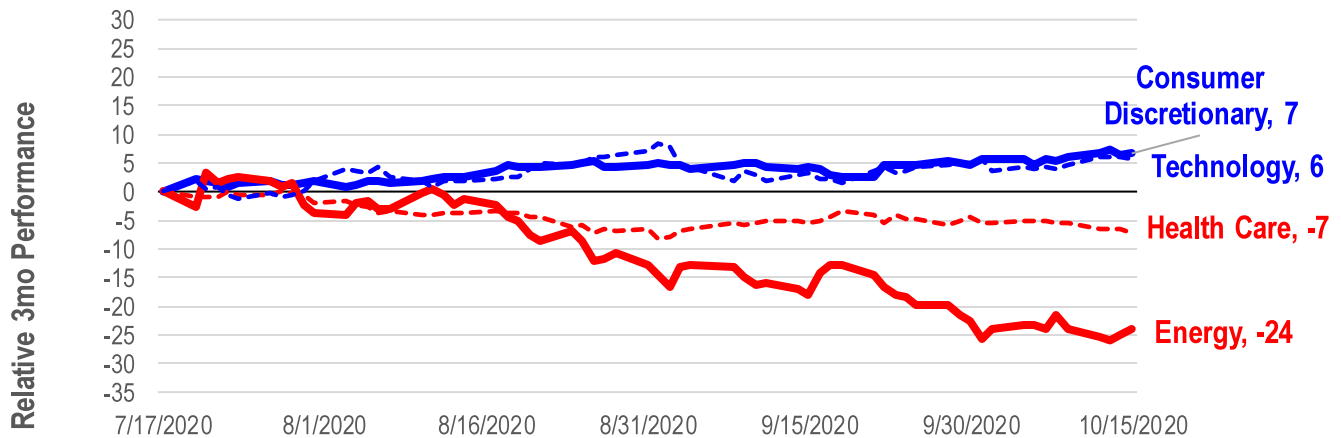


Figure: Best and worst performance sectors over past 3 months



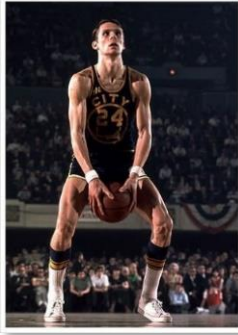
Source: FSInsight, Bloomberg

Robert Sluymer

Robert Sluymer, Head of Technical Analysis Strategy



GRANNY SHOTS: Best bets in 2020



Below we've highlighted stocks that we recommend across at least two of our investment strategies for 2020. These companies could benefit from multiple themes and secular tailwinds – clear picks in our view for the second half of 2020.

The granny shots portfolio was re-balanced this week and additions and subtractions from the portfolio can be found on page 1.

Figure: Granny Shots are the “best of the best”
Stocks which appear in multiple themes. Source: FSInsight

