

# Equity and Bond Observer

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## Review and Outlook

by Brian Bosse  
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The S&P 500 rallied to a new all-time high of 3626.91 this week. The TSX has also rallied but remains 1.2% below its start of year level and down 5.9% from its all-time high set on February 20, 2020.

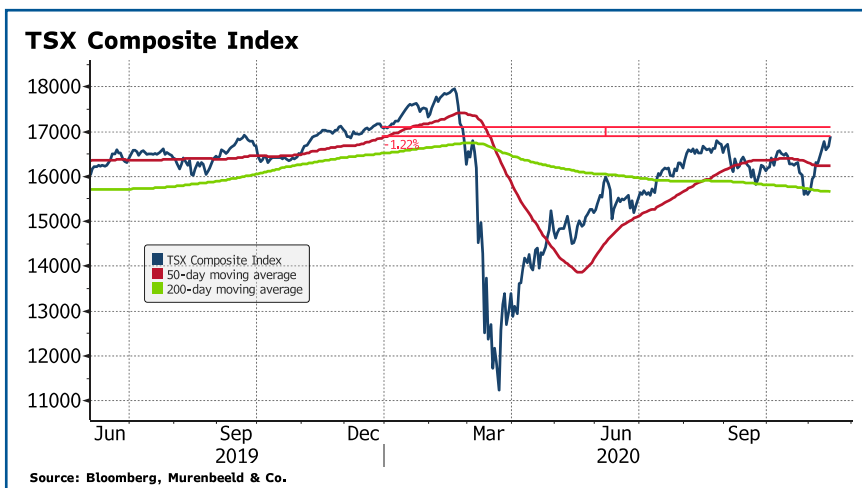
Two catalysts have led to the rally – Biden winning the election and news of significant progress on a Coronavirus vaccine. Starting with the second of the two. Both Moderna and Pfizer, have announced vaccines that promise to be more than 90% effective.

*The drugmaker Moderna announced on Monday that its coronavirus vaccine was 94.5 percent effective, joining Pfizer as a front-runner in the global race to contain a raging pandemic that has killed 1.2 million people worldwide.*

*Both companies plan to apply within weeks to the Food and Drug Administration for emergency authorization to begin vaccinating the public. Officials said the two companies could produce enough vaccine for a little more than 20 million people in the United States by sometime in December, with the first doses going to people with the highest risk, like health care workers, emergency medical workers and frail residents of nursing homes.*

*But a vaccine that would be widely available to the public is still months away, while the need for one is becoming increasingly urgent.*

*The pandemic has infected more than 53 million people around the world so far. U.S. cases are soaring, setting records every day. There have been more than 11 million cases and 246,000 deaths. Covid-19 is killing more than 1,100 Americans a day, and the last million cases occurred in just six days ([nytimes.com](https://www.nytimes.com), 11/16).*



Mentioned above was the US election result being prime catalyst for markets. The historical data reference for Biden's victory is discussed below via the historical relationship of US presidential elections to stock markets.

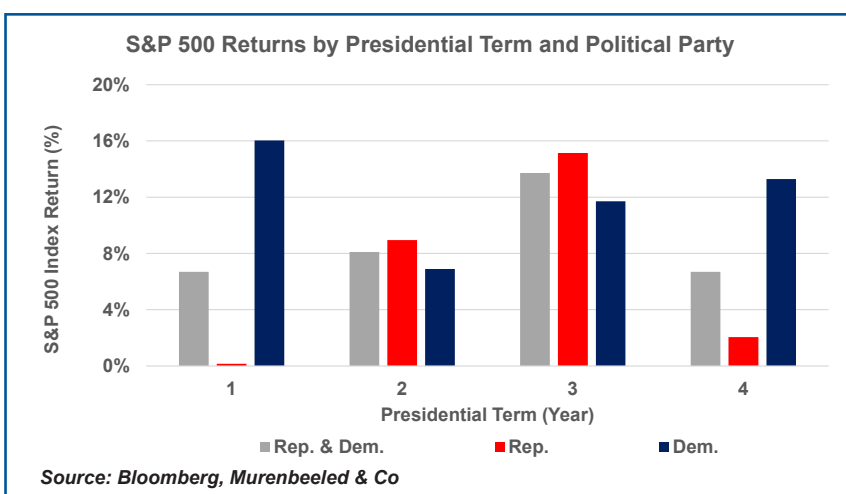
Examining data back to 1953 Eisenhower administration inauguration date we parsed stock returns by party.

The chart provides a summary of the table where the S&P 500 returns are broken down into the 4 year terms and by political party of US presidents, then the total for each 4 year term is provided.

The years are calculated from the date the president takes office. For example, Trump was first elected in November 2016, but his first year as president didn't start until January 20, 2017, which makes Trump's year 1 as president from January 20, 2017 to January 19, 2018; year 2 was from January 22, 2018 to January 22, 2019; year 3 January 23, 2019 to January 22, 2020; and year 4 started January 23, 2020 and will end January 20, 2021. The analysis counts second presidential terms the same way using years 1-4. Biden's 4 year term as president begins on January 21, 2021.

The S&P 500 has historically performed better in year 1 and year 4 under Democrat presidents, and in years 2 and 3 of Republican presidents. However, the S&P 500, on average has performed better in the third year of a presidential term cycle. These four-year cycles make intuitive sense because the best year to be tough on spending and control the budget is right after getting elected. The best years for president to spend extra money is the year before an election. As the reader can see from the table the individual returns under any one president can vary widely however.

With a new stimulus package on the horizon in the first few months of a Biden presidency and other campaign spending promises we expect equity markets to perform well in Biden's first term – even with the tempering of a Republican controlled Senate.



S&P 500 Returns by Presidential Terms (Years)						
President	Party	Year 1	Year 2	Year 3	Year 4	Total
Eisenhower 1	Rep	-1.8%	35.8%	24.5%	2.7%	70%
Eisenhower 2	Rep	-6.9%	34.9%	1.8%	4.5%	35%
Kennedy/Johnson	Dem	14.7%	-5.1%	17.1%	12.5%	44%
Johnson 2	Dem	8.2%	-8.1%	10.7%	8.1%	17%
Nixon	Rep	-11.8%	4.4%	10.8%	14.3%	17%
Nixon/Ford	Rep	-19.3%	-26.8%	36.9%	5.9%	-12%
Carter	Dem	-12.5%	11.0%	12.2%	20.5%	30%
Reagan 1	Rep	-11.9%	26.0%	14.2%	5.4%	33%
Reagan 2	Rep	18.4%	30.7%	-9.4%	18.0%	64%
Bush	Rep	18.3%	0.2%	25.7%	4.1%	52%
Clinton 1	Dem	9.4%	-1.7%	31.6%	26.6%	79%
Clinton 2	Dem	26.0%	29.4%	17.0%	-6.9%	73%
Bush 1	Rep	-16.6%	-22.1%	28.9%	3.8%	-12%
Bush 2	Rep	9.3%	13.4%	-7.9%	-39.8%	-31%
Obama 1	Dem	42.8%	12.6%	2.7%	13.5%	85%
Obama 2	Dem	23.5%	10.2%	-9.4%	18.7%	52%
Trump*	Rep	23.7%	-7.1%	25.9%	9.1%	60%
<b>Averages</b>		<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Total</b>
Total		7%	8%	14%	7%	39%
Rep		0%	9%	15%	3%	27%
Dem		16%	7%	12%	13%	54%

Source: Bloomberg, Murenbeeld & Co.  
 \*Trump's year 4 calculation is through November 16, 2020



## A GAAP in Thinking

by Brian Bosse

Over the last four years growth stocks like Tesla have attracted investors' money more quickly than cheap (value) stocks like General Motors have within the same industry. Figure 1 shows the magnitude that growth outpaced value during the current presidential cycle.

Whenever there is a large transition of investor objectives from 'make more' into 'lose less' that switch from growth stocks to value stocks it's always in response to turmoil. This type of change in objective will follow growth stocks failing versus value stocks. To get ready for that day, let us think about what value or cheap really means. Although many stock indices and textbooks label a stock as cheap or a 'value' when its price is low compared to high amounts of land, buildings, or inventory... this definition does not always hold.

This idea about value being the opposite of growth and defined via owned assets is in many textbooks but outdated. Maybe the idea was never valid at all, if for example, we consider that 'land' was a proxy representing growth in the railways' boom.

Below we discuss the performance of a stock I have considered cheap and safe since 2010, Axon Enterprise Inc (formerly called Taser International). Axon defies the textbook definition of value. This stock is also a growth stock. Note that the price-to-earnings ratio and the price-to-book ratio would not have screened as cheap by any textbook value metric. In Figure 2 the price-to-earnings ratio starts near 53 and finishes near 93, whereas price-to-book starts near 4 and never really changed through a decade of data. Readers should note the earnings used in this chart are next year analyst forecasts. Certainly the company was never cheap nor a value

Figure 1

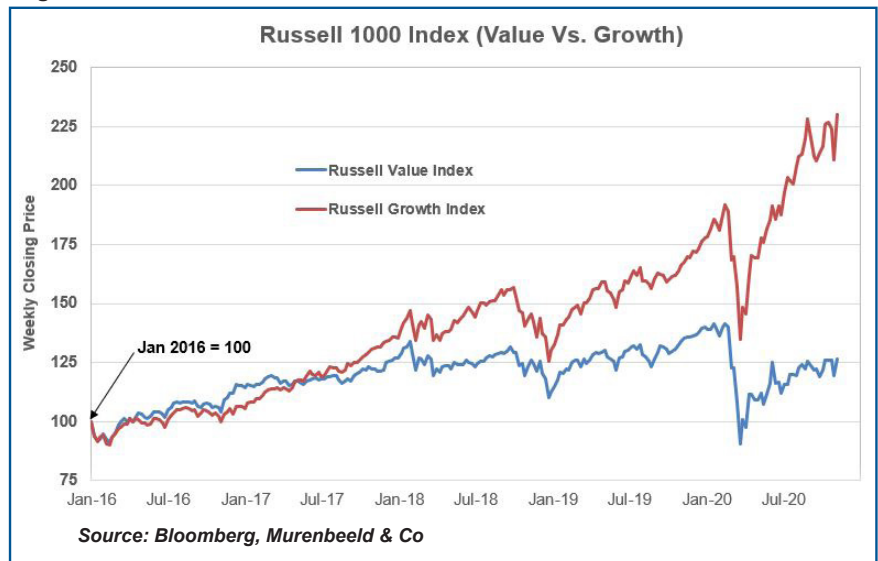
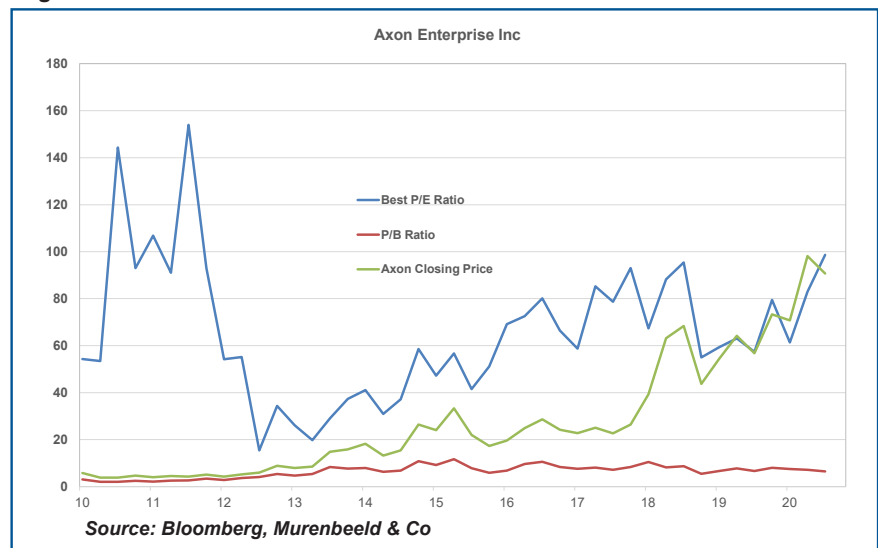


Figure 2



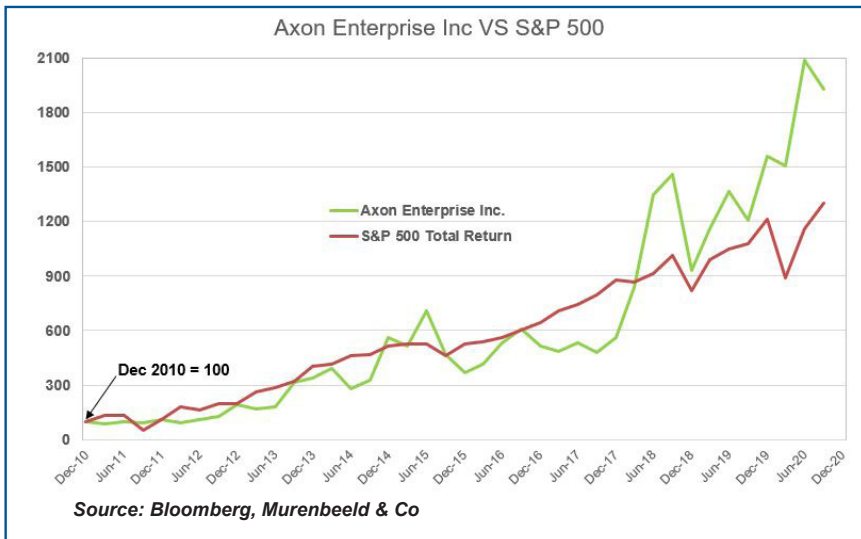
according to the textbooks. Nor was the company measured as cheap versus the S&P 500.

Yet, we can see the stock price performance handily beat the S&P 500 (Figure 3). Furthermore, the Sharpe ratio, used to measure return of investment, has been spectacular. You may reasonably ask what was ever cheap or safe about this company? What did we see that drew us to buy and hold this 10 bagger over 10 years?

The answer is that generally accepted accounting principles (GAAP) do a lousy job for





**Figure 3**

Regarding Axon Enterprise the stock charted in Figure 3 and discussed above, recurring revenue from an increasing client list also played a role. In fact, Figure 4 charts deferred revenue pulled from the balance sheet and superimposed over the stock price from a common starting value of 100 in December 2010.

Deferred revenue is a GAAP liability that measures the promises a company has made to deliver its service to customers who prepaid for a time period, which extends beyond the fiscal year-end of the company.

investors in certain industries. Some companies always look expensive because their industry came to exist after GAAP was laid down. Often the accounting methods capture liability very well but not as equally well as company assets. Therefore, the asset portion of the company is underrepresented in the balance sheet. When new industries and new companies are in the early stages of business, it is challenging to apply generally accepted accounting principles (GAAP) reporting. This challenge stems from the fact that pattern recognition by the accounting profession takes a long time to put into motion.

The cable industry, as characterized by John Malone, the American businessman, is an example of this challenge in GAAP reporting assets against liabilities. His debts, of course, were obvious and easily measured under GAAP. However, his asset of recurring revenue, the list of repeat cable-subscribing customers, was not captured clearly on the balance sheet. So, investors who only use GAAP could not see the value that John Malone drove to become a legendary billionaire. Readers interested in learning more can reference [Cable Cowboy](#) by Mark Robichaux.

This liability is an excellent marker of committed repeat customers whose gross profit margin will be unlocked by the company in the future and released onto the income statement. Therefore, if deferred revenue were increasing at the company, there would be little reason to sell. There was no reason to sell shares so long as the compound growth rate of deferred revenue liability in GAAP exceeded the Wall Street EPS compound annual growth rate forecast. We stayed long the stock in our fund as long as this situation remained.

**Figure 4**



Axon Enterprises demonstrates that safe is about owning a business whose earnings yield exceeds the risk-free rate, plus that yield can grow quickly for many years compared to expectations. Standard metrics of growth and value and cheap don't really drive market pricing conversations as much as many investors believe. But, if value is a term used to mean low price-to-balance sheet assets what changed, why isn't value safe anymore?

Well, maybe that change is an illusion. Just maybe land, railway rolling stock, and factories were the growth markers of their day when GAAP accounting rules were set. Maybe today, we have forgotten that connotation and think of those things only as sluggish assets, which cannot generate growth. If so, that explains why the price-to-book ratio is widely cited, but we simply have forgotten its original intent. This is like an old language going extinct.

Software is the new rolling stock. Patents are the new land. Deferred revenue is the new physical plant. Each, in turn, is that thing which is a precondition to get to gross margin from a paying customer; yet none of the software, patents, or deferred revenue that a company builds by itself are called an asset by GAAP.

In future essays, we can discuss how minuscule interest rates made software, deferred revenue, and patents more valuable than land, physical plant, and rolling stock. Until then, ponder this – if rates are low, then new entrants into certain industries like steel are always ready to eat an incumbent's profit margin. However, no amount of cheap financing can overcome the barrier to entry a patent provides against competitors.



## Canadian Government Bonds

### Canada Government 10-year Bond

Percent



Source: Bloomberg, Murenbeeld & Co.

*Canadian government 10-year bond yields have edged higher in recent weeks on news of a Covid-19 vaccine. However, rates are likely to stay low for at least the next two years while the vaccine is approved and rolled out. Our view is that if 10-year yields start moving higher that the BoC is likely to engage in yield curve control (capping rates).*

### Canada Yield Curve

Canadian 10-year government bond yield minus 3-month government T-bill yield



Source: Bloomberg, Murenbeeld & Co.

