

Morgan Stanley



## Monthly Musings

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*The Benedict-McLoughlin Group*

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*No, “Monthly Musings” hasn’t turned into “Semi-Annual Musings” but, yes, this is the first Musings I have written since September. It’s not that there haven’t been some interesting developments in the past 7 months...frankly, I have just been busy (mostly in a good way) with the day to day but, also, have recently undergone double hip replacement surgery (progress is slow and steady, thank you). Fortunately, the investment world has generally unfolded along the lines we had predicted in September.*

*Anyway, let’s get to it...*

### **A Return to Normalcy?**

Anyone else feel like this is the 17th month of 2020 instead of the 5<sup>th</sup> month of 2021? Expectations that a turn in the calendar along with a new U.S. Administration and a vaccine rollout would swiftly get us back to normal have been, well, maybe a bit too optimistic. Unfortunately, the debate surrounding COVID 19 continues to be highly politicized (along with just about every other important subject in 2021). Picture a Venn diagram...do you remember the overlap where common sense Americans from either side of the political spectrum could find some common ground? Now, it seems that the diagram is just two separate circles passing each other in the night. At the very least as it relates to this pandemic, I hope that, as a society, we perform some careful analyses and determine how we can improve our crisis management skills.

So, how can we move to de-politicize how we run society, the economy and how we teach our children? I’ve often said and written that campaign finance reform is the “one thing” that would likely lay the groundwork to allow us to solve around 90% of our issues. The amount of money being spent on campaigns alone is staggering. In the two senate races in

Georgia, more than \$830 million was spent by the candidates and their allies.<sup>1</sup> This is just one state and just one part of the government. Imagine if the many billions of dollars spent on the election process was instead used to address the issues that most of these politicians are running on? Could \$830 million spent on education and addressing the homeless problem in Georgia, for example, bring about some real progress? Imagine if each candidate in a given race had a limited but, equal amount to spend? Think about how much more time each elected official would have to work for the people instead of how to raise more money for the next election. And, imagine if these elections were tax payer funded or funded in some other anonymous fashion...wow, no political debt to repay to your big donors after you get elected!

Of course, it's not easy to change the rules because the people making the rules are the same people benefiting from the status quo. I've always said/written that we would most likely need a crisis like a pandemic, a nuclear war or an alien invasion to actually enable a change of this magnitude. Well, it looks like you can scratch pandemic off of the list...I guess we would need to see another Black Plague to shake things up enough. I do, however, think a nuclear war or alien invasion are still legitimate candidates and I also think we can add another one...revolution...or a credible threat of one.

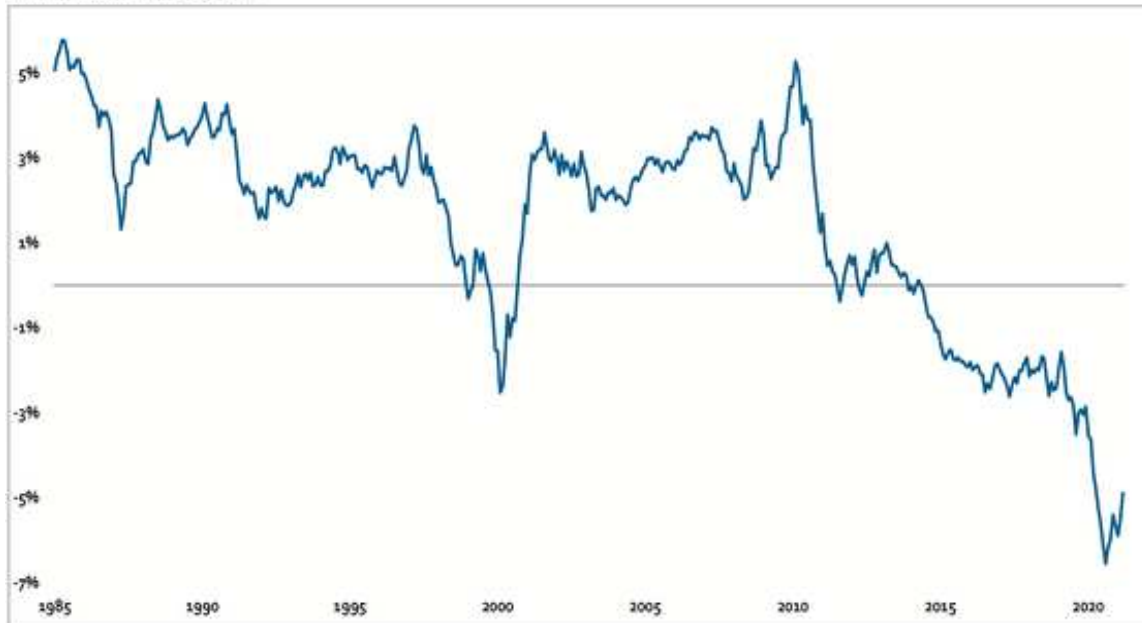
In any case, something's gotta give...and I expect a fair amount of political, societal and market volatility for the foreseeable future. One can only hope that we won't require a true crisis to improve our election/political system. The potential ramifications for investors and society as a whole are enormous.