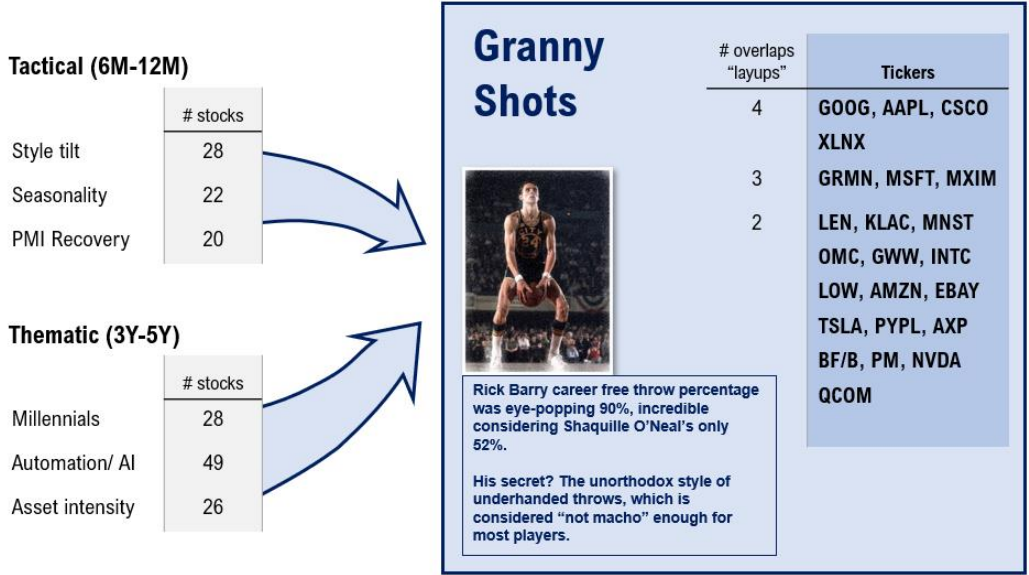


Figure: Granny Shots Portfolio Performance
Monthly. Source: FSInsight. FactSet as of 10/15/20