## US Government Bonds

### US 10-year Government Bond Yield



*US 10-year yields have also edged higher in recent weeks. The Fed did not make any changes to policy at its November 5 meeting, the next scheduled meeting is December 16.*

### US Yield Curve

US 10-year government bond yield minus US 3-month government T-bill yield





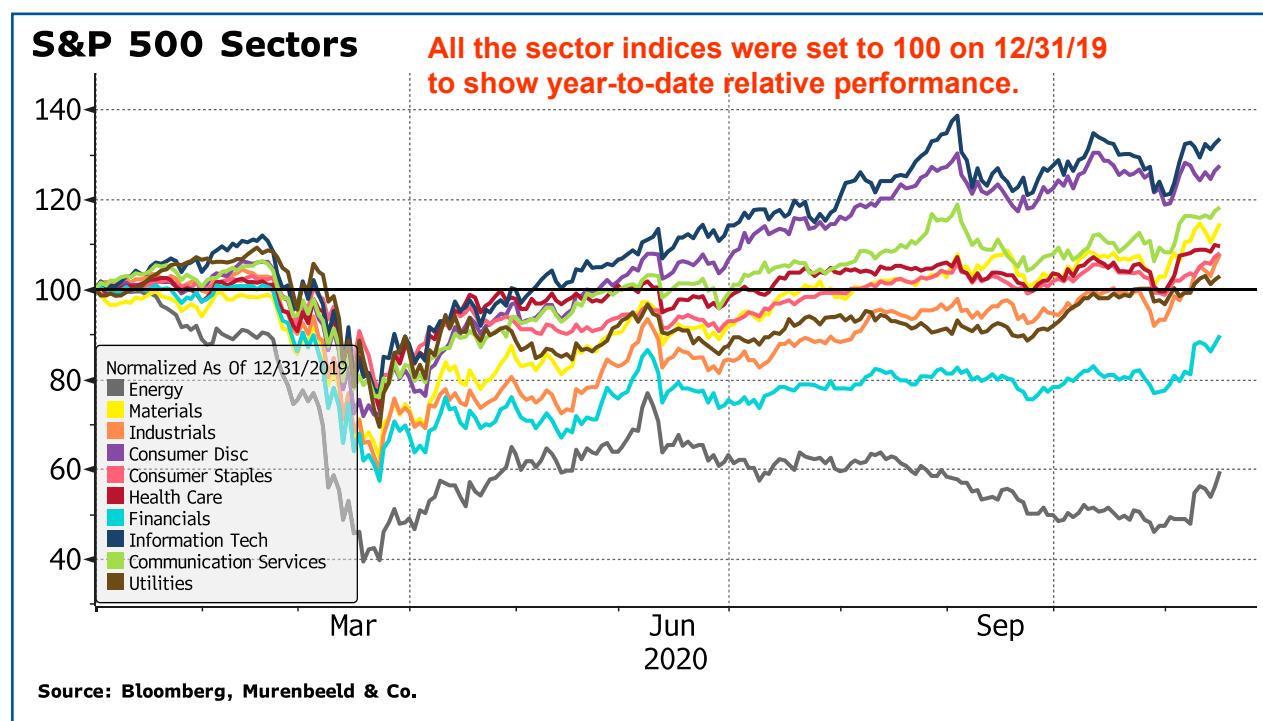
## S&P 500 GICS Sectors

(percent change)

	Value on 11/16/20	Year to Date	1-Month	3-Month	6-Month	1-Year	5-Year
<b>S&amp;P 500</b>	3626.91	12.26	4.11	7.24	26.65	16.23	76.88
<b>Energy</b>	271.09	-40.61	18.49	-4.94	-0.45	-38.45	-45.07
<b>Materials</b>	441.89	14.52	6.11	11.75	38.03	16.80	56.83
<b>Industrials</b>	741.35	7.82	7.51	13.85	47.76	7.08	57.68
<b>Cons Disc</b>	1257.53	27.50	-0.02	4.80	33.45	32.13	101.17
<b>Cons Stap</b>	698.69	7.99	2.59	5.78	19.12	11.03	40.25
<b>Health Care</b>	1302.87	9.65	3.60	4.19	11.58	15.63	59.61
<b>Financials</b>	458.56	-10.33	10.44	11.58	31.54	-7.03	41.23
<b>Info Tech</b>	2150.03	33.45	0.92	6.70	31.05	40.58	197.47
<b>Telecom</b>	214.49	18.08	7.05	8.83	24.59	20.75	46.77
<b>Utilities</b>	338.09	2.96	3.94	10.78	21.90	6.37	57.65

Data as of November 16, 2020

Source: Bloomberg, Murenbeeld & Co.



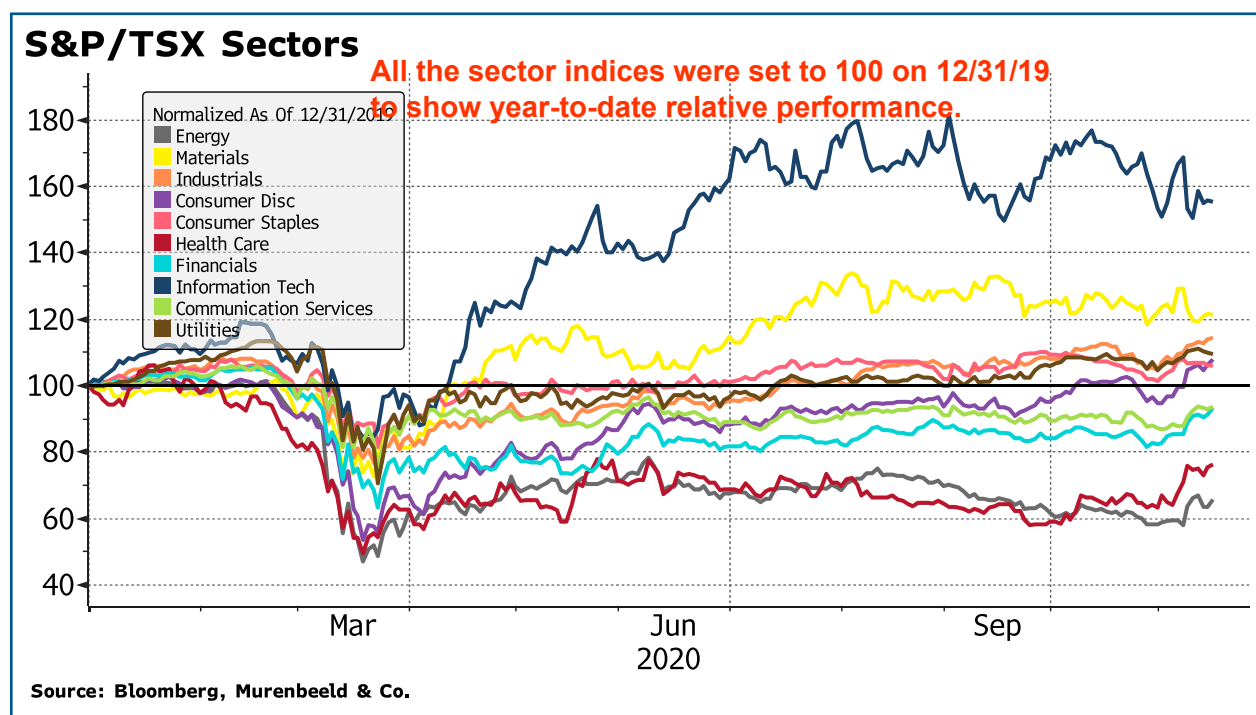
The Information Technology and Consumer Discretionary sectors have led the S&P 500 year to date – the Information Technology sector is up 33.5% and the Consumer Discretionary sector is up 27.5%.

## S&P/TSX GICS Sectors (percent change)

	Value on 11/16/20	Year to Date	1-Month	3-Month	6-Month	1-Year	5-Year
<b>S&amp;P/TSX</b>	16889.81	-1.02	2.74	1.40	15.38	-0.81	27.18
<b>Energy</b>	1411.81	-34.37	5.94	-10.37	-5.29	-31.99	-34.91
<b>Materials</b>	2986.21	21.17	-3.40	-7.76	3.66	26.96	99.01
<b>Industrials</b>	4077.01	14.30	1.50	7.81	29.35	13.17	89.18
<b>Cons Disc</b>	2371.41	7.77	6.66	13.60	37.90	5.57	26.60
<b>Cons Stap</b>	5676.30	5.93	-1.23	-1.15	8.50	4.27	37.12
<b>Health Care</b>	271.47	-24.03	19.05	14.23	19.02	-20.33	-77.09
<b>Financials</b>	2694.33	-6.84	9.03	8.09	27.29	-9.40	21.02
<b>Info Tech</b>	767.82	55.26	-9.87	-6.67	9.47	67.72	264.08
<b>Telecom</b>	1459.60	-6.59	3.26	1.53	6.11	-9.02	7.77
<b>Utilities</b>	2697.97	9.27	0.00	8.22	17.20	9.49	48.38

Data as of November 16, 2020

Source: Bloomberg, Murenbeeld & Co.



The Information Technology and Materials (Gold Companies) sectors have lead the TSX year-to-date. The Information Technology sector on the TSX has increased 55.3% and Materials 21.2%.

<b>S&amp;P 500 Models Summary Table</b>			
	<b>Undervalued</b>	<b>Fair-valued</b>	<b>Overvalued</b>
<b>S&amp;P 500 Index</b>	X		
<b>Energy</b>		X	
<b>Materials</b>	X		
<b>Industrials</b>	X		
<b>Cons Disc</b>		X	
<b>Cons Stap</b>	X		
<b>Health Care</b>		X	
<b>Financials</b>		X	
<b>Info Tech</b>		X	
<b>Telecom</b>		X	
<b>Utilities</b>	X		

<b>S&amp;P/TSX Models Summary Table</b>			
	<b>Undervalued</b>	<b>Fair-valued</b>	<b>Overvalued</b>
<b>S&amp;P/TSX Index</b>	X		
<b>Energy</b>	X		
<b>Materials</b>	X		
<b>Industrials</b>	X		
<b>Cons Disc</b>	X		
<b>Cons Stap</b>	X		
<b>Health Care</b>		X	
<b>Financials</b>		X	
<b>Info Tech</b>			X
<b>Telecom</b>	X		
<b>Utilities</b>	X		

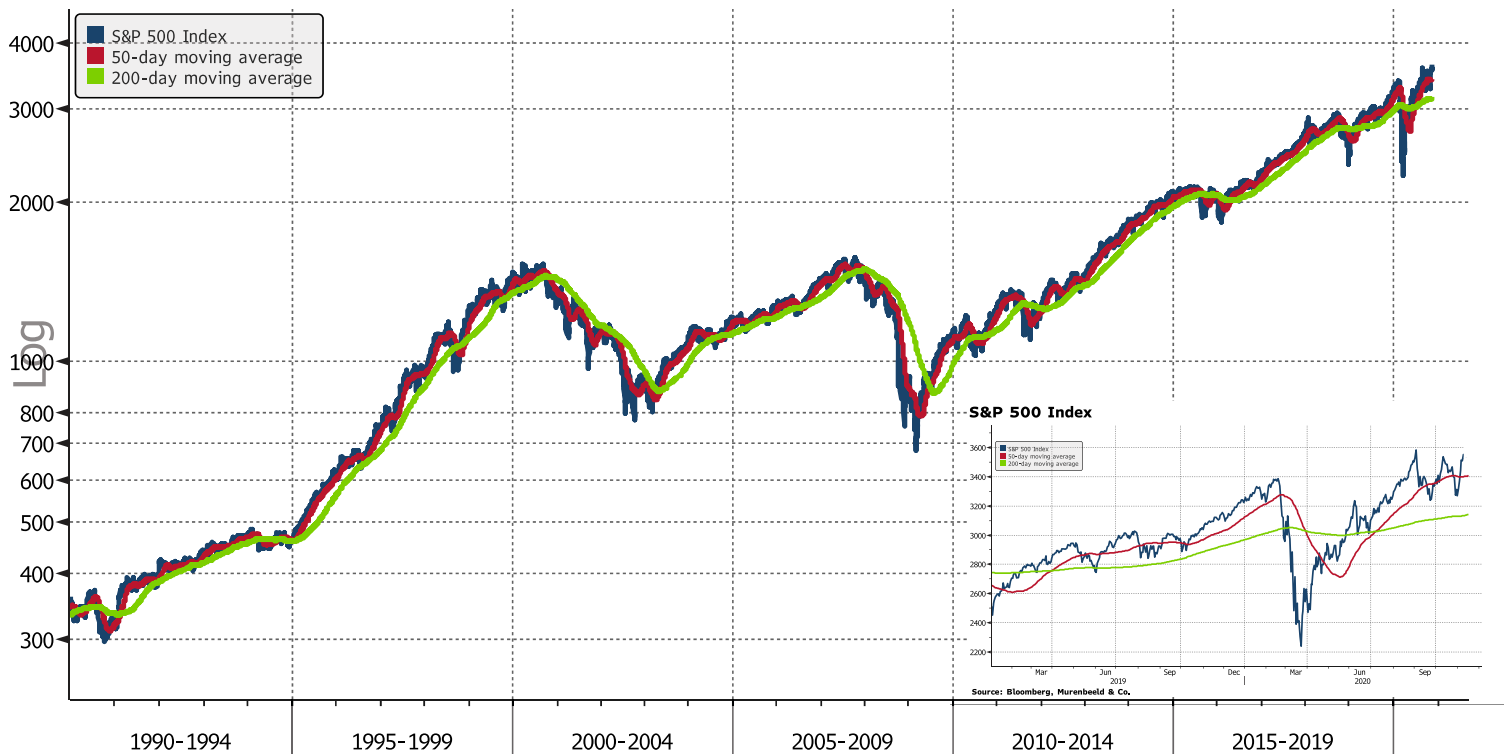
*Half of the S&P 500 sectors – Materials, Industrials, Consumer Staples, and Utilities remain in the undervalued range. The Information Technology, Financials and Health Care sectors are the standouts on the TSX.*





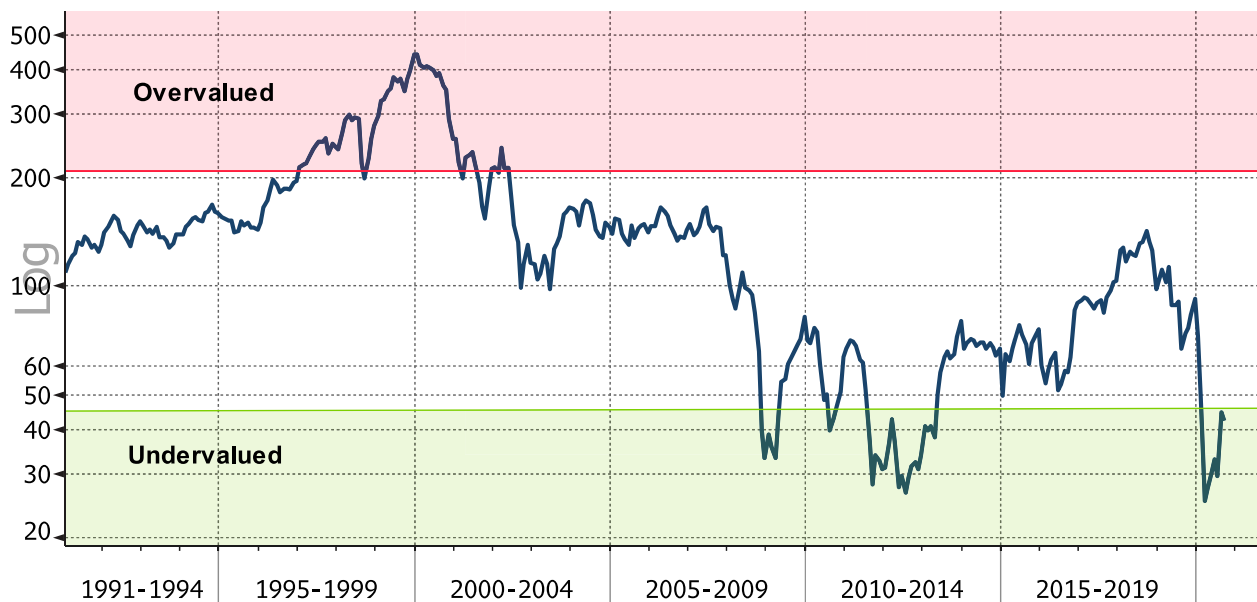
## S&P 500

### S&P 500 Index



Source: Bloomberg, Murenbeeld & Co.

### S&P 500 Index Model

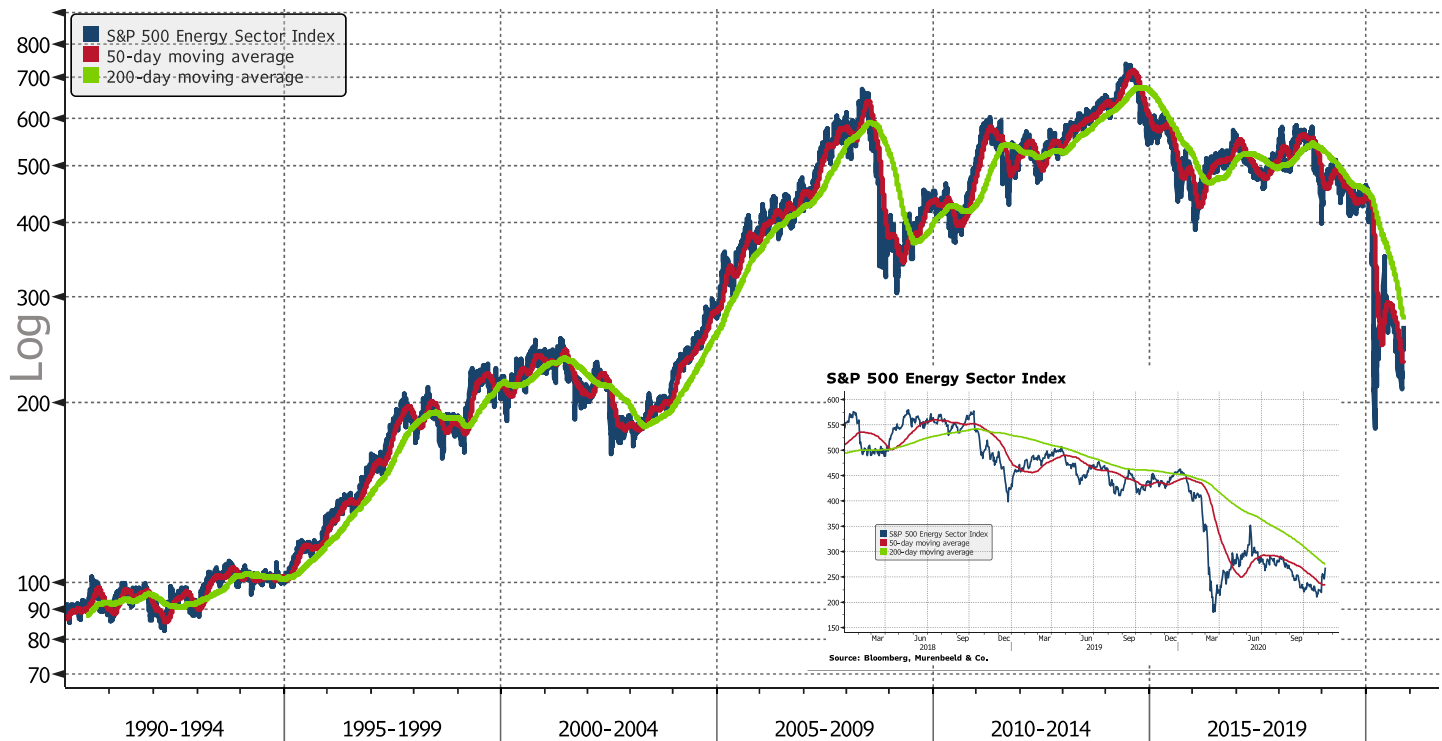


Source: Bloomberg, Murenbeeld & Co.