### **Greater Fool Theory**

So, the investment landscape has developed much as I had thought it would per my last "Monthly Musings" in September 2020. Investors have, in fact, changed their focus to companies and sectors that benefit from a re-opening of the economy. For example, the S&P Value Index has outperformed the S&P 500 Growth ETF by almost 11% from 9/30/20 – 4/30/21.<sup>2</sup> I believe this relative outperformance will continue...there is still a significant reversion to the mean story (see graph below) along with some important fundamental reasons.

#### MSCI World Value Index vs. MSCI World Growth Index\*

Monthly data as of March 31, 2021



Source: Morgan Stanley Chart Book

As the economy continues to re-open, the potential headwinds (absolute and relative) are multi-fold for many technology and many growth stocks in general. First, the fundamental boost that many technology companies experienced due to a forced stay-at-home economy will begin to wane. True, a certain % of the digitization of the economy will remain but, there has been a significant pull-forward of growth, in my opinion. I would expect a reduction in expected growth rates for many of these companies...and even a modest reduction in expected growth is all you need to knock down P/E multiples. Additionally, we're likely to see rising interest rates over the next year or two, which also puts pressure on P/E multiples, all else equal. Morgan Stanley estimates that a 50 basis point rise in the 10-Year US Treasury yield would result in a 13% decline in the P/E ratio of the tech heavy Nasdaq 100 Index.<sup>3</sup>

On the flip side, value stocks are still relatively cheap and are in the middle of a significant earnings recovery. This acceleration of earnings for value stocks combined with a deceleration of earnings for growth stocks will, I believe, be the most influential force in the global stock market for the foreseeable future. Let's not forget that all companies (really, all financial instruments) make the same thing...CASH FLOW!!! There simply is more cash flow per market cap available in value stocks right now vs. growth stocks, even after adjusting for growth differentials, in my opinion.

Finally, another interesting set up in all of this is how crowded the technology/growth trade has become. A large portion of investable assets are already allocated here along with another unattractive and overvalued asset class, U.S. Treasuries. Given how much larger these two asset classes are compared to others, any meaningful move out of these two areas could provide meaningful firepower to global value stocks.

**\*Tactical Allocation Tilts in my Global Growth and Global High Income Model Portfolios (as of 5/3/21):**

**Overweight**

Long/Short Equity, Quality Dividend  
Paying Global Equities, Value Equities,  
Emerging Market Consumer Equities,  
Short-Term High Yield Fixed Income,  
Total Return Strategies

**Underweight**

High P/E Technology/Growth Equities,  
U.S. Treasuries, "High Quality"  
Corporate and Municipal Bonds,  
Long-Term Fixed Income

\* These weightings do not consider each client's unique profile, preferences and/or constraints and therefore may not be applicable to you.

*The Benedict-McLoughlin Group always strives to use sound judgment...at every decision point.*

*We bring experience, credentials and tenacity which we expect to continue to enable us to help achieve our clients' goals over time.*

Regards,  
Chris

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**The Benedict-McLoughlin Group** – "Institutional Caliber Portfolio Management, Customized to Your Personal Situation"

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**Notes:**

1. The Hill, 1/5/21.
2. Bloomberg Markets, 5/2/21.
3. Morgan Stanley, Market Observations, 1/11/21.

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