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Could a Biden presidency and a COVID-19 vaccine make value stocks the next market winners?

By: Edward J. Perkin, CFA | November 17, 2020

Boston - Value and growth can take many different forms, but for most of 2020 the mega cap US technology companies have led the markets. While these are all great businesses, I think their rich valuations can explained by using lower interest rates today to discount their future cash flows back to a higher present value. That's just basic valuation math.

Other parts of the market have been downright cheap. Think of banks and some cyclical stocks that come with more risk because of their exposure to the fallout from the COVID-19 pandemic. Their balance sheets may be a bit more stretched, but the relative valuation gap — with some tech stocks trading at all-time highs and value stocks trading at multi-decade lows — suggested that investors should think about taking profits in growth winners and re-investing in value dividend payers.

At the beginning of November, I could see two primary catalysts for the outperformance of value stocks: a Biden victory, and a coronavirus vaccine.

To clarify, the catalyst is the election result itself — not the inauguration or the passage of legislation. And the announcement of an effective and safe vaccine would also be sufficient to catalyze cyclical optimism — even though the economic and public health benefits could still be months away. Remember, equity markets always look forward.

We got closer to the first catalyst when Biden passed the threshold in the Electoral College tally last Saturday. What we didn't get was the blue wave that would bring more fiscal spending and higher interest rates to benefit value stocks like banks — at least, not yet. Control of the Senate — and the outlook for tax and healthcare policy — will come down to two runoff elections in Georgia on January 5, after financial advisors and clients have to make their end-of-year tax planning moves. Meanwhile, healthcare stocks may get a stay of execution from an expansion of the Affordable Care Act.

And with the big news last week of 90% efficacy in trials of a potential coronavirus vaccine developed by US and German pharmaceutical companies, there were also big moves in value stocks as we moved toward the second catalyst. Trading desks told me that they saw hedge funds dump growth stocks to buy cyclicals, particularly the banks. Even the beaten-down airlines and other travel-related stocks bounced up 30% last Monday.

Bottom line: There are several secondary catalysts — higher interest rates, a steeper yield curve, inflation, a weaker dollar, an economic upturn, falling risk aversion and so on. Arguably, each of these is a derivative of the two primary catalysts. Yet with so many variables, this is an interesting place to be a stock picker.

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