Eaton Vance Management

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Equities | Markets and Economy

Taking stock of change to focus on value opportunities

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Boston - This season always brings intermittent moments of reflection and anticipation for the coming year. Even the least contemplative among us must take a moment to consider what we have all endured over the past nine months.

History will forever mark this extraordinary period, but 2020 will not be alone in the annals of time. The continual advancement of civilization simply means that the challenges change over time. Many facets of society will return to what was considered normal relatively quickly. Other changes may endure far longer than expected.

"We could be on the cusp of a meaningful generational shift in inflation and interest rates."

Prevailing dynamics of 2020 equity returns

This optimism for the future and respect for change have inspired many of our value equity team conversations throughout the year —with the focus on building portfolios that can help to protect client capital, while aiming to provide robust risk-adjusted returns over time. As we see it, two specific changes had the greatest unexpected impacts on the complexion of equity market returns in 2020:

Rapid adoption of technology. The first and most lasting change has been the acceleration of technology adoption, ushered in by the need to work, learn and even live in a virtual world. Companies had long flirted with and slowly implemented the concepts of remote working environments, but that gradual approach has sped up dramatically as employees fully entered the world of virtual environments.

Not only did teams and businesses immediately need to interact in real time, education and entertainment also had to be fully pursued in a home environment. The acceleration of these trends and the progress achieved is nothing short of amazing. For this reason, it should surprise no one that technology and communication services industries have led the market this year.

Monetary and fiscal relief. The second most impactful change was the monetary and fiscal response to the devastating economic effects of COVID-19. To be sure, the fiscal response to assist small businesses and the unemployed likely staved off the worst effects of this economic crisis.

Yet the near-zero interest rate policy from the US Federal Reserve has crippled profitability for financial institutions and holders of long-dated liabilities. Beneficiaries of the Fed's interest rate policy and asset purchase strategy included equities with higher market valuations or long-tailed growth, as well as owners of real assets.

Achieving exit rate velocity

Taking stock of change in 2020 naturally leads us to consider what the next several years may have in store for society, the economy and, ultimately, equities. We don't need to go much further than the two dynamics we discussed above to broadly understand why we are still debating growth versus value investing. That simply reflects the need for the global economy to achieve what has been termed an ***exit rate velocity*** — economic activity has to reach a level that will allow global central banks to abandon the often dangerous and misaligned policies of zero interest rates.

For global and value investors who benefit from greater cyclical investment, the news may be quite good. Massive stimulus and the potential for improved political stability around the world could usher in more capital investment and better employment opportunities — and possibly even revive the maligned commodity sectors. In other words, we could be on the cusp of a meaningful generational shift in inflation and interest rates.

Testing intrinsic values against market views

The large cap value team at Eaton Vance has remained steadfast in our philosophy and process of allocating capital throughout 2020. We constantly test our fundamental outlooks and the long-term intrinsic values of businesses against market views, looking for the greatest discrepancies at any given moment relative to the risk assumed.

Bottom line: Throughout the past nine months, we have found the greatest opportunities in businesses and stocks where the market seems to be myopically focused on the near term, but that, in our view, may offer the greatest potential to benefit from the beginnings of this shift in inflation and interest rates.

The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the US and global markets. The value of equity securities is sensitive to stock market volatility.