Election Update & Vaccine Surprise

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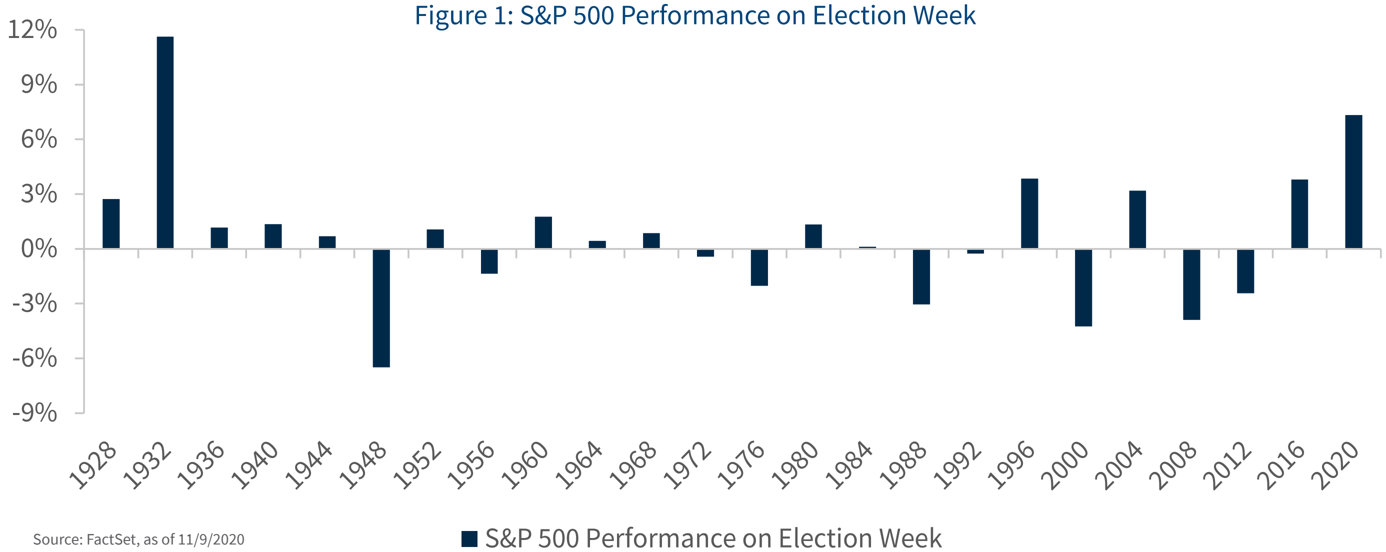
Coming off its best week since April (7.3%), the S&P 500 rallied ~1.2% today and narrowly missed setting a new record high as Joe Biden won enough votes to win the election and by tradition is known as the president-elect. Additionally, Pfizer announced a vaccine efficacy rate above 90% in its Phase III trials. Although the two key run-off Senate elections in Georgia won't occur until January, the outcome of the 2020 election appears to be split government, and with substantial policy shifts seeming unlikely, investors have been able to refocus on the overall supportive fundamentals. As for Pfizer's announcement, a vaccine seems to truly be developing at warp speed given that we only received positive Phase I study results about six months ago. With Pfizer's efficacy rate well above the necessary 50-60% threshold, it is hard not to join the markets in celebrating this scientific feat (the previous quickest vaccine development on record was four years). While there are still many questions surrounding the durability and production goals of this vaccine, this is a monumental step toward the eventual return to normality.