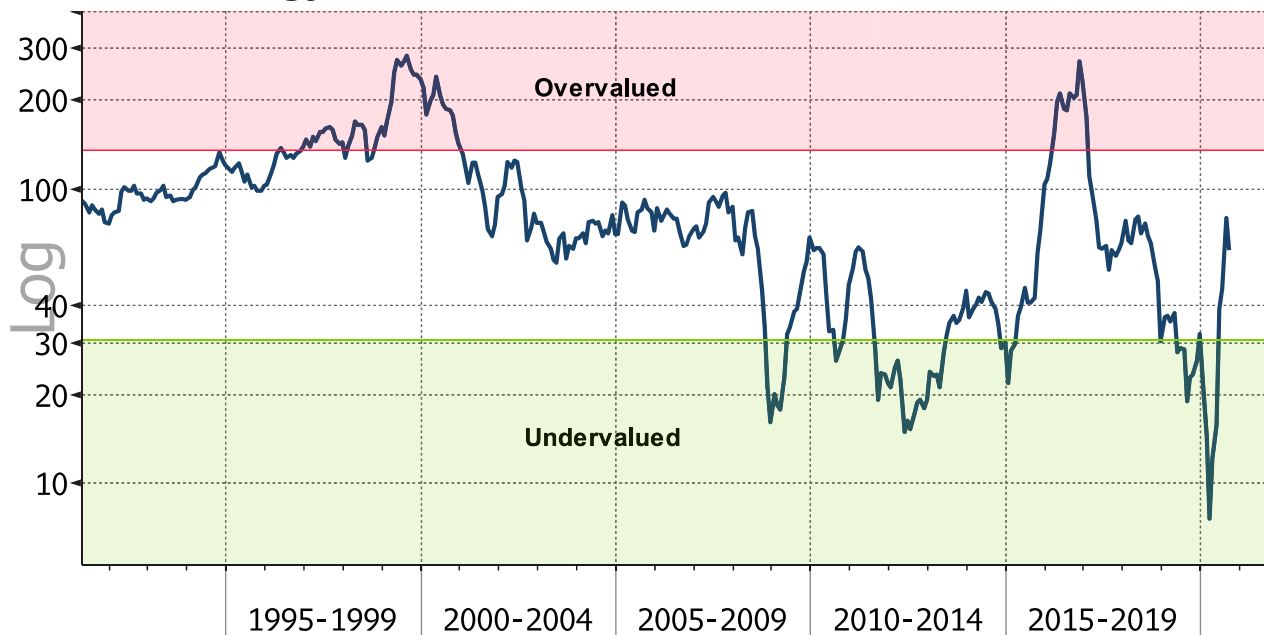
## S&P 500

### S&P 500 Energy Sector Index



Source: Bloomberg, Murenbeeld & Co.

### S&P 500 Energy Sector Model



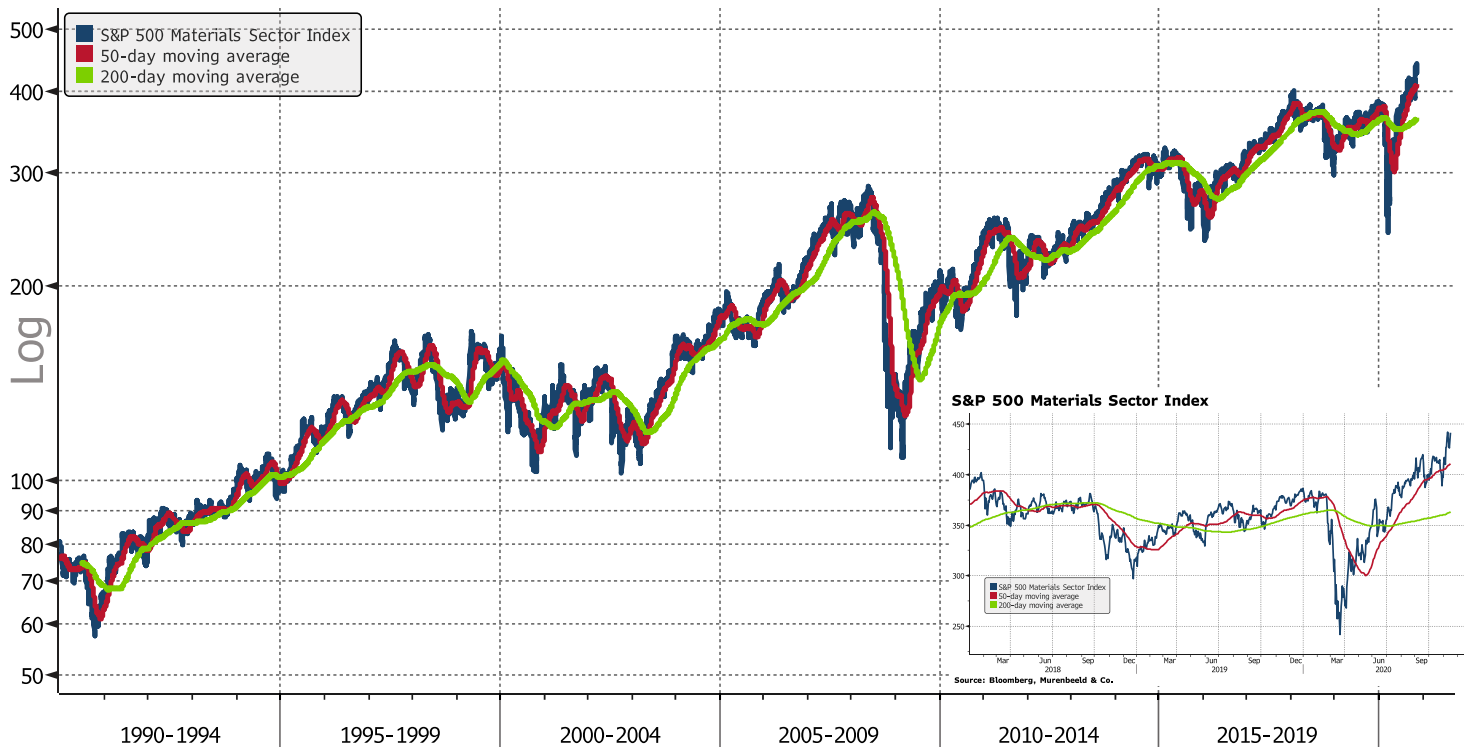
Source: Bloomberg, Murenbeeld & Co.

Due to a spike in the EV/EBITA for the S&P 500 Energy sector, the data was "capped" in the model for mid-2016.

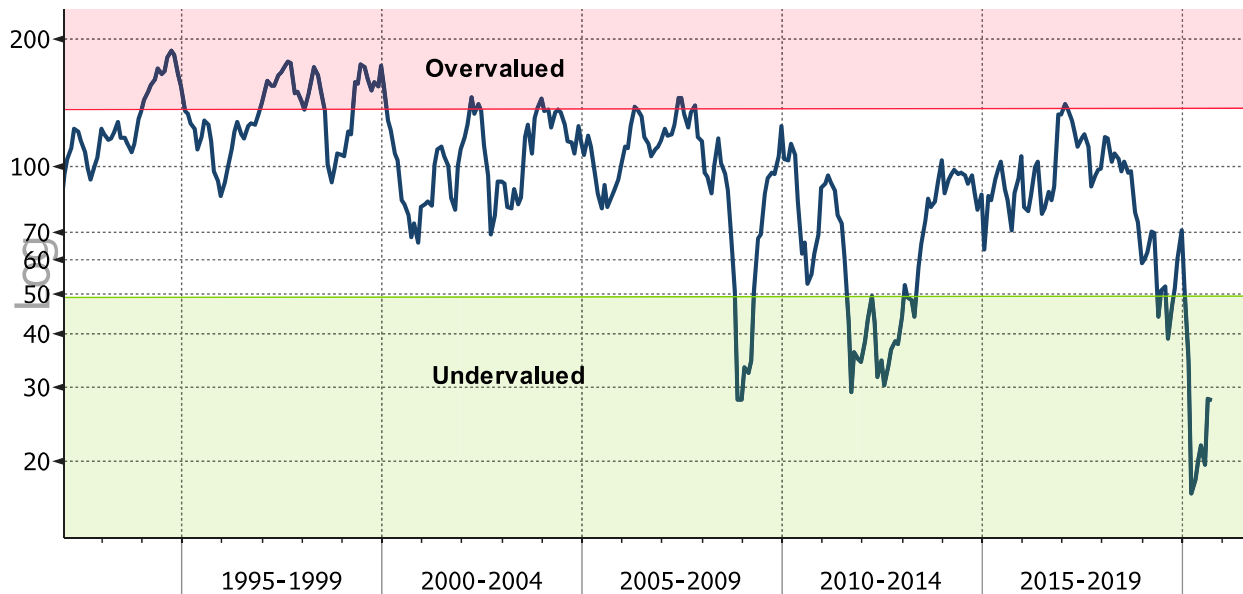


## S&P 500

### S&P 500 Materials Sector Index



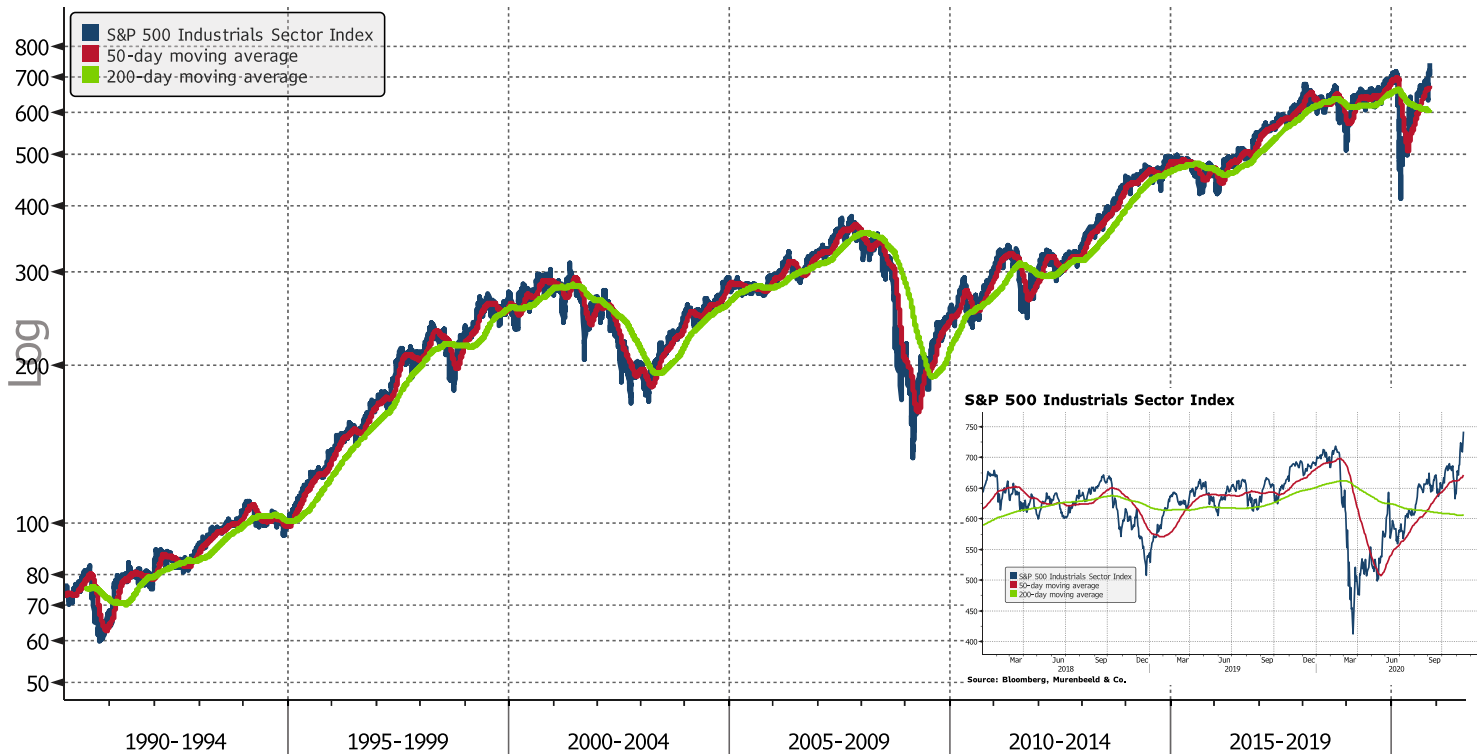
### S&P 500 Materials Sector Model



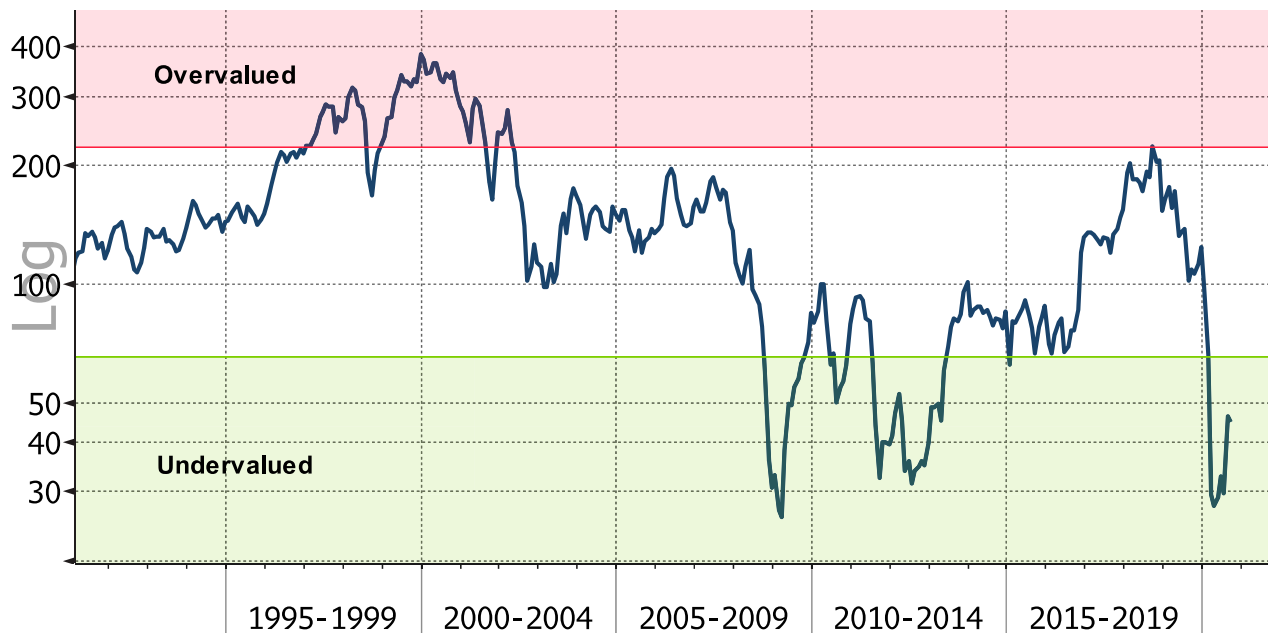


## S&P 500

### S&P 500 Industrials Sector Index

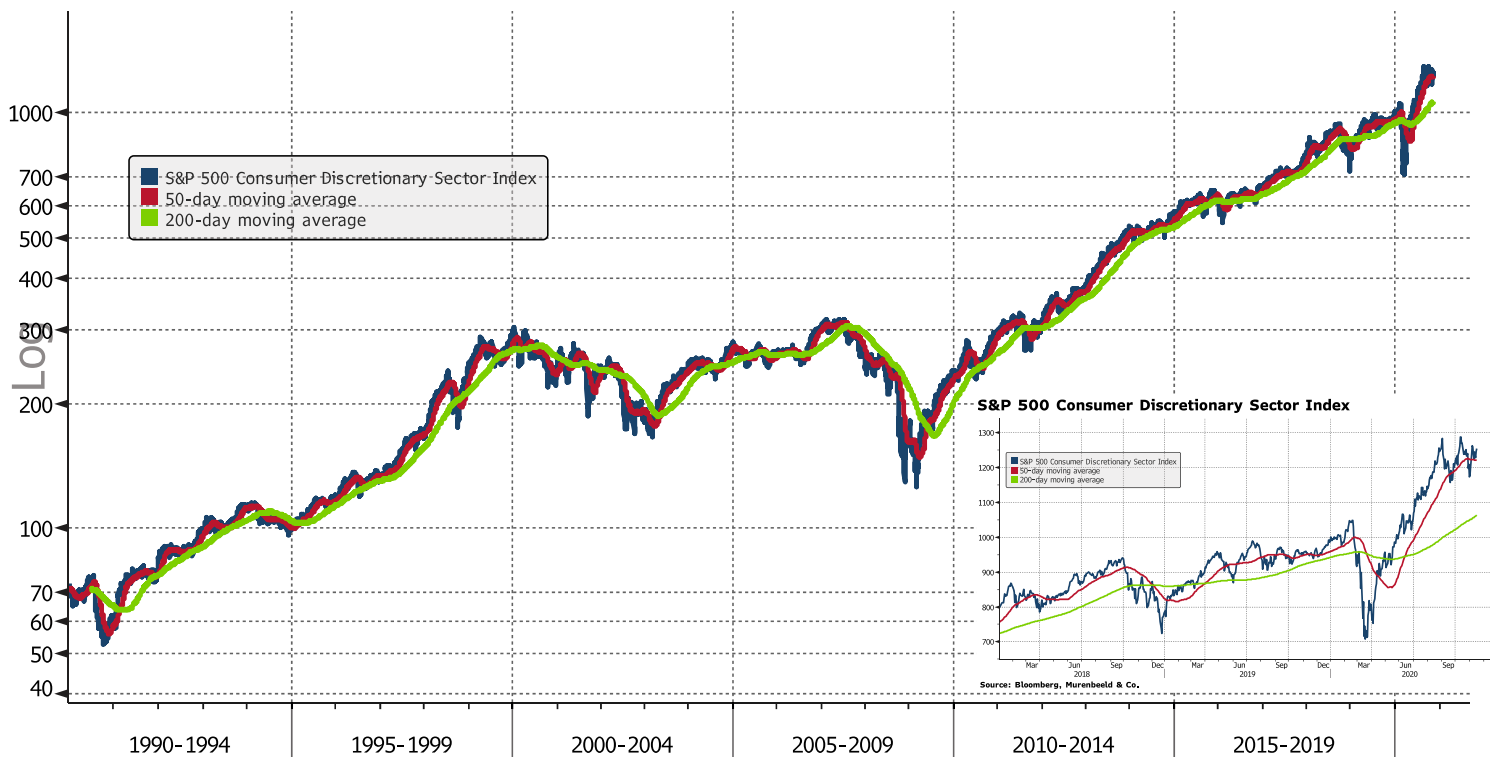


### S&P 500 Industrials Sector Model



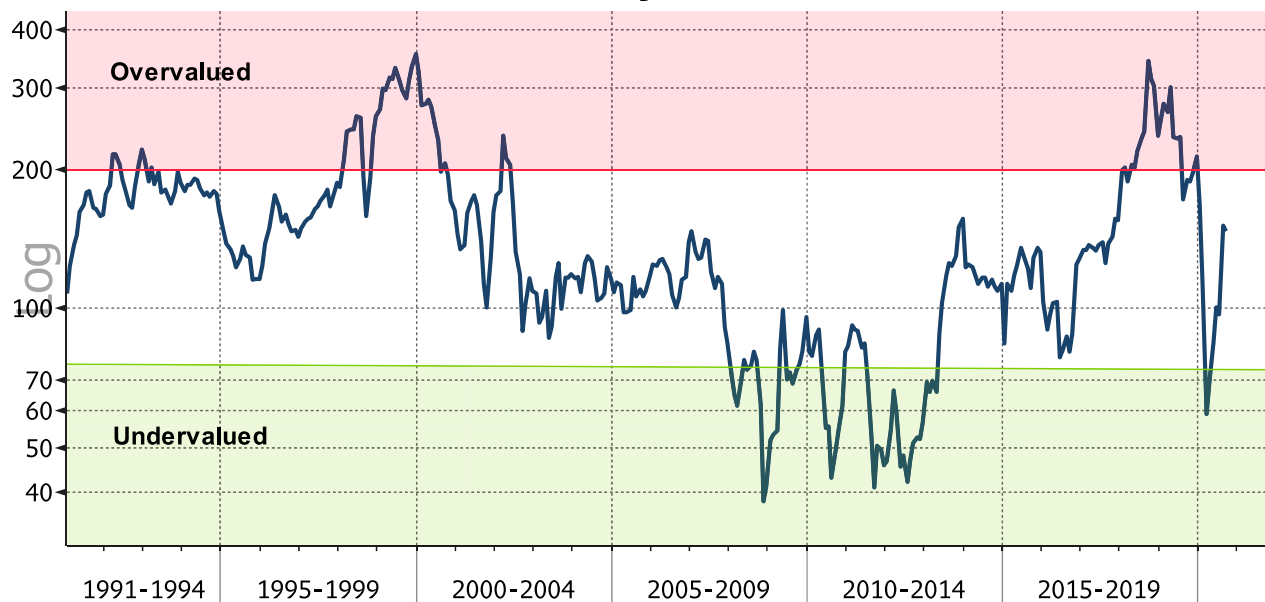
## S&P 500

### S&P 500 Consumer Discretionary Sector Index



Source: Bloomberg, Murenbeeld & Co.

