State Street Global Equity Fund

STATE STREET GLOBAL ADVISORS

Two Days in the Lives of High-Sentiment Stocks

- The most relevant single dimension of stocks that reacted to the Pfizer vaccine news on 9th November was price momentum.
- We believe that the best places to find opportunities are outside of the extremes of value, risk, or price momentum.

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In recent months, we have been discussing the vulnerability of expensive and high-sentiment stocks as they have become a more and more concentrated part of the listed equity market. On November 9, the news of a potentially successful vaccine discovery by Pfizer unlocked a major shift in market sentiment, which continued through 10th November. There were clear winners and losers from this rapid rotation.

Losers

The steepest declines occurred in the most expensive names with the strongest market sentiment (on our multi-dimensional measures of both themes). These declines also had a large impact on market indices due to company sizes. The ten largest negative contributors to the overall market return in this category were Amazon, Microsoft, Facebook, Apple, Nvidia, Paypal, Adobe, Zoom, Shopify and Netflix. These all sit in the segment of the market that is most expensive, and which shows the most positive sentiment — and they all experienced sharp reversal on the vaccine news. While the MSCI World returned around 1.5% over those two days, these companies experienced an average return of -10%.

Winners

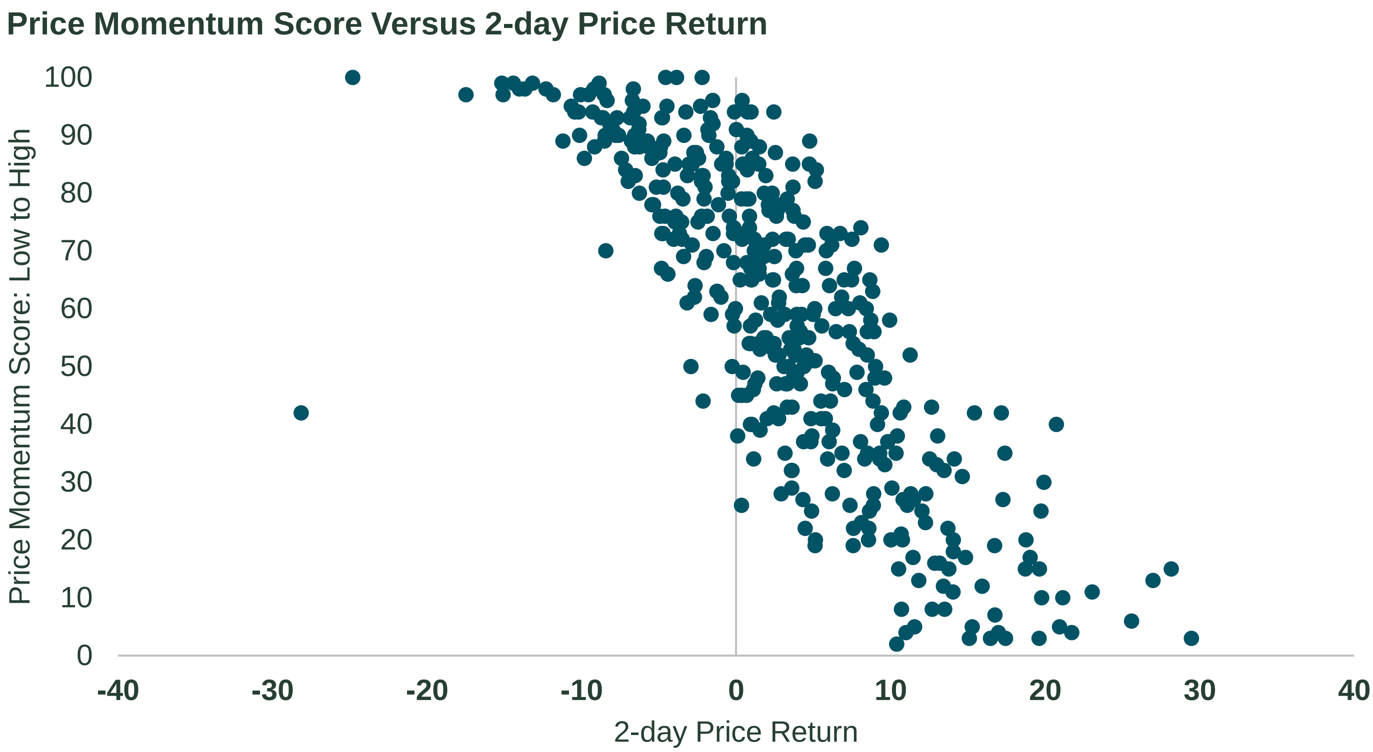
The stocks that were most heavily purchased by investors during those two days were highly risky, deep value stocks. We would characterize “deep value” as having a low price/book ratio; risk stocks are characterized by high beta and high volatility. Many of the companies in this category are Banks, Automakers, Energy stocks, and Real Estate. The most extreme quintile — low price/ book, and high risk — had a return of 16% on average over two days. Banks and Energy stocks in this segment rallied 20% on average, and Real Estate went up 27%.