The Markets Believe Split Government is Good

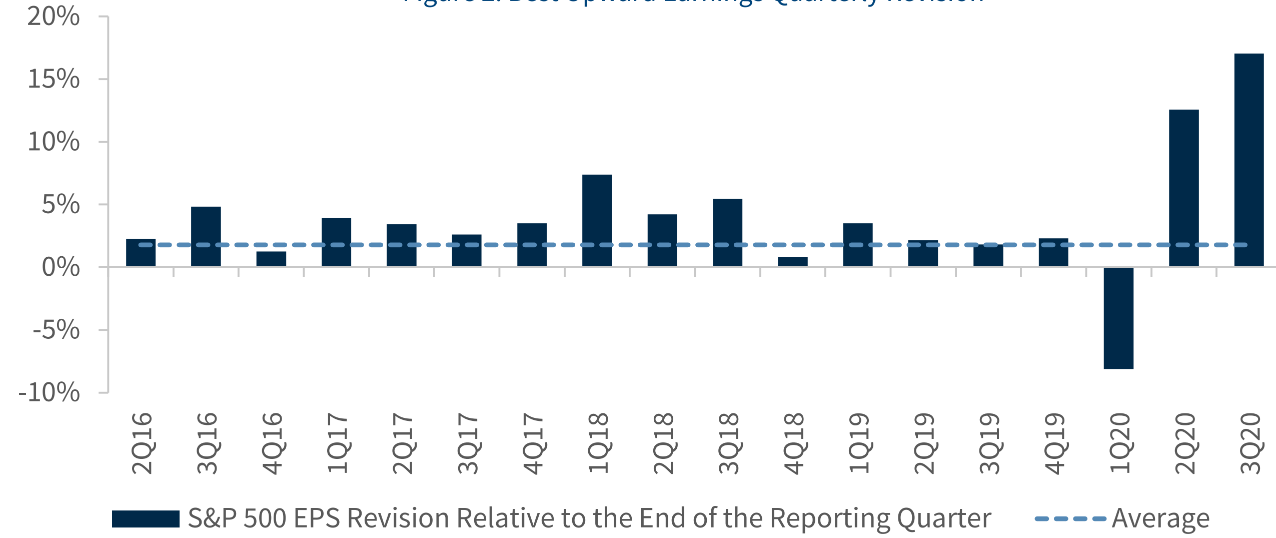
Ahead of election day, most investors assumed that delayed results in the presidential and congressional elections would induce volatility and cause the markets to falter. While the final results were unknown, it was apparent that split government was the most likely outcome, and instead the S&P 500 had its best election week performance since 1932. Leading this rally was the decreased probability of a Blue Wave tax increase, which we expected would reduce 2021 S&P 500 earnings by ~10% ($151 versus $165). With policy risk subdued, investors were able to focus more squarely on the fundamentals, which we believe are supportive of equities in the longer term. First, recent economic data provides evidence that the US economy is still on the road to recovery. Last week, both ISM indices remained in expansion territory (a level above 50), the unemployment rate fell from 7.9% to 6.9%, and 638k jobs were added in the month of October, surpassing consensus estimates by 58k. Second, a better than expected 3Q20 earnings season will hopefully carry into 2021. Since the end of the third quarter, the 3Q20 earnings estimate has been revised higher by 17%, the best upward quarterly revision since 2002. (Figure 2 on the next page) While the equity market may experience some short-term volatility just ahead of the run-off elections in Georgia, our base case is the Republicans win at least one seat and maintain control of the Senate. However, in the event the Democratic candidates sweep the two seats, our expectation is that the most aggressive policy shifts will remain limited. More important, a supportive macroeconomic backdrop and the ongoing improvement in earnings will likely carry more weight over the longer term in determining the trajectory of the equity market.

Figure 1: S&P 500 Performance on Election Week



Source: FactSet, as of 11/9/2020

Figure 2: Best Upward Earnings Quarterly Revision



Source: FactSet, as of 11/9/2020

Efficacy Is Just One Piece Of The Puzzle

Today, Pfizer announced that it achieved an efficacy rate north of 90% at just seven days following the second dosage of their MRNA-based vaccine candidate. The company hopes to apply for emergency use authorization after it collects two full months of data, which correlates to the third week of November. With more than 50 million cases globally and with more than 10 million cases in the US alone, Pfizer's announcement gives hope that there is finally a light at the end of the tunnel mitigating the COVID-19 crisis. This is especially true given that other MRNA-based vaccines (e.g., Moderna) are now likely to be successful too.