### S&P 500 Consumer Discretionary Sector Model

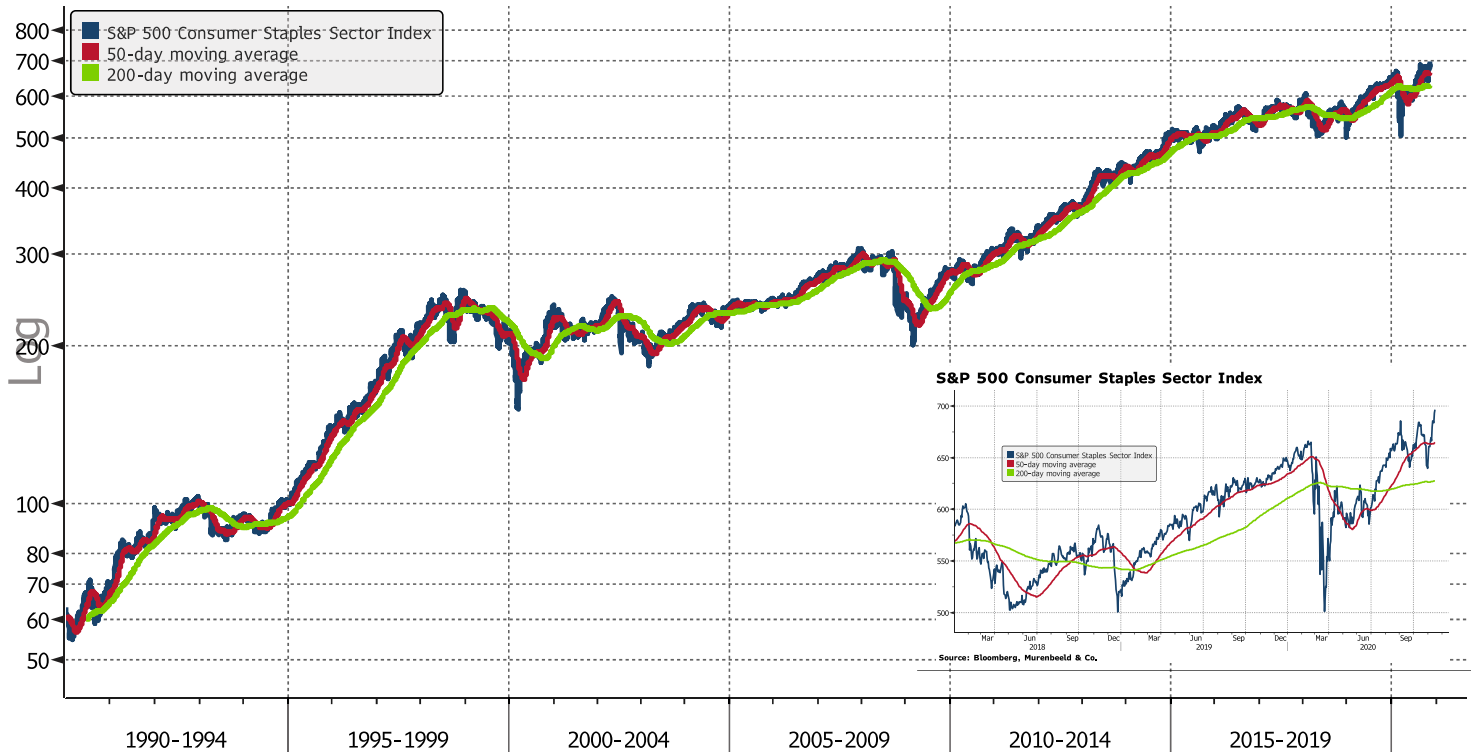


Source: Bloomberg, Murenbeeld & Co.



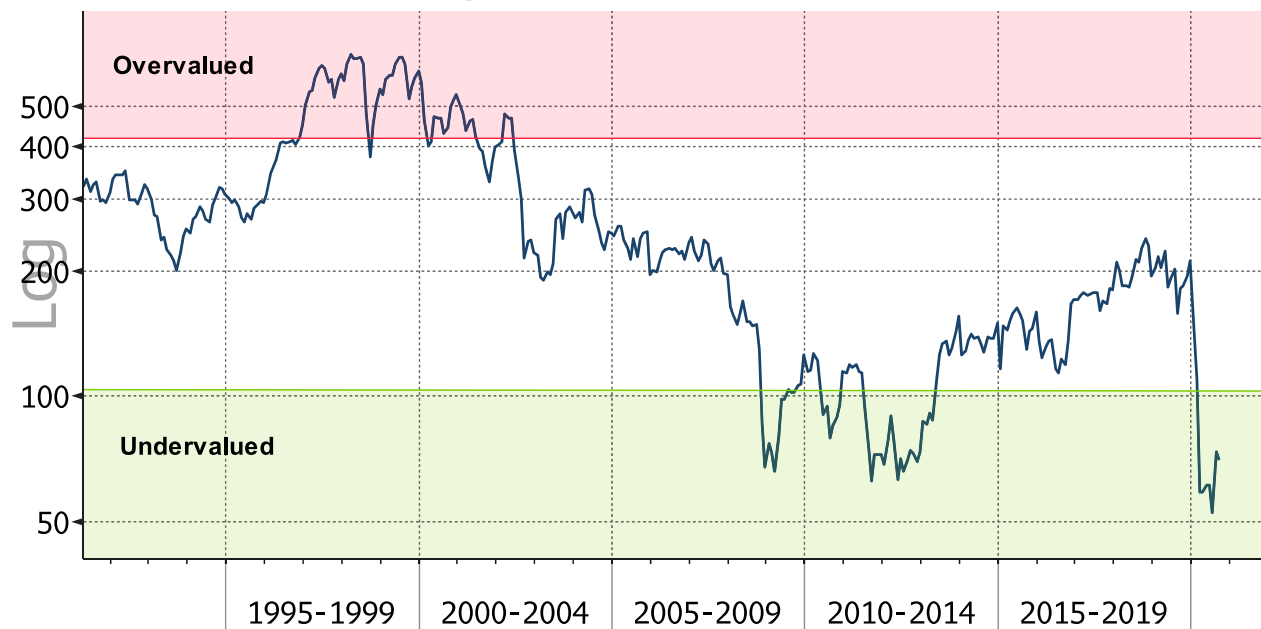
## S&P 500

### S&P 500 Consumer Staples Sector Index



Source: Bloomberg, Murenbeeld & Co.

### S&P 500 Consumer Staples Sector Model



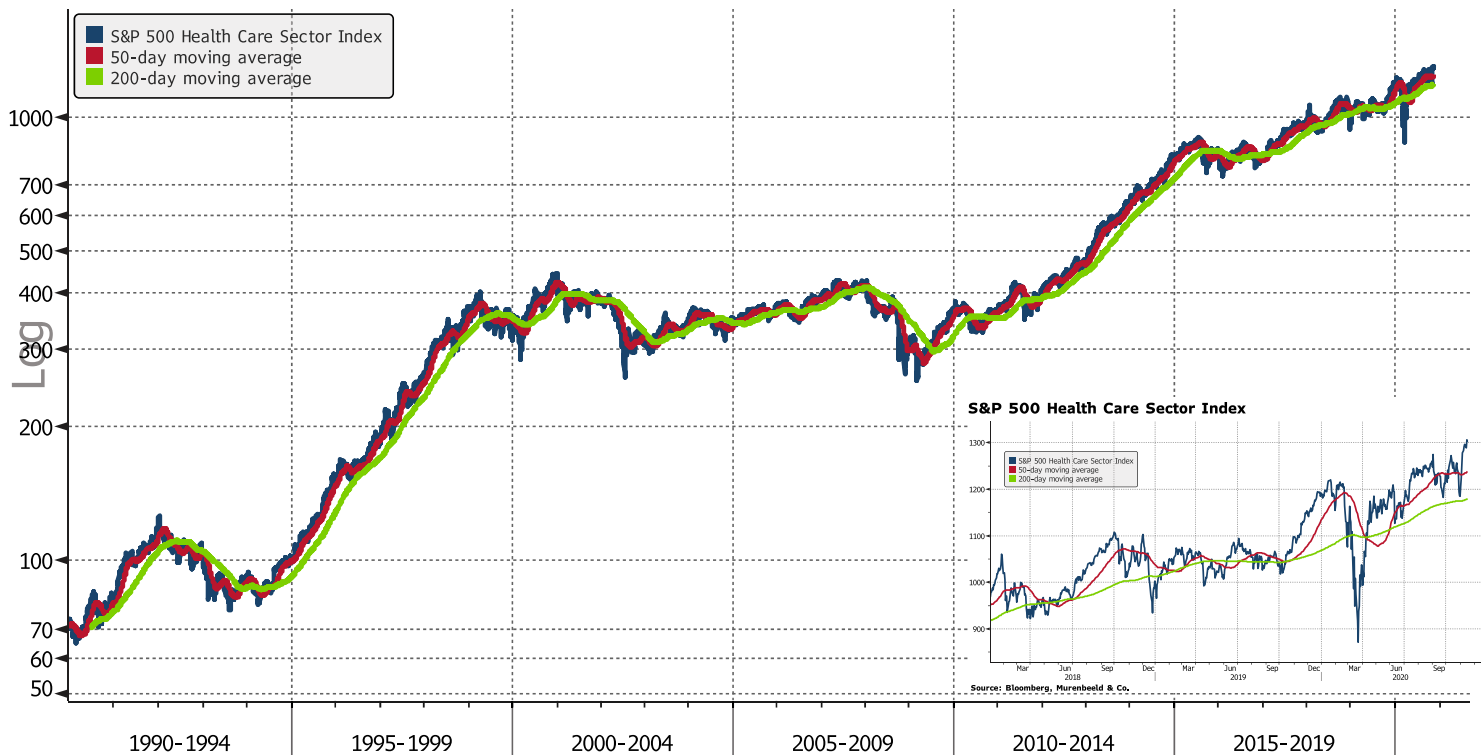
Source: Bloomberg, Murenbeeld & Co.



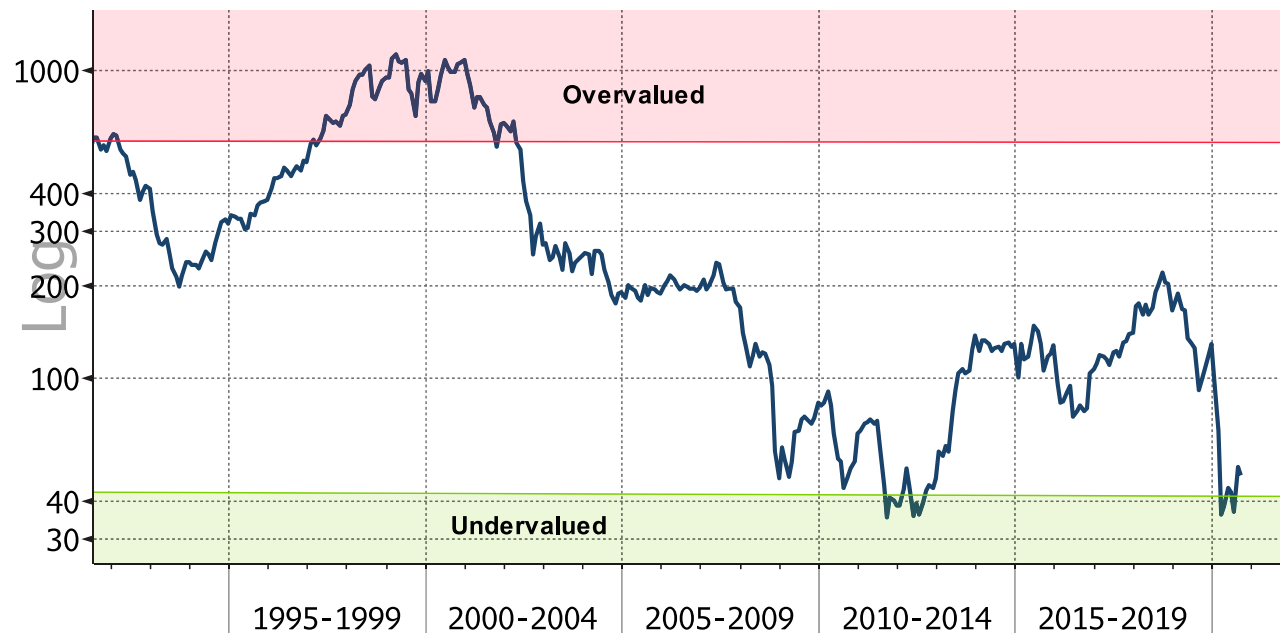


## S&P 500

### S&P 500 Health Care Sector Index

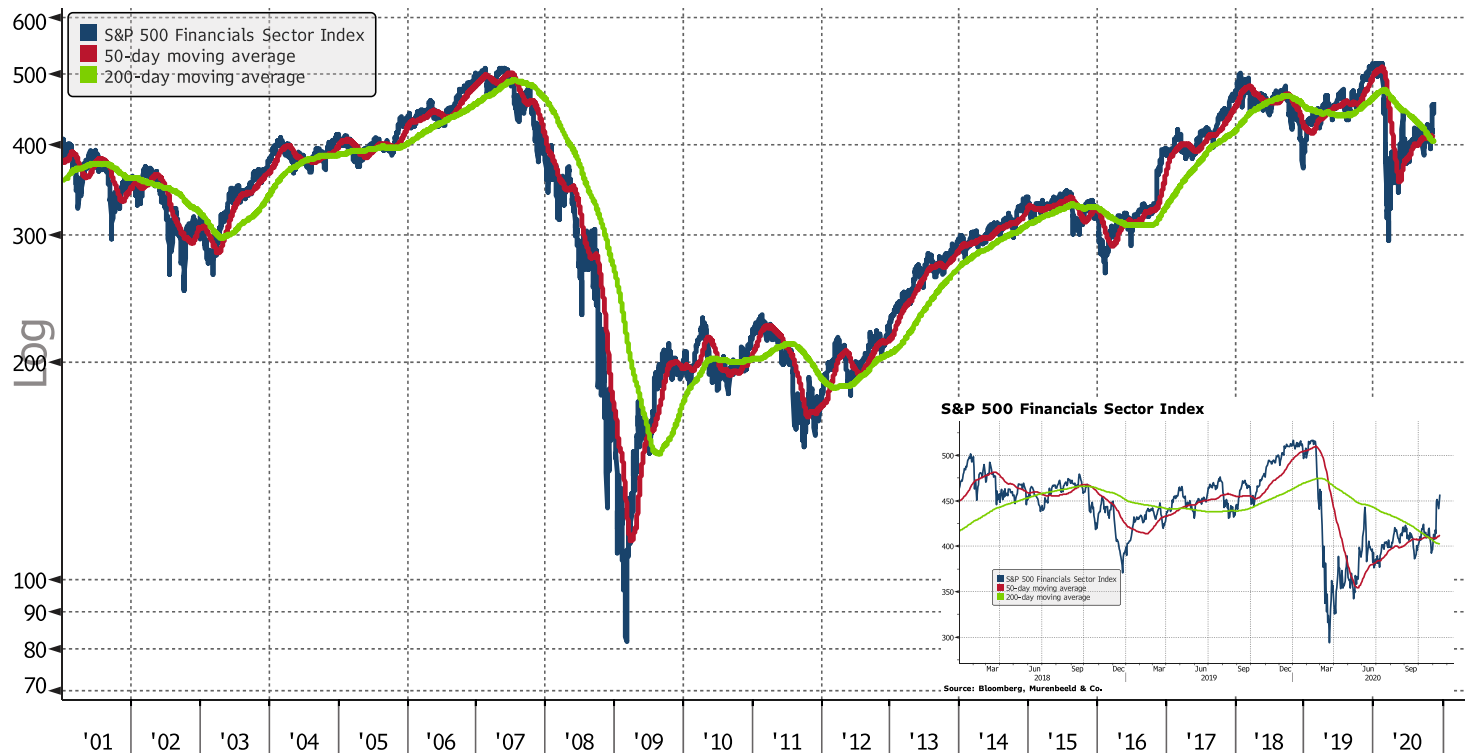


### S&P 500 Health Care Sector Model



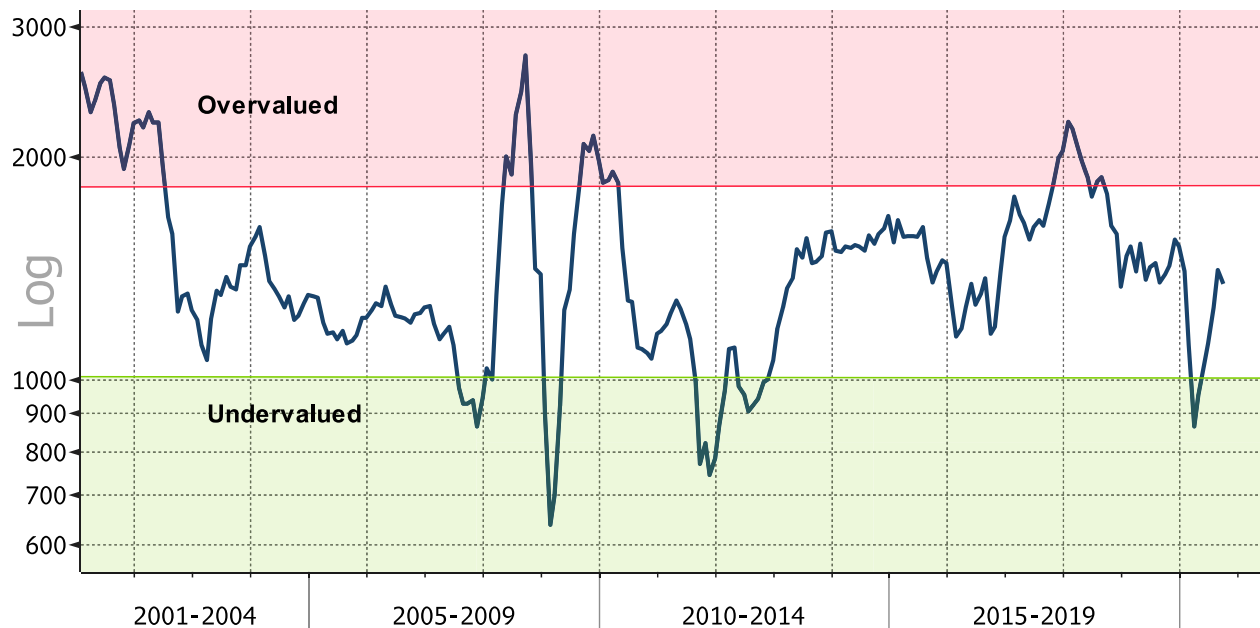
## S&P 500

### S&P 500 Financials Sector Index



Source: Bloomberg, Murenbeeld & Co.