Losers	Winners
Expensive, high-sentiment names that have been strong beneficiaries of a locked down/online world, plus disruptors. Examples: Amazon, Microsoft, Facebook, Apple, Nvidia, Paypal, Adobe, Zoom, Shopify, Netflix, Tesla.	Deep value, high-risk, low-momentum names. Examples: BNP Paribas, Citigroup, Truist Financial, ConocoPhillips, ING Groep, Canadian Natural Resources, Barclays, Phillips 66, Valero Energy, Banco Bilbao Vizcaya.

What Did All The Other Stocks Do?

The most relevant single dimension of stocks that reacted to the news was price momentum. Figure 1 shows a very clear negative relationship between the stock price movement of MSCI World stocks and their current price momentum score[1].

Figure 1: Price Return Versus Price Momentum for MSCI World Stocks Greater than USD25 Billion Market Cap



Source: State Street Global Advisors, Eikon as of 10 November 2020.

The Bottom Line

We believe that the best places to find opportunities are outside of the extremes of value, risk, or price momentum. We have highlighted the risks associated with the expensive, high-sentiment cohort in previous commentaries.

We believe the cheapest, highest-risk reversal stocks are unlikely to sustain their strong returns in the coming 1–2 months. This is due to the risk of increasing COVID-19 cases in large parts of the world and possible further economic shutdowns to curb the spread of the virus. A widely distributed vaccine is still on the distant horizon and there are many solvency risks still present in large parts of the economy.

We prefer to hold undervalued names with balance sheet strength — i.e., companies that have the best chance of withstanding the wait for widespread vaccine distribution without going bankrupt — and those that aren't as vulnerable to consumer weakness in the event of wider job losses or economic shutdowns.

[1] Measured as 12 month price return excluding the most recent month. Source: State Street Global Advisors.

Portfolio Attribution and Performance[2]

Global markets retreated through October, driven by fading stimulus expectations, weak US tech results and rising COVID-19 cases. Utilities, Communication Services and Financials were the only sectors that did not fall, as Energy, IT, and Health Care underperformed. From a regional perspective, European stocks fared the worst – falling sharply as COVID-19 cases surged and as multiple countries entered nationwide lockdowns.

The State Street Global Equity Fund underperformed the broader index in October. From a sector perspective, good stock picking within Discretionary and not holding any Energy names were the key contributors towards relative performance. However, this was more than offset by negative stock selection within Communication Services and Health Care. Currency hedging lost -1.2% as the AUD fell on the back of risk-off market sentiment and dovish RBA comments.

Year to date, underperformance has been concentrated in two cohorts – the very expensive (where we are underweight) and the very cheap (where we are overweight). The strategy aims to minimise total portfolio volatility and as part of achieving that objective we have avoided the most expensive, high sentiment segments of the market that harbor higher valuation risks. While COVID-19 and central bank interventions have exacerbated certain trends that favoured the most expensive, high sentiment (stay-at-home) stocks, our current positioning (in reasonably valued, higher quality stocks with positive sentiment) reflects our strong conviction that these market imbalances will inevitably revert. As such, we stand by our belief that a risk-aware strategy requires a balanced view of return drivers.

[2] Source: Factset, SSGA as at 31 October 2020. Past performance is not a reliable indicator of future performance. This information should not be considered a recommendation to buy or sell any security or sector shown. It is not known whether the securities or sectors shown will be profitable in the future. Characteristics are as of the date indicated, subject to change, and should not be relied upon as current thereafter. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

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