> "A VACCINE IS A BIG DEAL, BUT WE DO NEED TO MANAGE EXPECTATIONS. MOST PEOPLE WON'T BE ABLE TO GET A VACCINE IN THE NEXT FEW MONTHS.
>
> ADDITIONALLY, WITH THE SURGE WE HAVE GOING ON, MORE LOCAL AND STATEWIDE SHUTDOWNS ARE LIKELY"
>
> *- CHRIS MEEKINS, HEALTHCARE POLICY ANALYST, EQUITY RESEARCH*

While this development is a positive game changer and a significant development, a few more dynamics need to be considered. First, scientists have yet to disclose how long the heightened level of immunity may last and how potential mutations in the virus may impact its protection. Second, while Pfizer has previously stated it would have 50 million doses available in 2020 and 1.3 billion doses in 2021, it currently only has hundreds of thousands available. Given that this vaccine requires supercooled containers, the production timeline and speed of transport are yet to be determined. Our Biotechnology Analyst still believes that initial dosages will likely be available for first responders and at-risk groups come the end of this year, but that widespread availability will not occur until 2021. And lastly, even if all production goals are met, the general public must be willing to receive the vaccination. Over the last several months, several studies suggested that public trust surrounding the safety of a COVID-19 vaccine had declined, mostly due to the record speeds at which pharmaceutical companies were conducting trials. While a vaccine may have been developed in record time, it may take time or additional evidence of safety for the majority of the population to feel comfortable receiving it.

Bottom Line

The likely outcome of a split government has removed some of the political risk from the financial markets, but we expect near-term volatility surrounding vaccine development and the COVID-19 outbreak to remain. While the vaccine development is a positive signal that a return to normality is hopefully in the not too distant future, it cannot remedy the current surge or the risk of the outbreak worsening as we head into the winter months. To further discuss these events and the risks ahead, our experts offer their insights on the large-scale logistics of vaccine development, how the announcement may impact stimulus negotiations, whether or not the movement in Treasury yields may be premature, and how we may be seeing the early signs of rotation within the equity market.

Steve Seedhouse, PH. D. Director, Biotechnology Analyst, Equity Research

The Pfizer vaccine is definitely a game changer. Consensus and Pfizer, in their trial protocol and commentary, were hoping for vaccine efficacy above 60%. Today's announcement suggesting better than approximately 90% is better than expected.

Are there concerns about durability?

Durability of immune response associated with Pfizer's vaccine is an open question. Given we are less than a year into the pandemic, and highly variable immune responses (antibody levels, etc.) have been seen in patients who have recovered from COVID-19, durability of immune response in the absence of vaccination is also an open question. While documented reinfections have occurred, they are so far on the order of dozens only. The potential need for re-vaccination yearly or every few years has not been ruled out. This highlights an advantage for Pfizer's vaccine in that it does not use a viral vector (i.e., AstraZeneca, Johnson & Johnson). Viral vector vaccines are susceptible to eliciting an immune response to the viral vector itself and appear to be less suitable for repeat dosing. That's not the case for the Pfizer vaccine which can be re-dosed every year if needed.

Will people be willing to take the vaccine?

Vaccine hesitancy is a big challenge for COVID-19 vaccine developers. While willingness to take the vaccine has fallen in recent months, it's likely the high apparent vaccine efficacy and good safety/tolerability results for Pfizer's vaccine will increase public confidence in this and other (i.e., Moderna) mRNA-based vaccines.

What's the format for this vaccine and are there factors impacting production and distribution?

Pfizer's vaccine is two injections (prime, followed by boost dosing three weeks later). Ultra-low temperature is required for long-term storage of Pfizer's vaccine (-80C), which primarily encumbers distribution of the vaccine material given ultra-low temp capacity will need to be expanded and short-term storage at very low temperatures during transport/site storing will need to be addressed logistically.