### S&P 500 Financials Sector Model



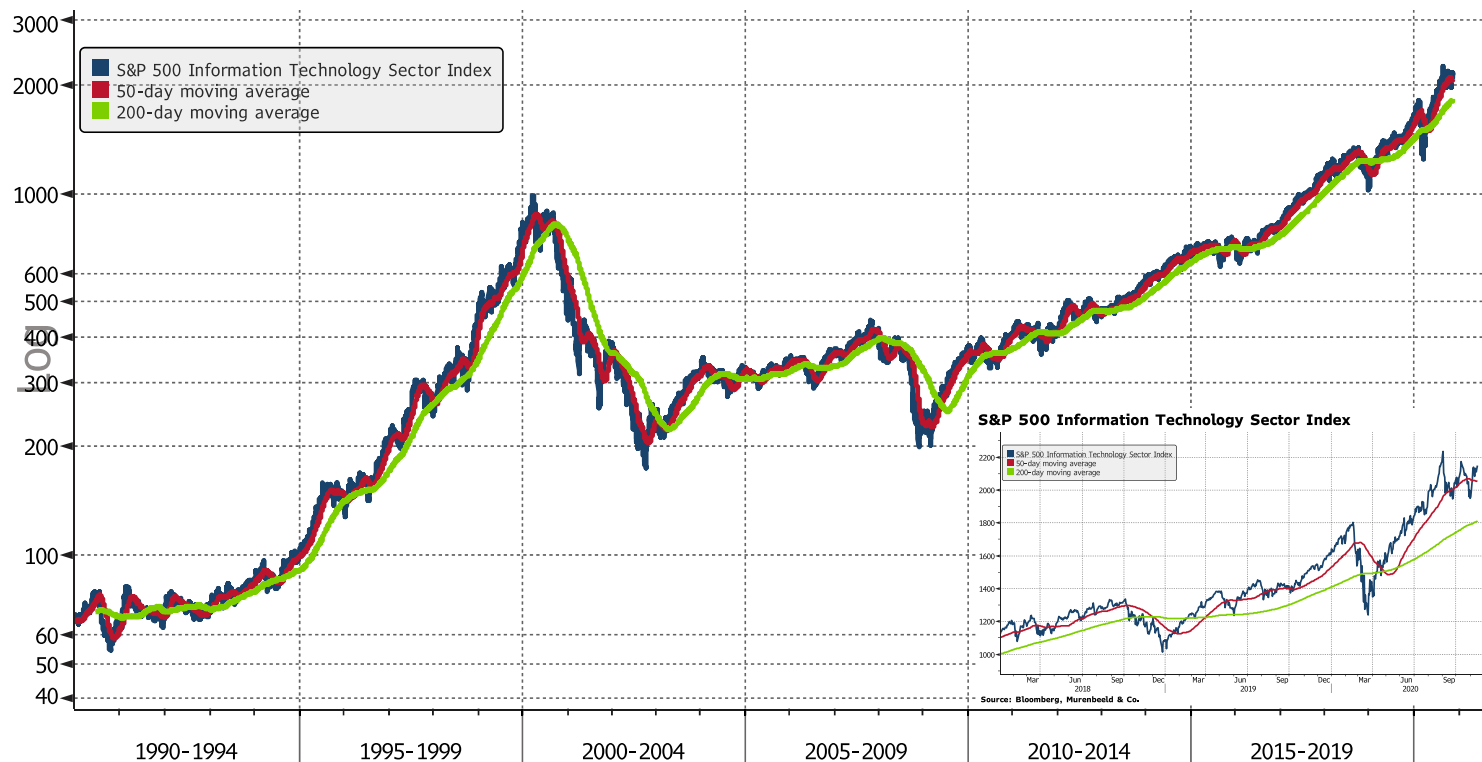
Source: Bloomberg, Murenbeeld & Co.

Due to wild swings in the EBIT for the S&P 500 financials sector, the variable was "capped" in the model for the end of 2008 and beginning of 2009.



## S&P 500

### S&P 500 Information Technology Sector Index



Source: Bloomberg, Murenbeeld & Co.

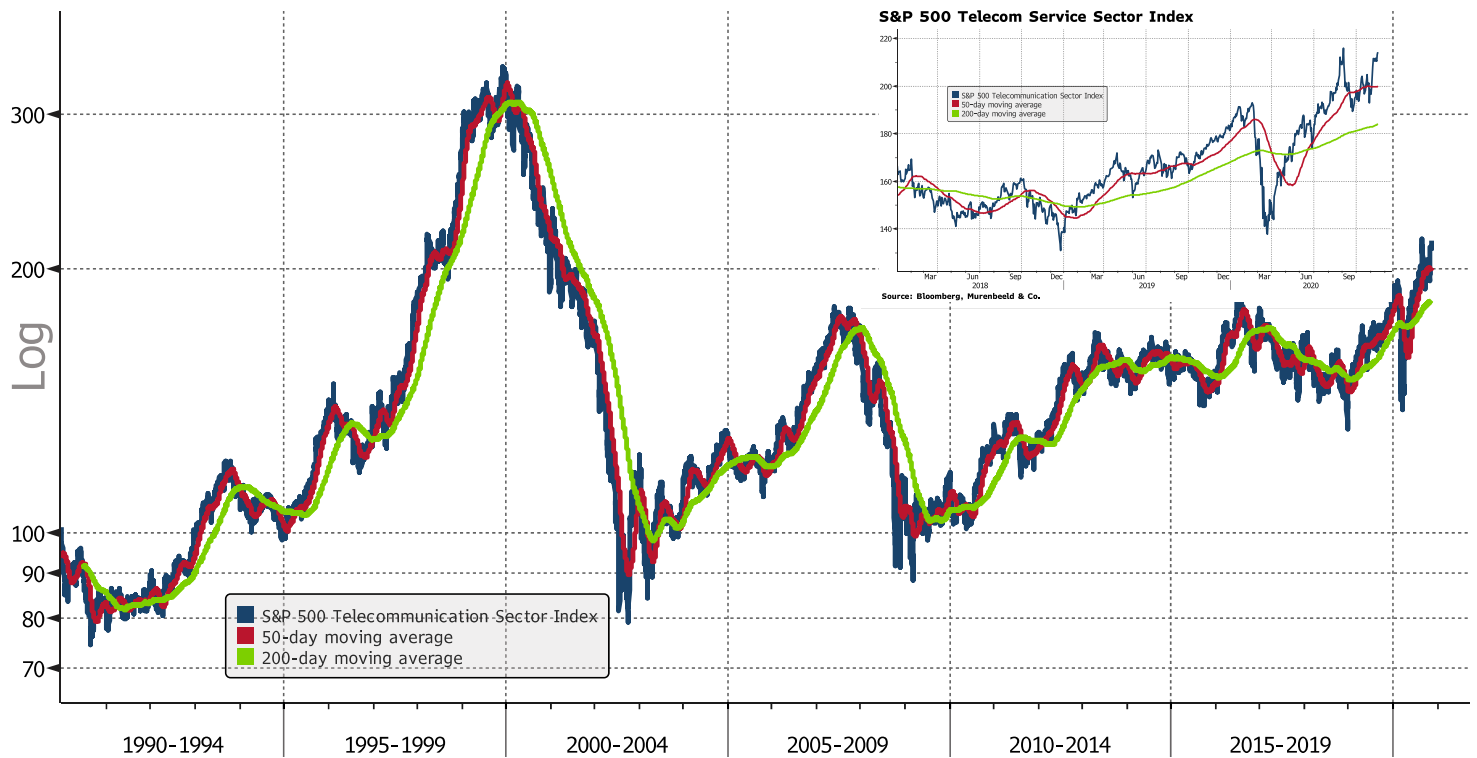
### S&P 500 Information Technology Sector Model



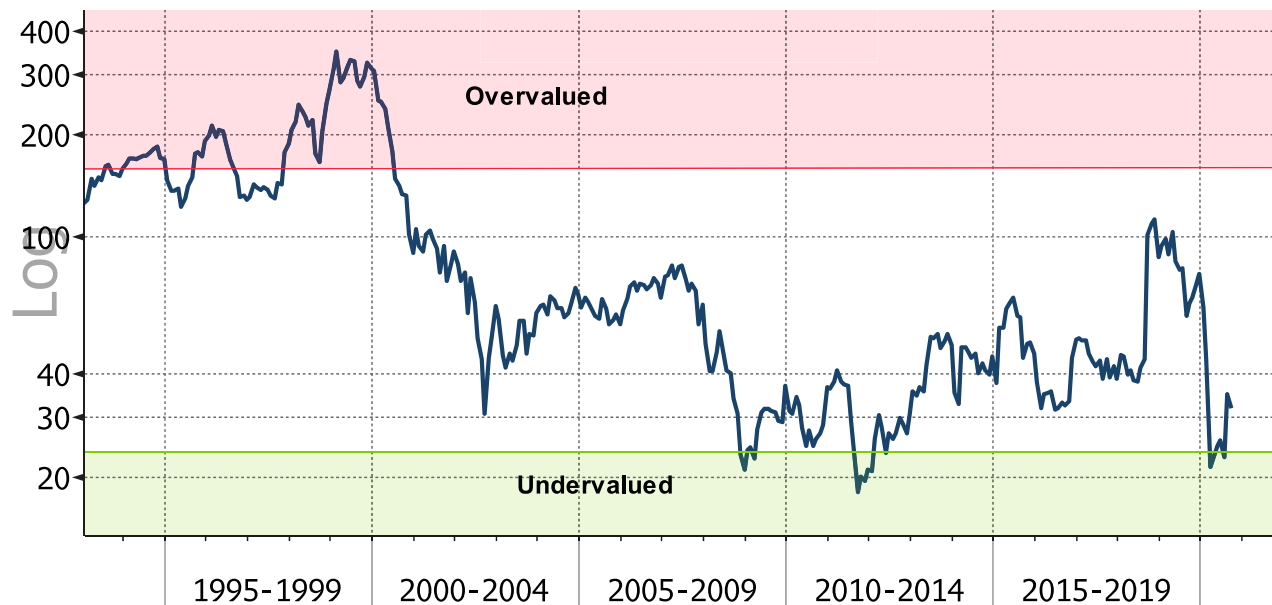
Source: Bloomberg, Murenbeeld & Co.

## S&P 500

### S&P 500 Telecom Service Sector Index

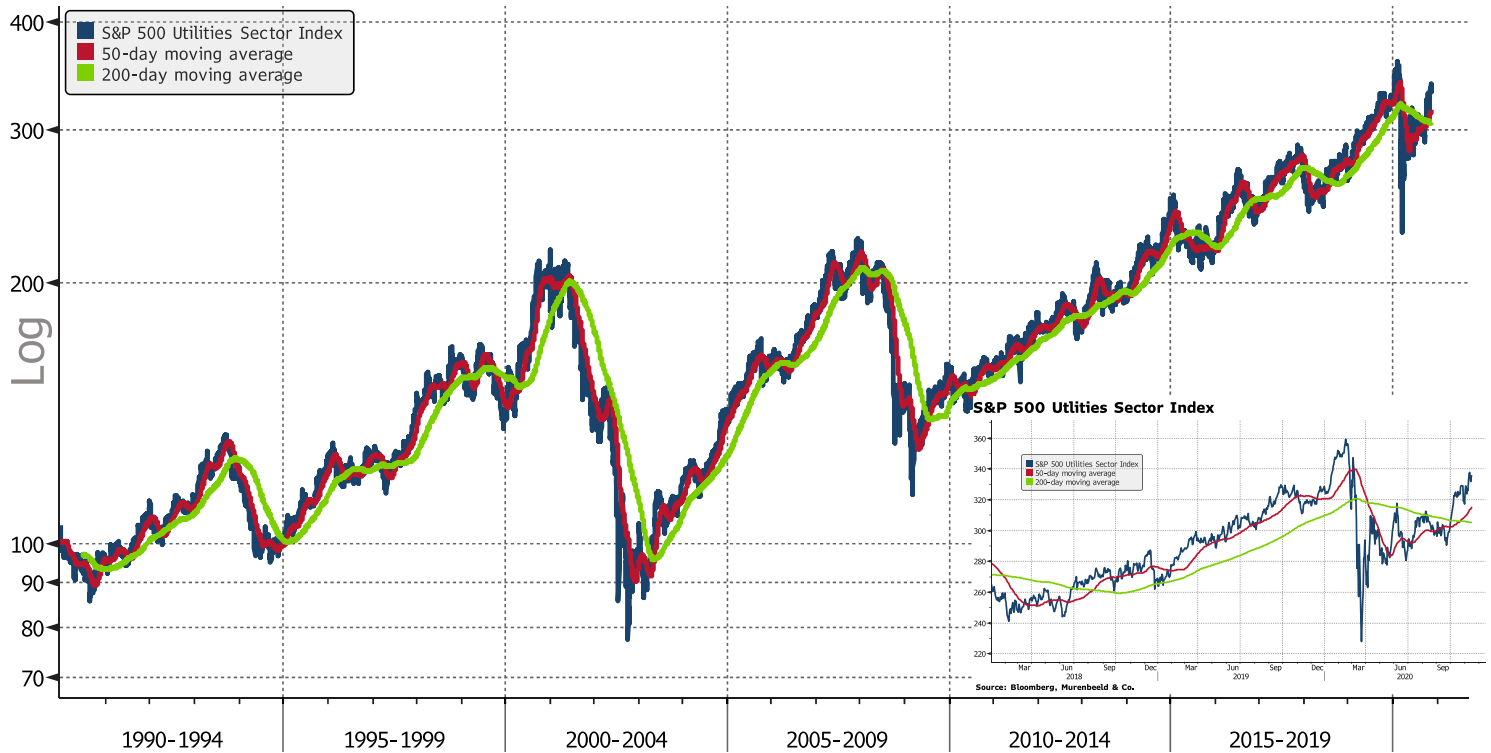


### S&P 500 Telecom Service Sector Model



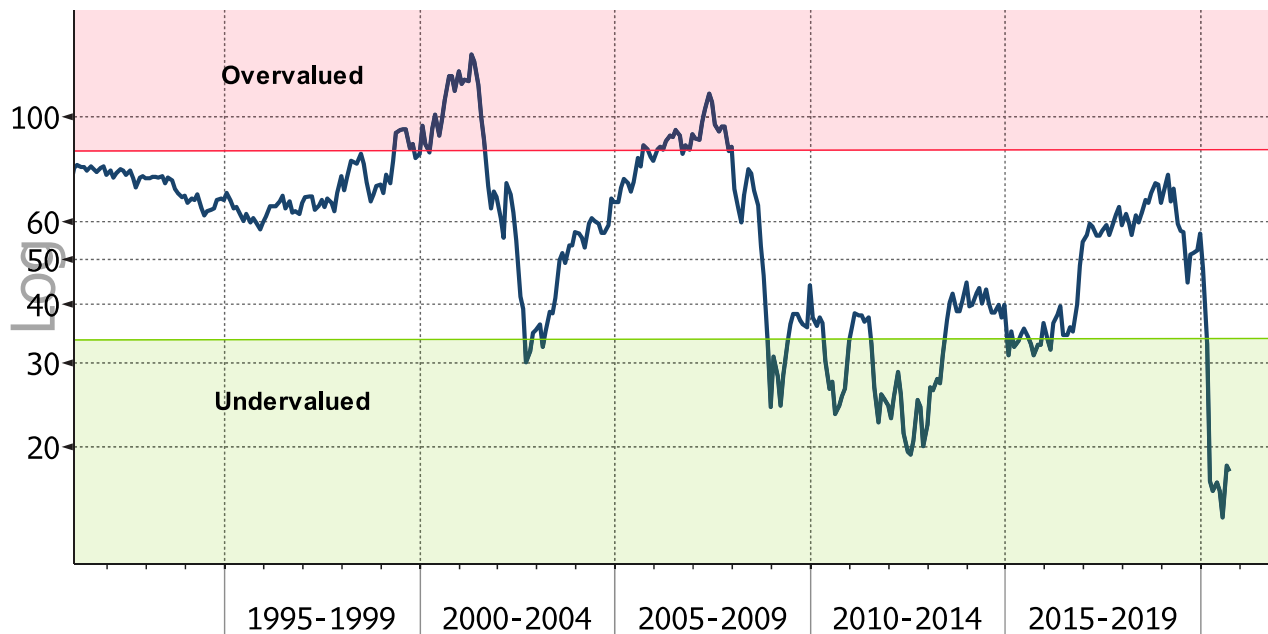
## S&P 500

### S&P 500 Utilities Sector Index



Source: Bloomberg, Murenbeeld & Co.