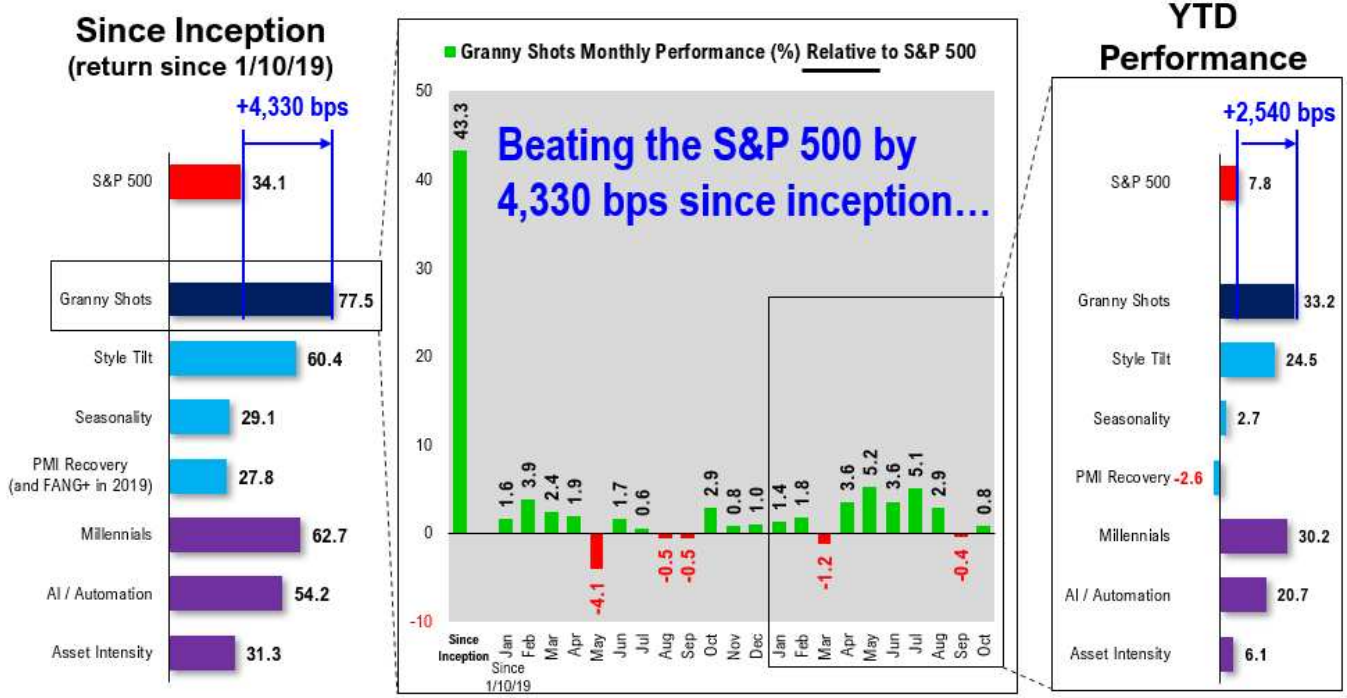


Figure: Intersection of investment recommendations by strategy

As of 10/15/20, Source: FSInsight, FactSet

Ticker	Company	Mkt Cap (\$M)	YTD perf (relative to S&P 500)	P/E ('21E)	Value / Growth Tilt	Seasonality	PMI Recovery	Millennials	AI / Automation	Asset Intensity	Strategy Count
1	GOOG	Alphabet Inc	\$987,548	8.8%	27.5x	•		•	•	•	4
2	AAPL	Apple Inc	\$2,092,790	56.6%	31.3x	•		•	•	•	4
3	CSCO	Cisco Systems Inc	\$169,210	(24.5%)	13.0x	•	•		•	•	4
4	XLNX	Xilinx Inc	\$28,885	13.1%	35.0x	•	•		•	•	4
5	GRMN	Garmin Ltd	\$18,938	(6.3%)	21.5x	•		•	•		3
6	MSFT	Microsoft Corp	\$1,662,311	31.5%	34.0x	•	•	•		•	3
7	MXIM	Maxim Integrated Products Inc	\$19,699	12.0%	30.2x	•	•				2
8	LEN	Lennar Corp	\$25,882	44.0%	10.6x	•	•				2
9	KLAC	Kla Corp	\$33,053	11.8%	18.8x	•	•			•	2
10	MNST	Monster Beverage Corp	\$42,925	20.3%	31.9x	•		•			2
11	OMC	Omnicom Group Inc	\$11,343	(42.7%)	9.8x	•	•				2
12	GWW	Ww Grainger Inc	\$20,660	6.1%	21.4x	•	•				2
13	INTC	Intel Corp	\$229,024	(17.8%)	11.4x	•	•				2
14	LOW	Lowe'S Cos Inc	\$133,123	39.3%	20.6x	•		•			2
15	AMZN	Amazon.Com Inc	\$1,672,295	72.9%	75.9x	•		•			2
16	EBAY	Ebay Inc	\$38,773	45.6%	14.2x	•			•		2
17	TSLA	Tesla Inc	\$419,047	428.7%	145.2x			•	•		2
18	PYPL	Paypal Holdings Inc	\$238,344	80.0%	44.5x			•		•	2
19	AXP	American Express Co	\$84,083	(23.9%)	15.4x			•		•	2
20	BF/B	Brown-Forman Corp	\$35,230	5.0%	40.1x			•		•	2
21	PM	Philip Morris International In	\$123,244	(14.8%)	13.9x			•		•	2
22	NVDA	Nvidia Corp	\$345,179	129.7%	50.5x	•		•			2
23	QCOM	Qualcomm Inc	\$145,072	37.9%	19.9x	•		•			2
Average (relative to S&P 500)		\$372,898	39.7%	32.0x							
Median (relative to S&P 500)		\$123,244	13.1%	21.5x							



The stocks in the Granny Shots portfolio collectively outperformed the S&P 500 by 4330 bps since its inception (S&P 500 is up 34.1% during the same period).



Views on Washington Policy from Tom Block



L. Thomas Block
Washington and Policy Strategist
Formerly Global Head of Government Relations at J.P. Morgan for 21 years, and previously served as Legislative Assistant and Chief of Staff in the House, and Legislative Staff Director in the Senate

@TomBlock_FS

Stimulus Deal Still Possible Before Election

This may sound crazy, but I think a stimulus deal is still possible before the election. Earlier this week, Speaker of the House Nancy Pelosi had a tough interview on CNN when Wolf Blitzer ended by asking the Speaker if she is letting "perfect be the enemy of good" in getting a deal. The Speaker is also hearing from some of her members who are back home campaigning that the policy of saying no to the President's \$1.8T offer, while unemployment claims grow, is becoming harder to defend.

