

KANAWHA CAPITAL MANAGEMENT

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NEW BEGINNING

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Good riddance

An investor who had been off the grid, checking only year-end account statements, might conclude that the backdrop has been uneventful, if not favorable. In fact, for most of us, 2020 could not end soon enough after the health, social, political, and financial upheaval that has buffeted the country and many other nations around the globe. The period has seemed almost surreal, unlike any other in modern times.

Stocks certainly took investors on a wild ride, experiencing both a sharp bear and bull market over the course of 2020. After COVID-19 hit our shores, the S&P 500 plunged 34% during a five-week period early in the year, the quickest descent into bear territory on record. But aggressive policy responses helped stem the tide. Stocks rallied 68% from those March lows and actually ended the year with double-digit gains (single-digit for the Dow).

Besides being extremely volatile, performance proved very uneven under the surface. Three hundred S&P 500 constituents saw stock price increases, their average return being 31%. However, the other two hundred dropped by an average of 18%. A handful of mega-cap, mostly technology-related companies dominated the index returns.

Viral tug-of-war

With the news headlines still ominous, can 2021 represent a *New Beginning*? Much will hinge on the speed at which our society can halt the spread of the coronavirus. As summer ended, a third wave of COVID-19 slammed into the United States. The combination of more social interaction due to pandemic fatigue and colder weather in the Northern Hemisphere allowed the virus to regain traction. Not only have most health metrics worsened, they have also become exponentially worse.

It took ten months to see 10 million cases in America; it only took two additional months to reach the 20 million mark. Hospitalizations surged to a level of 60,000 patients

at the peak of each of the first two waves, before receding. Currently, twice that number is hospitalized with COVID-19. Some hospital systems have run out of ICU capacity.

The case fatality rate — the proportion of confirmed cases leading to death — has been dropping since the initial outbreak. Nevertheless, deaths keep rising and the number of *new* fatalities has more than tripled from a rate of 1,000/day during the summer and fall to over 3,000/day in early January.

Cavalry is coming

Thanks in part to the public-private partnership, *Operation Warp Speed*, the medical community is developing vaccines in record-shattering time. Two (Pfizer/BioNTech and Moderna) with efficacy rates of 95% received FDA approval and are being distributed. Additional vaccines from AstraZeneca/Oxford University and Johnson & Johnson could also soon obtain green lights. And a handful of other promising candidates are in phase three trials.

One month in, the U.S. vaccine rollout has proceeded unevenly across the states while falling short of federal projections. The initial round of shots has been primarily administered through hospitals and other institutional health-care settings. The next phase broadens the pool of eligible recipients and will marshal pharmacies and health clinics; some states are utilizing large venues such as sports arenas to speed up the process.

By mid-January, 10 million Americans had received at least the first dose of the 30 million that had been distributed. That only accounts for 3 out of 100 citizens. But the vaccine initiative marks an unprecedented, massive undertaking that should accelerate in the coming weeks after the initial bumps. Safe and effective vaccines should become widely available this year.

Another bridge

In the meantime, additional financial support is on the way for households and businesses to bridge the ongoing lockdowns — but only after nine months of squabbling by House Democrats, Senate Republicans, and the White House. This new \$900 billion relief package follows the \$2 trillion boost from the CARES Act in March.

The measures will extend aid to millions of struggling families through stimulus checks and enhanced federal unemployment benefits, including aid to part-time and gig workers who did not qualify for state jobless benefits. For small businesses, the bill includes \$284 billion for a new round of forgivable *Paycheck Protection Program* loans. And the hardest-hit small businesses may apply for a second loan. Also, certain sectors such as transportation and entertainment will receive targeted assistance as will colleges and school systems.

The capture of Georgia's two Senate seats will grant Democrats control of both chambers of the 117th Congress, albeit with the thinnest of majorities. This blue ripple raises the odds of even more fiscal support in 2021. And unlike the aftermath of the *Great Financial Crisis*, there may be few calls for immediate austerity or recriminations. This is not a case of bailing out the perpetrators of a crisis. Ultimately, the bill will come due for such deficit spending but in the context of the next few years, it would be pro-growth.

Pent-up consumers

The vaccine rollout should allow for the progressive reopening of those sectors still in lockdown. That transition will increase employment and improve consumer and business confidence, boosting overall demand. Indeed, consumer spending could act like a coiled spring, given the opportunity.

Fed Vice Chairman Richard Clarida, in a speech, noted that "...this was the only downturn in my career in which disposable income actually went up in a deep recession, and a lot of that has been saved." He attributed this phenomenon to effective fiscal policy. So while total personal income has risen above pre-pandemic levels, spending has dropped. Not surprisingly, the spending cutbacks relate primarily to services, the side of the economy most impacted by the shutdowns.

These numbers mask divergences between the fortunes of some higher-paid white-collar workers (who could telecommute, whose businesses remained open) and lower-paid blue-collar and service workers (whose hours were cut, or jobs eliminated). But in the aggregate, significant pent-up demand should be unleashed as the economy reopens.

Batter up

The COVID shock of 2020-21 can be viewed as akin to a large-scale natural disaster, an external shock to an otherwise healthy economy. And a swift economic restart has occurred thanks to sizable policy support. With the Fed likely to keep interest rates low for two to three years, we should be in the early innings of a new business cycle. Assuming continued momentum on the virus front, the year should be one of economic healing.

A rapid economic recovery would bring an accelerated earnings recovery. Following the three previous recessions, it took 3-5 years for S&P 500 earnings to return to their prior peaks. This time, it could happen within 1-2 years. Earnings estimates have been rising in recent months.

However, at current valuations, the stock market already reflects much of this good news. Some segments are absolutely frothy. And for the moment, investors also appear to be shrugging off the possibility of higher corporate tax rates. So while the macro environment for stocks seems favorable, they could certainly take a breather.

— *Christopher J. Singleton, CFA, Managing Director*

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