### S&P 500 Utilities Sector Model

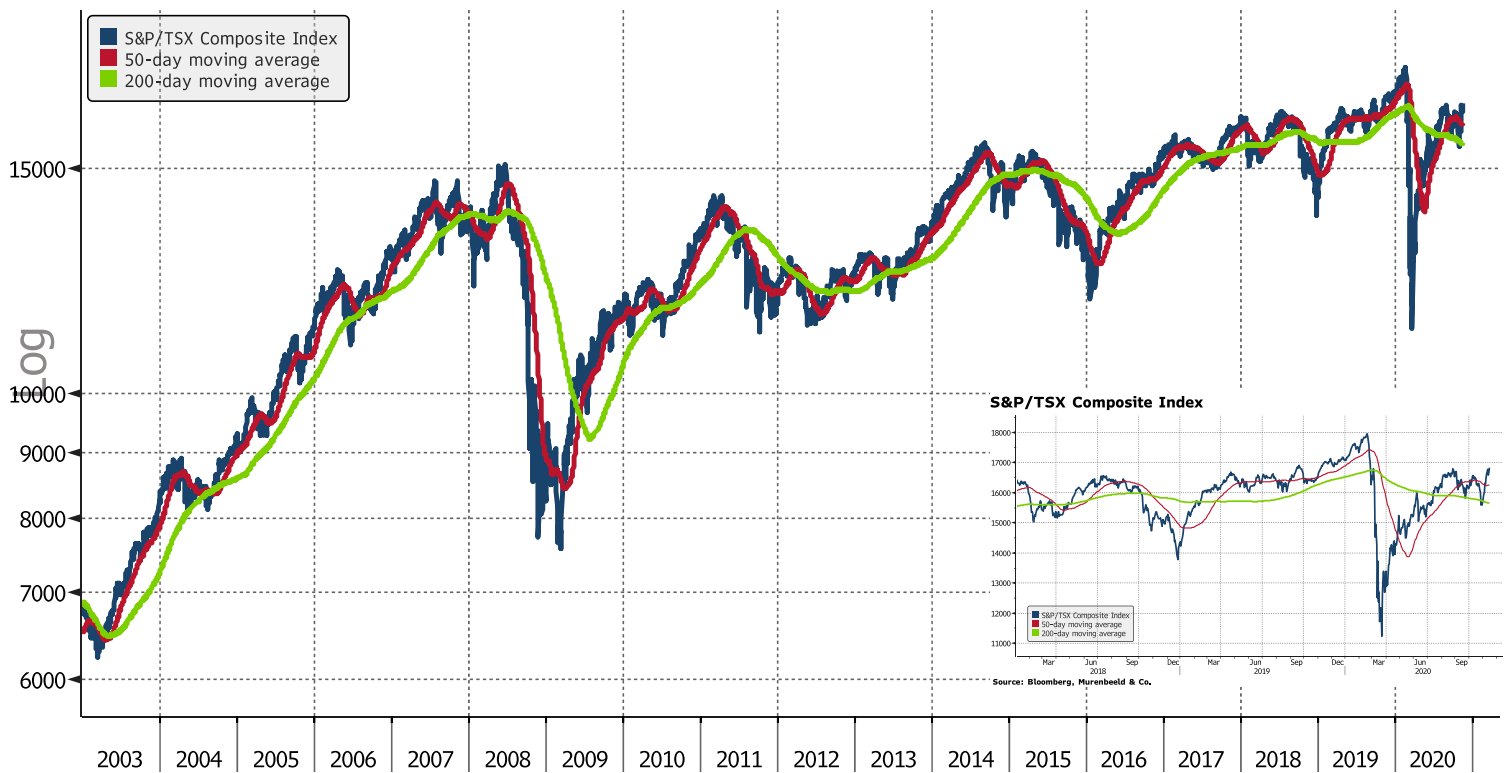


Source: Bloomberg, Murenbeeld & Co.



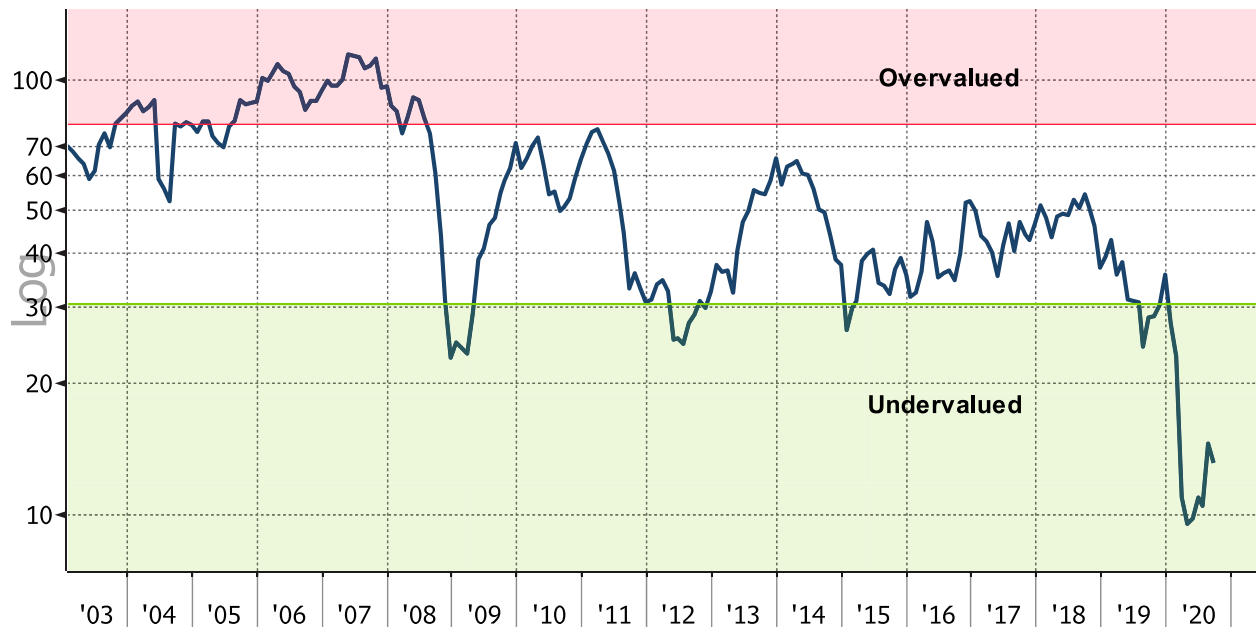
## S&P/TSX

### S&P/TSX Composite Index



Source: Bloomberg, Murenbeeld & Co.

### S&P/TSX Composite Index Model



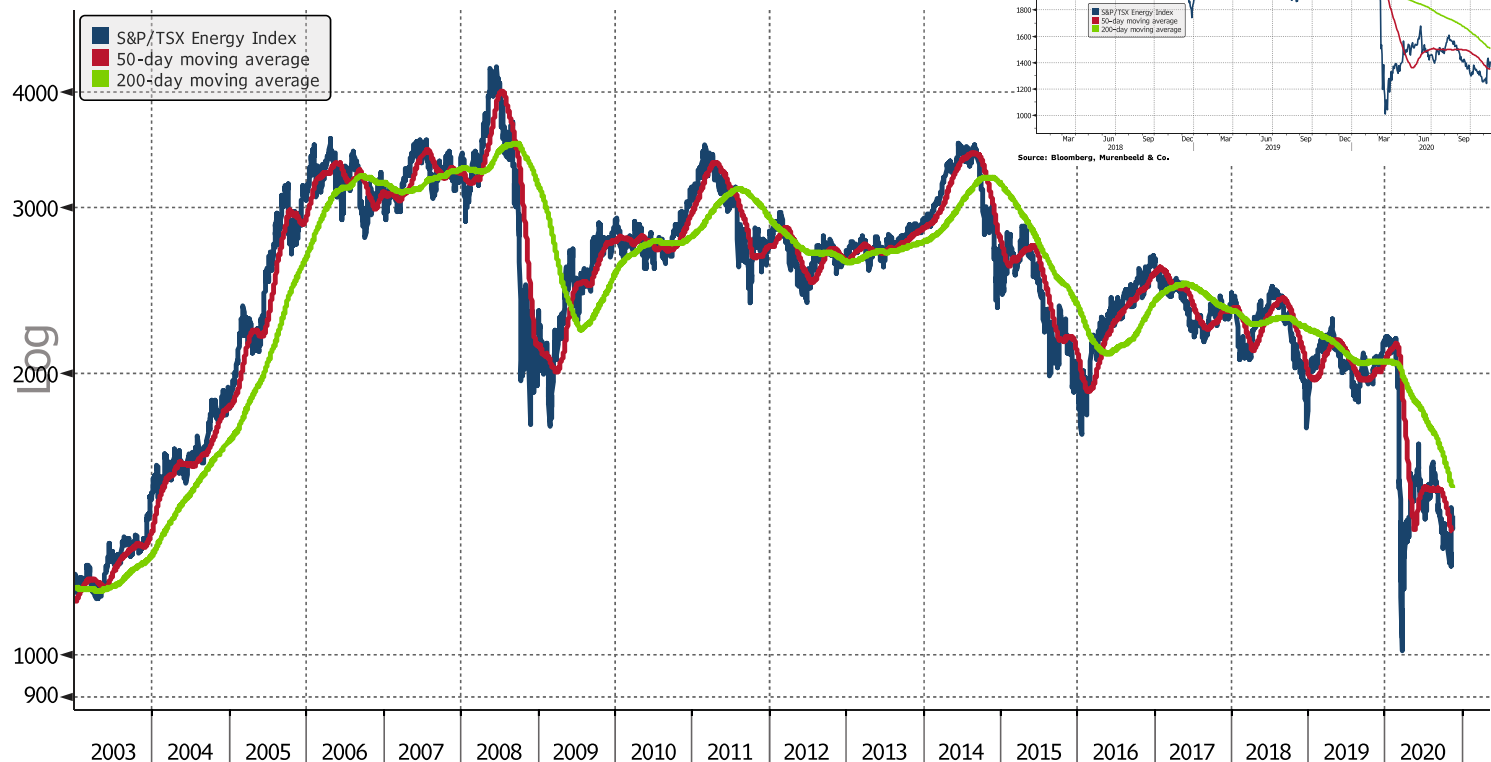
Source: Bloomberg, Murenbeeld & Co.





## S&amp;P/TSX

## S&amp;P/TSX Energy Sector Index



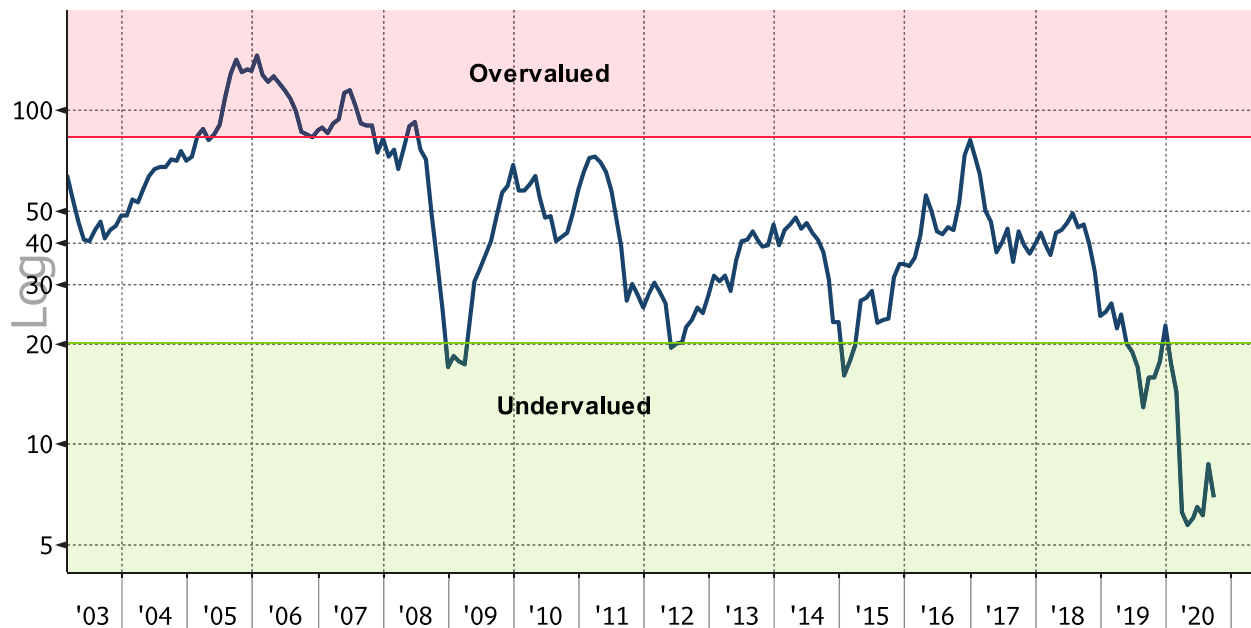
Source: Bloomberg, Murenbeeld &amp; Co.

S&amp;P/TSX Energy Sector Index



Source: Bloomberg, Murenbeeld &amp; Co.

## S&amp;P/TSX Energy Sector Model



Source: Bloomberg, Murenbeeld &amp; Co.



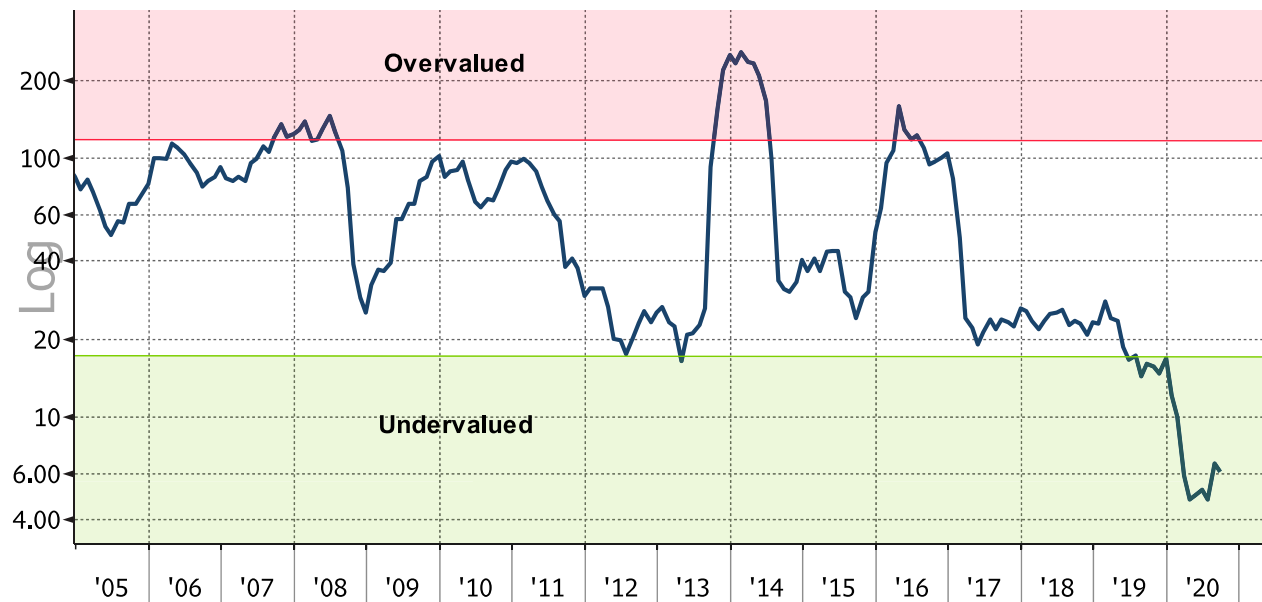
## S&amp;P/TSX

## S&amp;P/TSX Materials Sector Index



Source: Bloomberg, Murenbeeld &amp; Co.

## S&amp;P/TSX Materials Sector Model



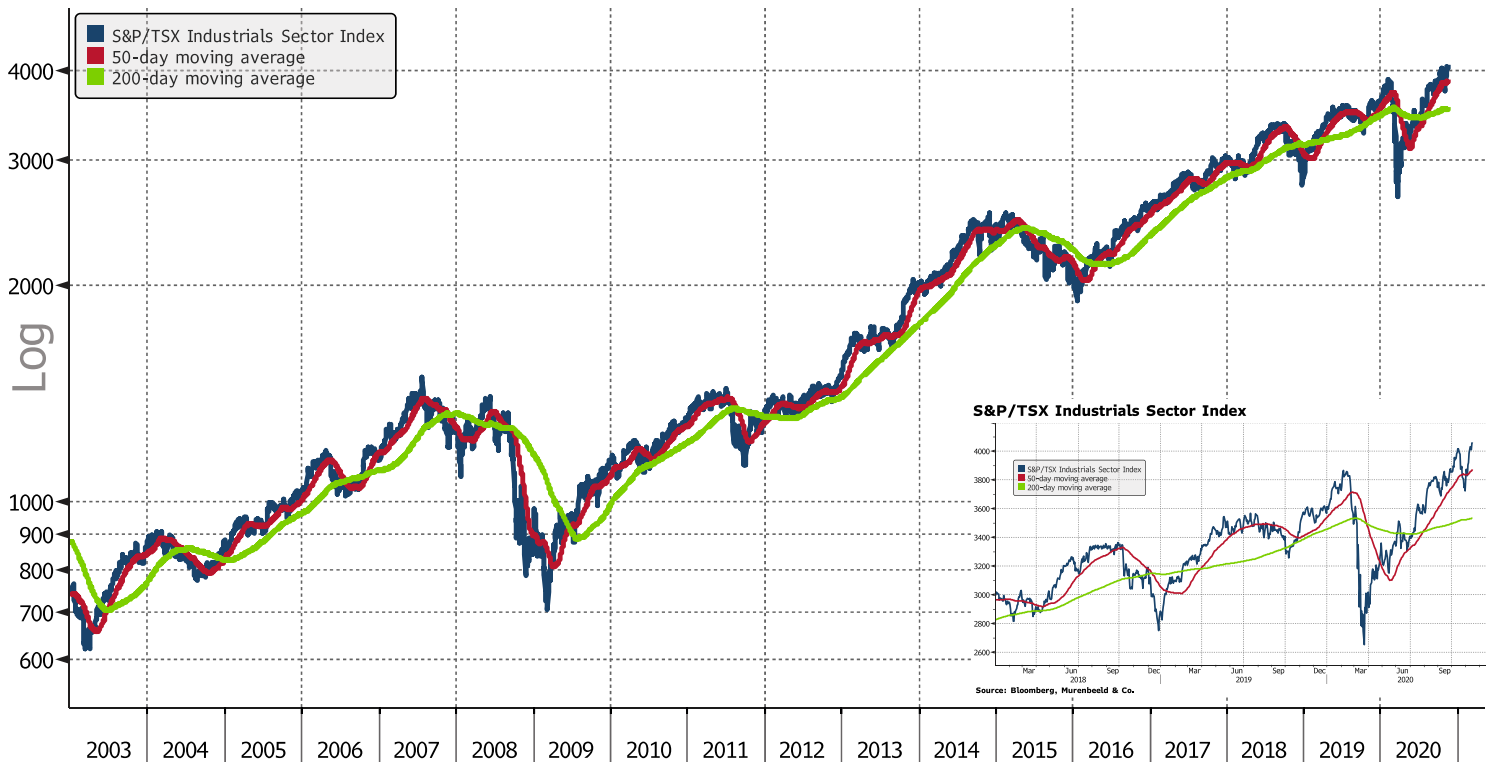
Source: Bloomberg, Murenbeeld &amp; Co.