If the Speaker's motives are basically related to the Presidential campaign, maybe it is late enough in the game to give the President a win. Plus, there is a major split among DC Republicans as Senate Leader McConnell has said the Senate will consider a \$500B deal and that he doesn't support the bigger deal. A public fight between Republicans, two weeks before the election, may help the Democrats accept the President's deal.

In my view, the President has no higher priority than signing a stimulus bill in a gala White House ceremony to help his campaign. This is in fact what Pelosi doesn't want to see; but a mud fight between the President and Senate Republicans might help minimize this concern. This may be a unique period for a deal that could disappear when the votes are counted. A defeated Donald Trump is unlikely to be in a mood to deal, and McConnell is unlikely to be energized to deal win or lose with his Senate majority.

In the past few days, the President has chastised Secretary Mnuchin for "not coming home with the bacon," and telling Senate Republicans to "go big or go home." While McConnell has opposed the big bill, it is hard to imagine him saying no to the President on the eve of the election. Today, economic adviser Larry Kudlow said the White House would be able to line up the needed Republican votes to get a bill through the Senate.

Bottom line on stimulus: It could happen as final act of crazy campaign.

Next Thursday in the final debate moderated by NBC's Kristen Welker. The general consensus is that the President hurt his cause in the first debate with his yelling and interrupting. What debate persons will President Trump bring to next week's debate? Does he just talk to his base that loves his tough guy approach or try to broaden his appeal to the suburban women he pleaded "like me" at a rally this week.



L. Thomas Block, Washington and Policy Strategist



 [@federalreserve](https://twitter.com/federalreserve)

Clarida Weighs in; Main Street Loans Still Stuck in Neutral

Believe it or not, Fed Chair Jerome Powell is not the only person at the Fed who can make headlines. This week, Vice Chair Richard Clarida had some interesting things to say.

Clarida thinks it could take “another year or maybe more”, for GDP in the United States to recover to its previous 2019 peak. And given the dismal outlook that many members of the FOMC have had, my natural reaction is: Just one year? Not bad, we’ll take it.

But just like every positive statement that comes out of the Fed these days, it was met with many qualifiers. And if I had to pick the most important one, it has to be Clarida’s outlook for the labor market.

He thinks it will take even longer for the unemployment rate to return to a level consistent with the Fed’s maximum employment mandate. In particular, he highlighted that even over six months since the pandemic’s onset, the unemployment rate is still at 7.9 percent as of September and would be about 3 percentage points higher if labor force participation remained at February 2020 levels. Yikes.

Clarida also noted that “additional support from monetary-and likely fiscal-policy” will be needed. Economist Tim Duy sees this as a hint that the Fed is gearing up for something new in the coming months. I think he is well reasoned and would not be surprised if the words “balance sheet” begin working their way back into the financial media.

Regarding the Fed’s struggling Main Street Lending Program, Congressional Oversight Committee member Bharat Ramamurti had some interesting insights this week. His view on the state of the program is pretty simple: “so far it has failed”.

And while this failure of this program has been swept under the rug in the midst of the election and the virus, Ramamurti points out that these midsize businesses targeted by the Main Street Lending Program account for about a third of GDP and “it’s a real problem that we are failing to provide them with sufficient economic relief”.

And in case you were not aware, some of them are in serious need of economic relief. Earlier this week, a group of individuals from the hotel industry wrote to President Trump: “We strongly urge you to use your executive authority to direct the Treasury to encourage the Federal Reserve to amend and expand the Main Street Lending Program.”

A recent survey conducted by the Fed found that more than half of participating banks said they rejected Main Street loan requests from companies that were “creditworthy before the COVID-19 crisis, but too severely impacted to remain viable and hence unable to repay the loan.” Looks like we have a textbook instance of adverse selection our hands here. If and how the Fed and Treasury breath some life into this program bears watching.

The Fed’s asset purchases continue at \$80 billion worth of treasury and \$40 billion worth of mortgage backed securities per month. They show no signs of slowing down.

The yield on the benchmark 10-year U.S. Treasury is 0.74% down from 0.77% last week.

Next FOMC meeting is Nov. 4-5. No action expected.





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