When Wall Street Became Broad Street

November 16, 2020

The good news for stock market participants is that equities have put together two weeks of positive returns in the face of the uncertainties surrounding the national election. Ever since the market plunge in March due to the Coronavirus, stocks divided along the lines of the virus winners and losers. Companies that benefited from the virus soared versus the companies that suffered from lockdowns. This divergence appeared among traditional categories of stocks. Large cap growth stocks, as measured by the NASDAQ 100, has risen 43.6% over the past 52 weeks while the small capitalization S&P 600 has risen by only 1.2%. The rationale for this divergence was that the large companies would benefit due to strong financial staying power while the smaller companies were operating on thinner margins and couldn't last long if the lockdown continued. The large/small comparisons carried over to the growth/value comparisons. A similar fate was expected to befall the value stocks that paid dividends and would find difficulty in maintaining a payout as their businesses suffered from the pandemic.

When the announcement that Pfizer had discovered a viable vaccine, equity markets responded with a sharp rally as measured by the Dow Jones Industrial Average with an initial rally of over 1,600 points then falling back to close up over 800 points for the day. The importance of this rally was that the companies that would benefit from a vaccine rallied strongly while the prior coronavirus winners experienced sharp price declines. Investors began to get a taste of what the market might be like as a viable vaccine would eliminate the need for all of the safeguards that had been put in place during the surge in coronavirus cases. Today's announcement that drug company Moderna also had a vaccine that was more than 90% effective buoyed the markets to at or near record highs.

As last week wore on, the opinions of distributing the Pfizer vaccine became an issue due to the need to keep the serum at a temperature below 86 degrees Fahrenheit. As a result, the markets backed up somewhat with growth stocks continuing to push higher. By the end of last week, the S&P 500 hit an all-time high with the DJIA and the NASDAQ Composite not far behind, even though there was an increase in virus cases that threatened further shutdowns.

In the face of these events, fundamentals of both the economy and corporate America continued to improve. Falling unemployment, rising consumer incomes and low interest rates were accompanied by rising corporate profitability even though the government has not moved forward on another "stimulus" package to aid companies that continue to suffer from restrictions imposed by past and current lockdowns. One lesson to learn from last week's stock performance is that successfully distributing the vaccine, and the vanquishing of the virus, will contribute to a realignment of the various stock sectors to allow a broader stock market rally.

We don't underestimate the prospect for a change in the tax laws in 2021 that might have an impact on equity prices going into the spring of next year. However, the combined effects of the massive government programs to offset the impact of the shutdown should continue to foster a broader stock market rally that is expected by many to lead to a new highs in stock prices next year. The Federal Reserve's commitment to keep interest rates near record lows for the foreseeable future is one good omen for equity investors.

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