Due to a spike in the EV/EBITA for the TSX Materials sector, the data was "capped" in the model for the beginning of 2016.



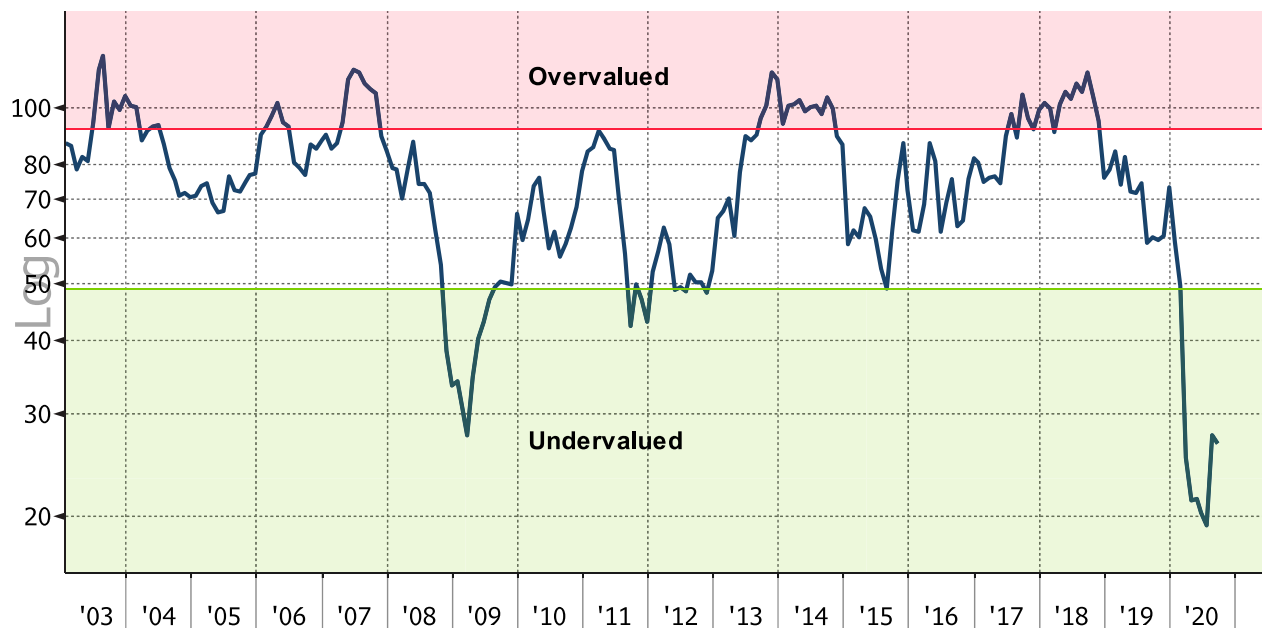
## S&P/TSX

### S&P/TSX Industrials Sector Index



Source: Bloomberg, Murenbeeld & Co.

### S&P/TSX Industrials Sector Model

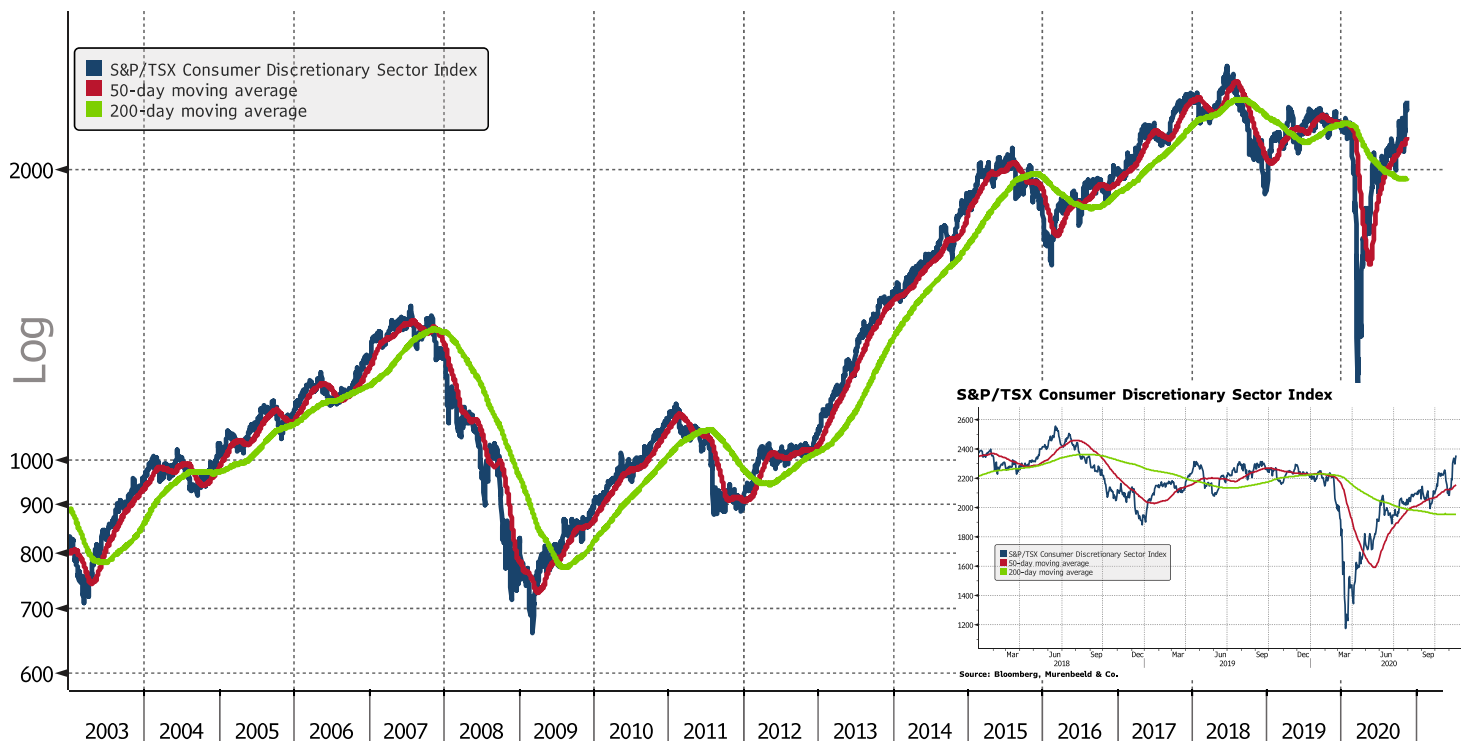


Source: Bloomberg, Murenbeeld & Co.



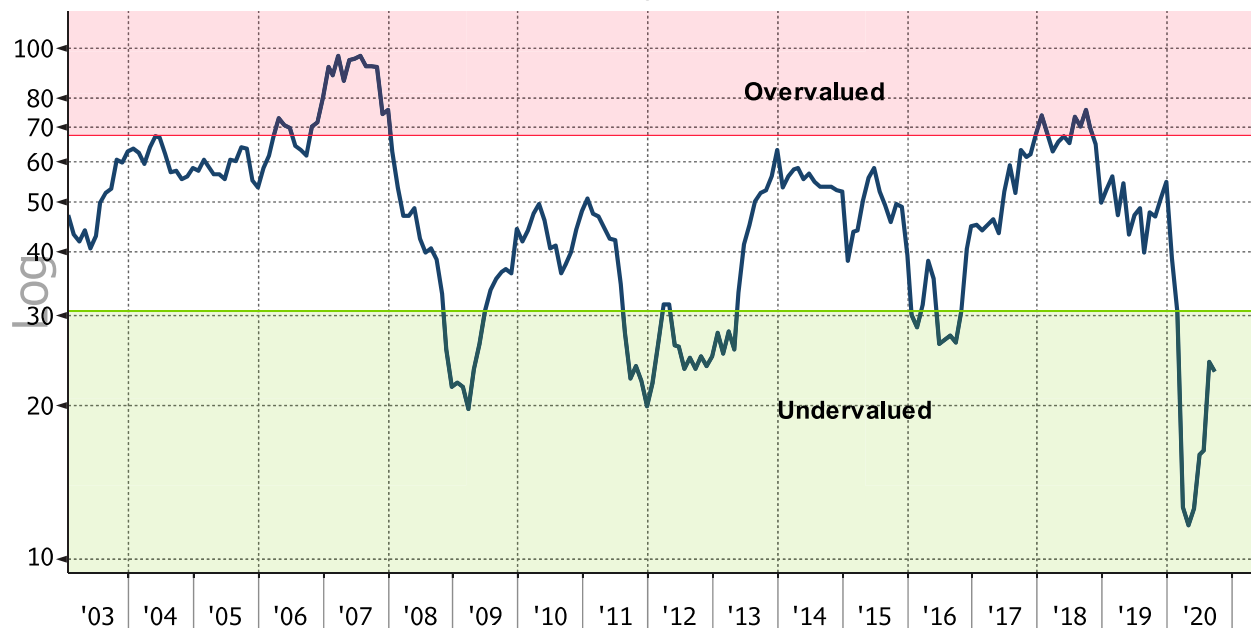
## S&amp;P/TSX

## S&amp;P/TSX Consumer Discretionary Sector Index



Source: Bloomberg, Murenbeeld &amp; Co.

## S&amp;P/TSX Consumer Discretionary Sector Model

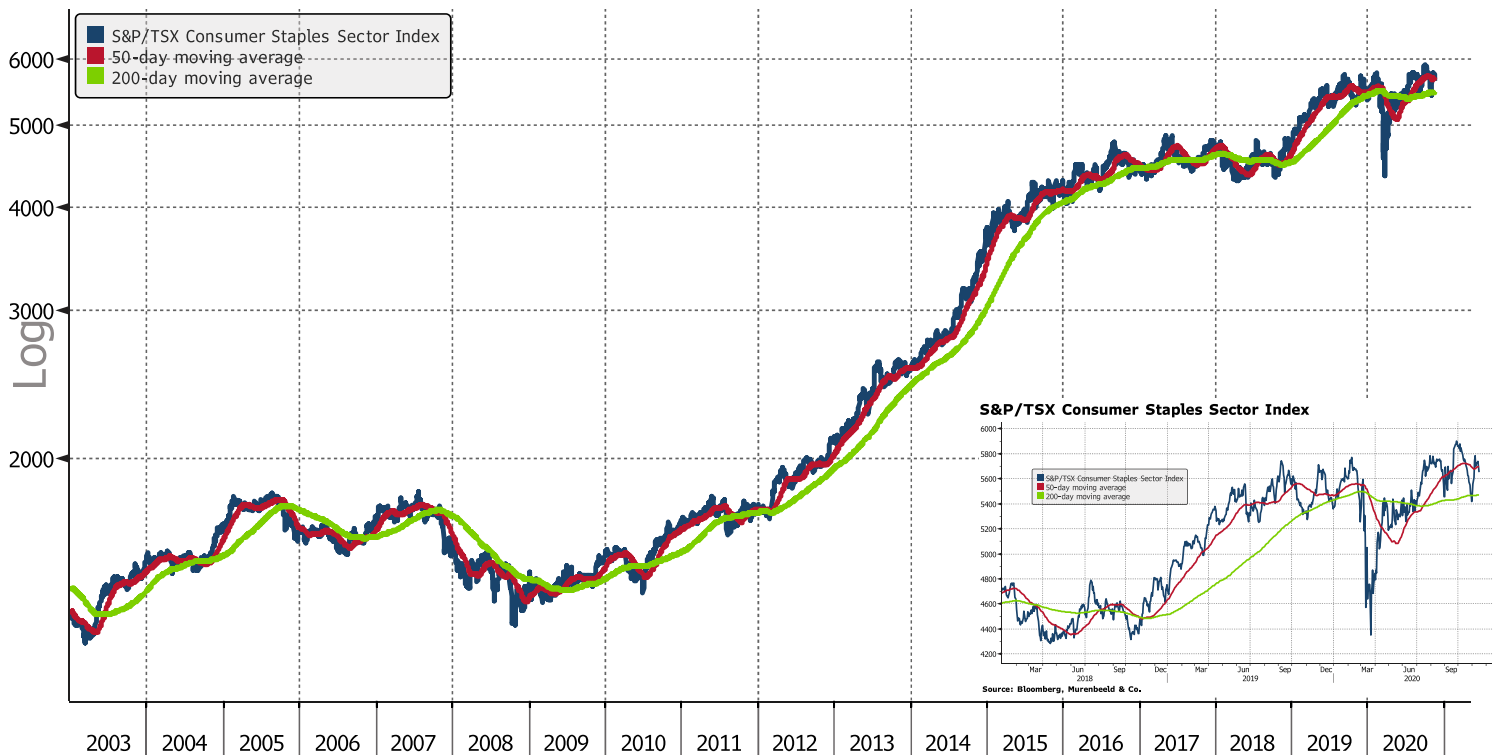


Source: Bloomberg, Murenbeeld &amp; Co.



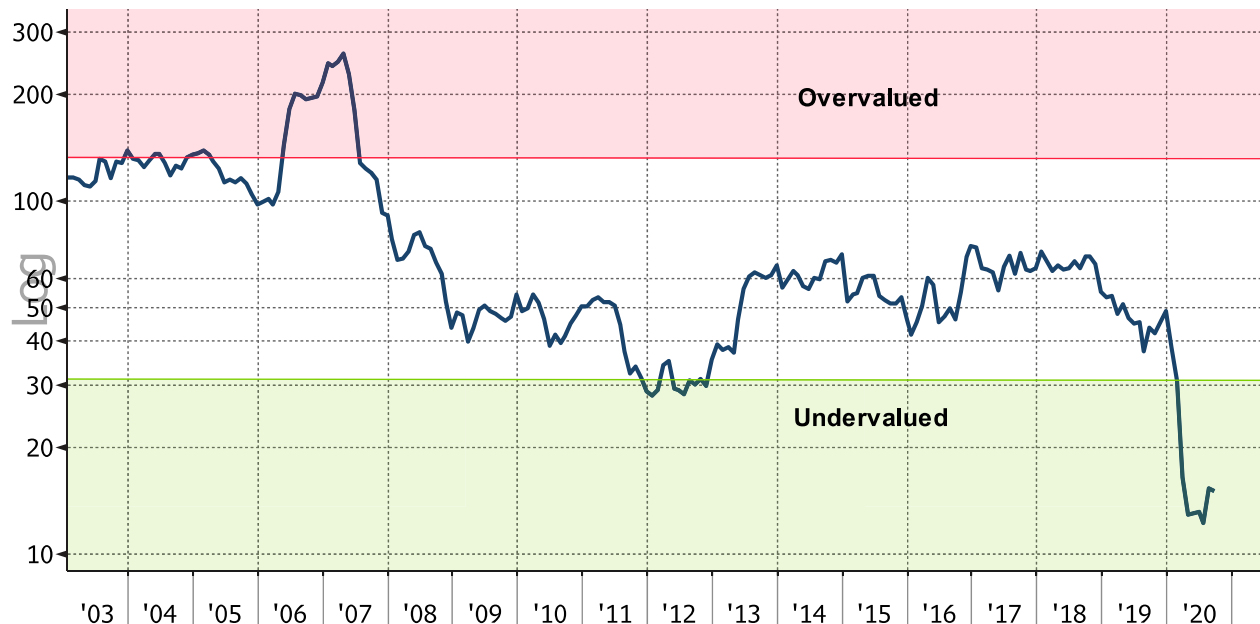
## S&amp;P/TSX

## S&amp;P/TSX Consumer Staples Sector Index



Source: Bloomberg, Murenbeeld &amp; Co.

## S&amp;P/TSX Consumer Staples Sector Model



Source: Bloomberg, Murenbeeld &amp; Co.



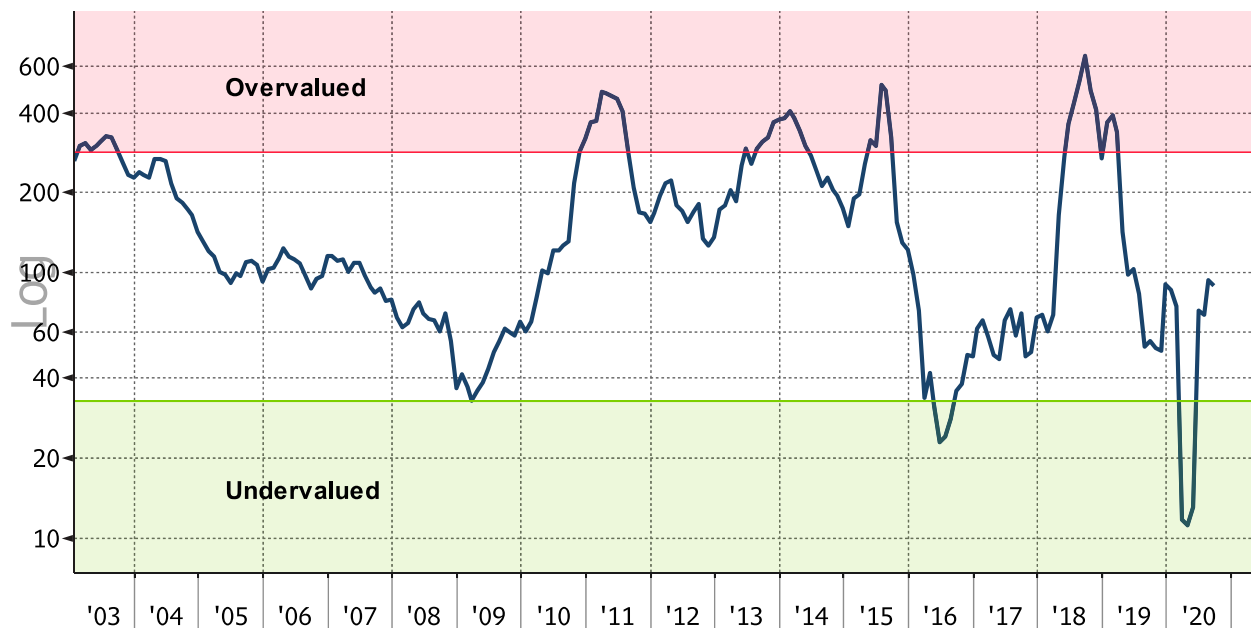
## S&amp;P/TSX

## S&amp;P/TSX Health Care Sector Index



Source: Bloomberg, Murenbeeld &amp; Co.

## S&amp;P/TSX Health Care Sector Model

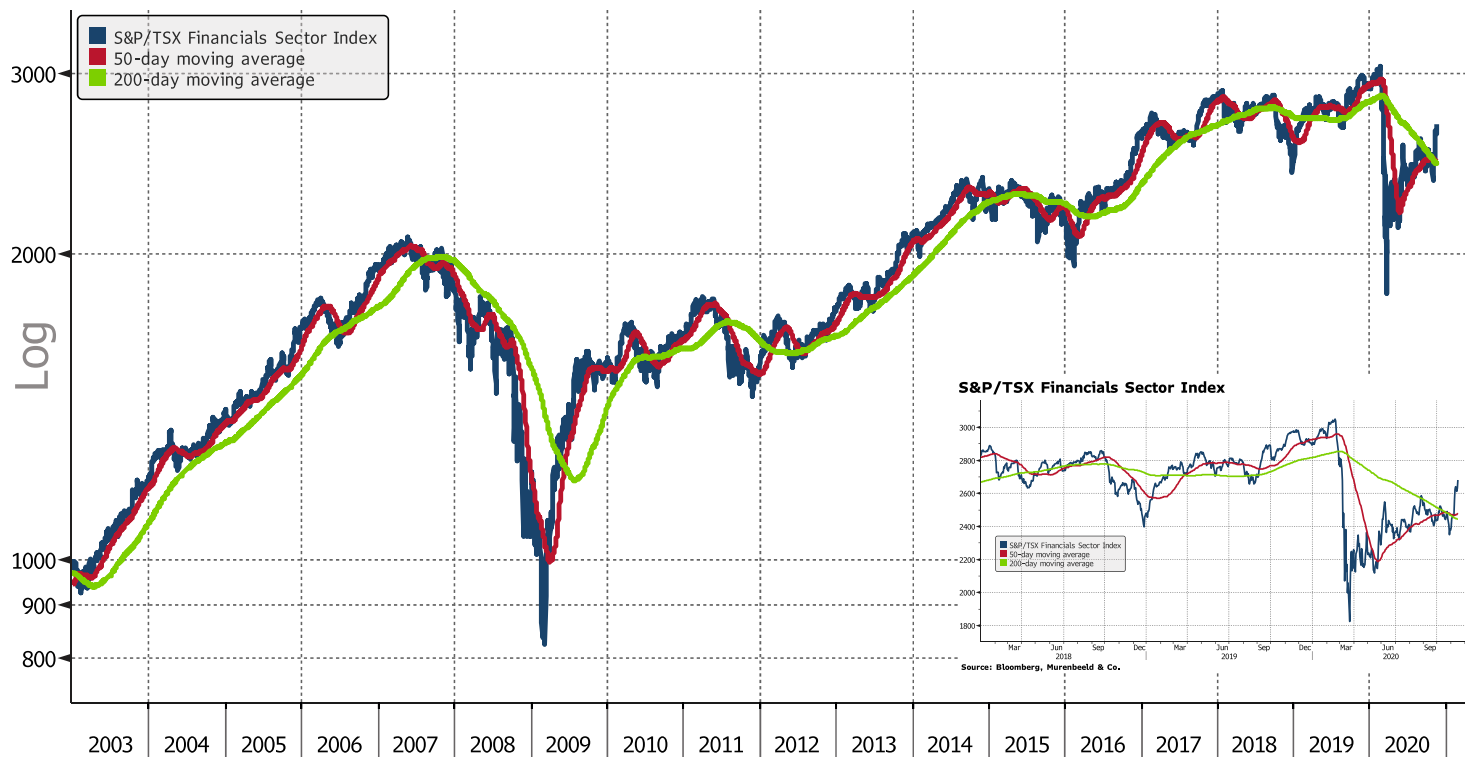


Source: Bloomberg, Murenbeeld &amp; Co.



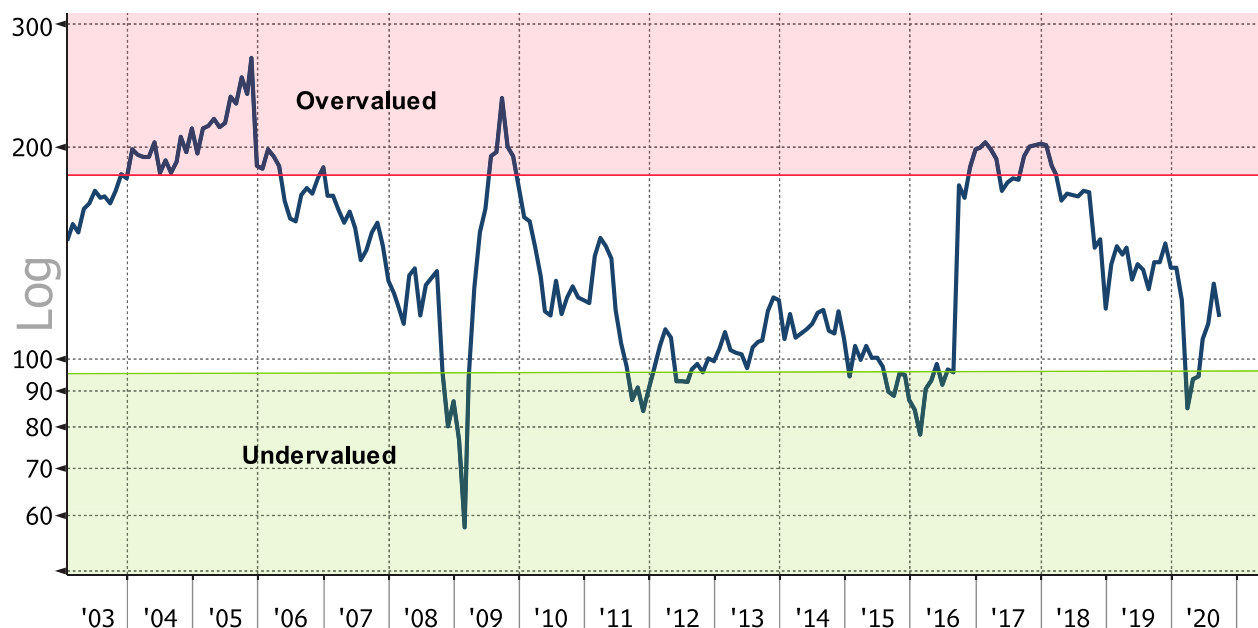
## S&P/TSX

### S&P/TSX Financials Sector Index



Source: Bloomberg, Murenbeeld & Co.

### S&P/TSX Financials Sector Model

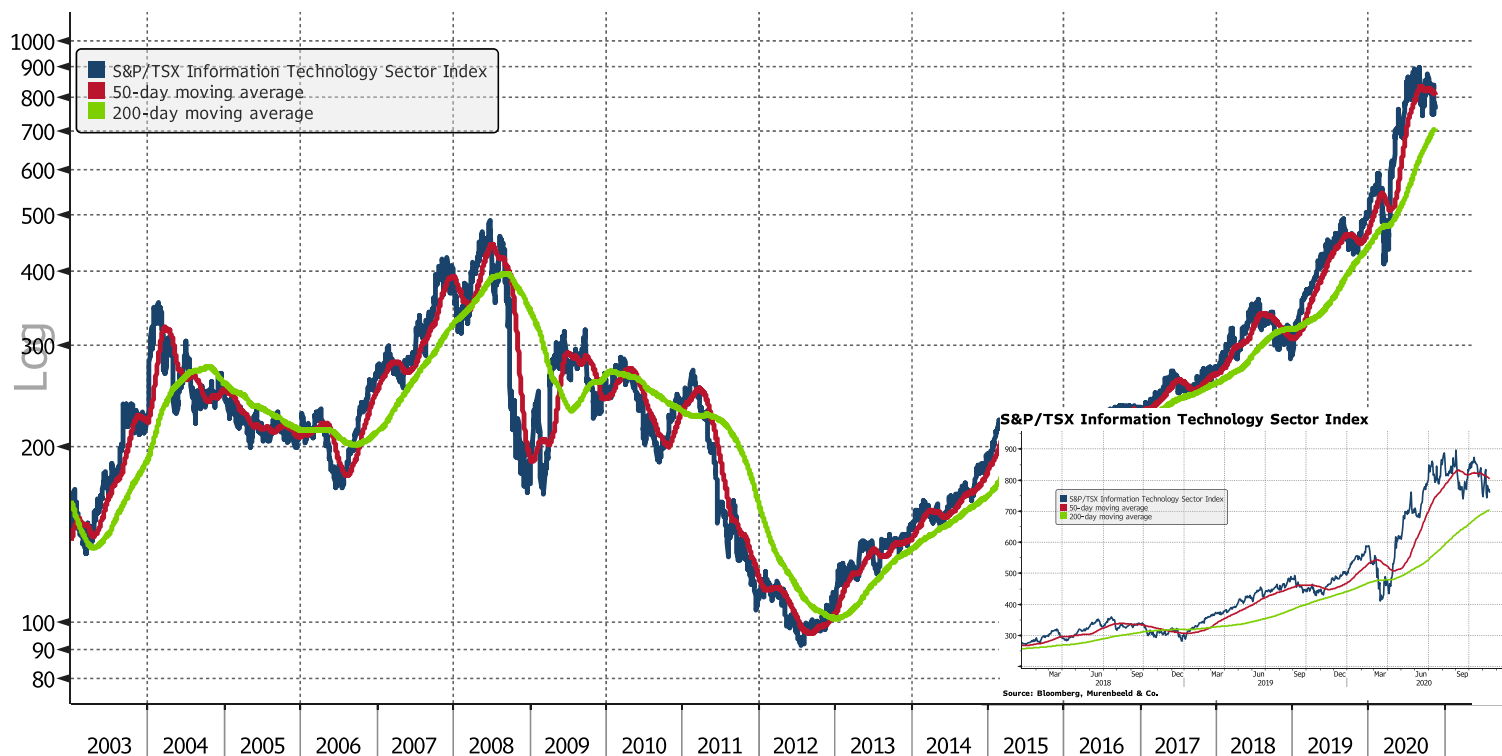


Source: Bloomberg, Murenbeeld & Co.



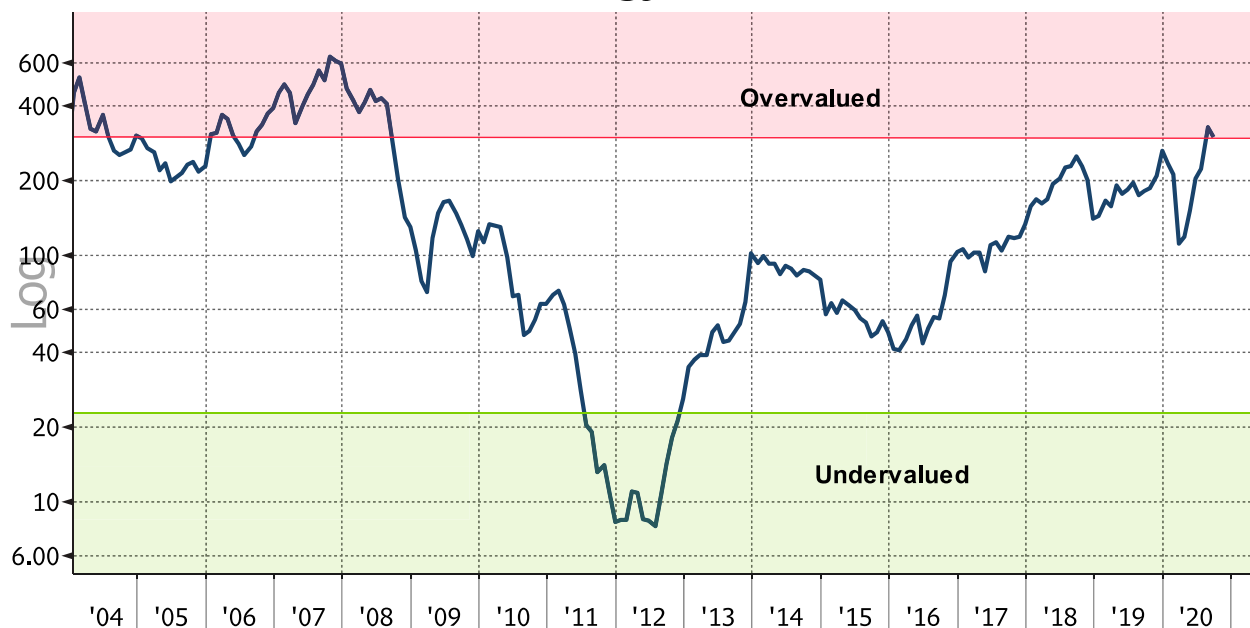
## S&amp;P/TSX

## S&amp;P/TSX Information Technology Sector Index



Source: Bloomberg, Murenbeeld &amp; Co.

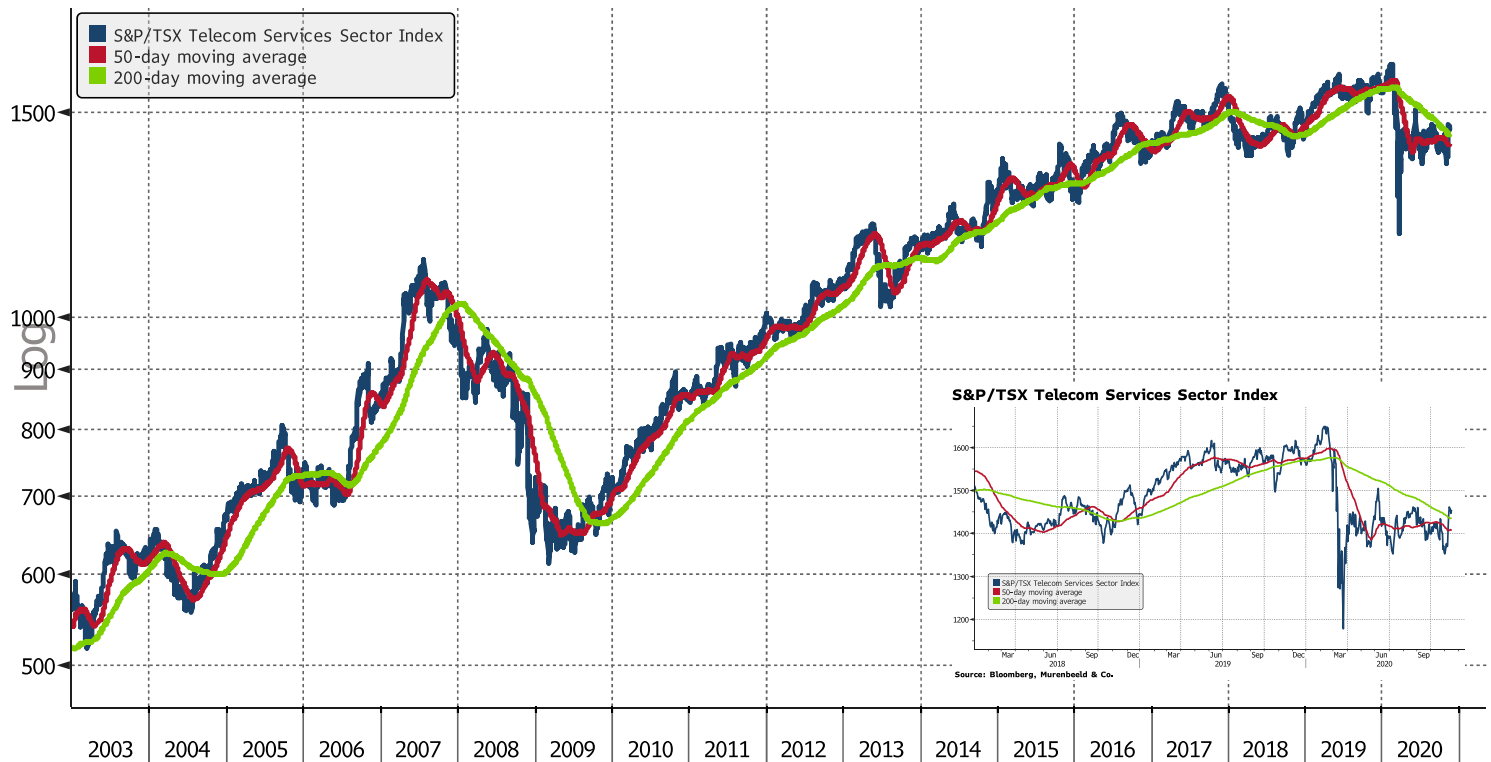
## S&amp;P/TSX Information Technology Sector Model



Source: Bloomberg, Murenbeeld &amp; Co.

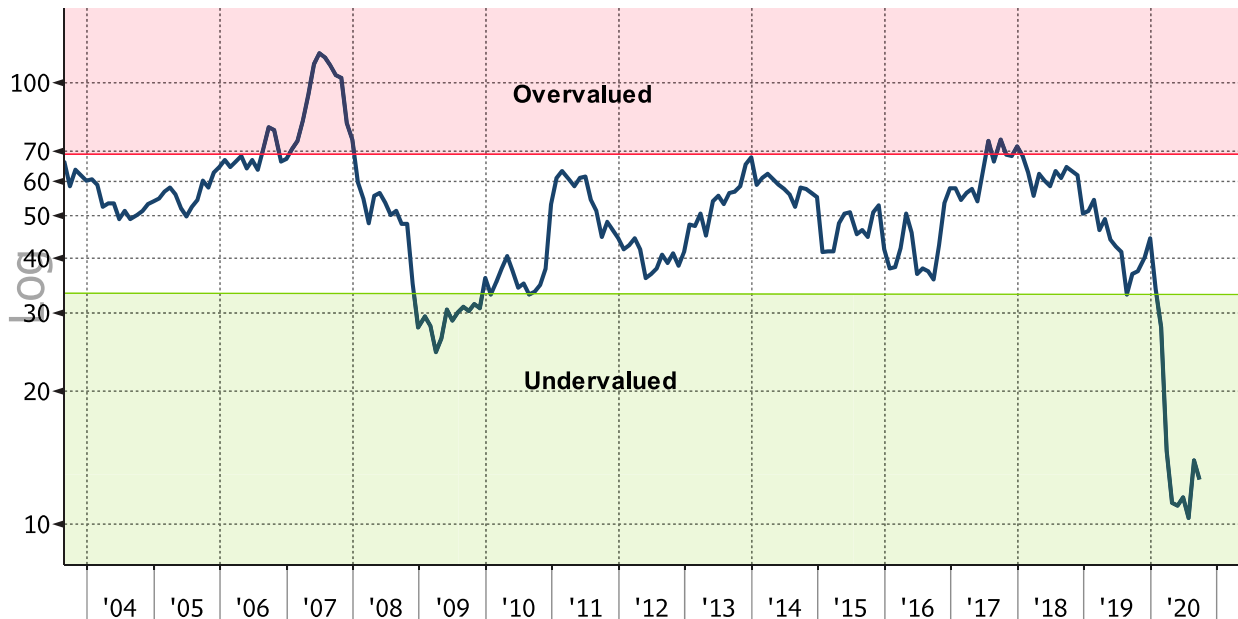
## S&amp;P/TSX

## S&amp;P/TSX Telecom Services Sector Index



Source: Bloomberg, Murenbeeld &amp; Co.

## S&amp;P/TSX Telecom Service Sector Model



Source: Bloomberg, Murenbeeld &amp; Co.



## S&P/TSX

### S&P/TSX Utilities Sector Index



### S&P/TSX Utilities Sector Model