How many doses are required and how is that achieved?

The rough outlook for 2020/2021 production is 50 million doses in 2020 and 1.3 billion doses in 2021. Pfizer/BioNTech (like most first wave COVID-19 vaccine developers) have been producing vaccine material concurrently with running their clinical trials (i.e., 'at-risk' production), which has accelerated normal production timelines. Production (and distribution) of ~1B vaccines in 2021 will leverage Pfizer's growing production capacity activities (i.e., purchasing new sites in the US and Europe) in addition to capacity secured by Operation Warp Speed in the United States.

How does the existence of more than one viable vaccine affect production and distribution capability?

Given the similarity between Pfizer's vaccine candidate and other mRNA-based candidates from Moderna, Curevac, Arcturus, and Translate Bio/Sanofi (to name a few), the potential for multiple high-efficacy vaccine candidates hitting the market in the next 1-12 months is becoming more likely. The production capacity already secured by these developers as well as by US and European governments appears to be adequate to support on the order of billions of doses in 2021 on. Distribution will be a challenge in all cases, however given other mRNA-based vaccine candidates are likely to have equivalent or less restrictive long/short-term storage temperature requirements, more vaccines approved could mean easier overall distribution.

Ed Mills, Washington Policy Analyst, Equity Research

In terms of the election outcome, a clear result is the takeaway by the market with a Biden victory. This is not a contested election scenario, in our view, as there are multiple paths to a Biden Electoral College victory with significant vote margins in key swing states.

The Senate outcome, however, is less clear. Two run-off elections in Georgia on January 5 will ultimately decide control of the Senate. A Democratic majority is still possible, but it will be an uphill battle to reach a 50-50 split with Democratic control. While the market expectation is a Republican-led Senate, that is not yet a certainty, and the trajectory of the Georgia races should be watched for their impact on policy in 2021.

While the vaccine news is a clear market positive, it likely changes the dynamics of fiscal relief negotiations in favor of a smaller overall package. The overall expectation is that a deal will eventually be struck, but the timing remains a moving target. President-elect Biden will want his policy priorities reflected in the next package, and Senate Majority Leader McConnell is now in the driver's seat for Republicans after having been notably absent in recent negotiations. While a lame-duck deal is certainly possible, significant hurdles remain in a limited time period, which could push negotiations into early 2021.

Michael Gibbs, Managing Director, Equity Portfolio & Technical Strategy, and **Joey Madere, CFA,** Senior Portfolio Strategist, Equity Portfolio & Technical Strategy

As Steve Seedhouse says above, Pfizer and BioNTech have announced that their COVID-19 vaccine candidate was 90% effective in the first interim analysis of its ongoing Phase 3 trial. The companies also noted there were no serious side effects and they believe FDA emergency use authorization remains on track by the end of November. There will be questions surrounding how quickly the companies can ramp up manufacturing of the vaccine, along with the population's willingness to broadly receive it. Nonetheless, this is a positive first step to the eventual return to normality. We also expect further positive news flow on other vaccines and improved therapeutics in the weeks and months ahead.

Although most investors expected a vaccine sooner rather than later, it had yet to be confirmed. Now it is a reality. The path of least resistance is higher for equities. Given the positive news and likelihood that other drug companies follow with additional success, our bias is to focus on the S&P 500 moving toward our bull case scenario of 3,910 in 2021, instead of our current base case target of 3,600. This 3,910 target applies a 23x P/E to $170 earnings (vs. current consensus estimate of $166 and P/E of 24.6x). Our bull case scenario has hinged on a vaccine by year end, divided government (removing the headwind of higher taxes), the economy and earnings recovering ahead of expectations, and low interest rates — all of which are playing out currently. Low interest rates and inflation support the market's current high valuation. We believe rates are likely to remain low with the near-term overhang of Covid-19 cases and the potential need for increased mitigation measures. There are obviously still risks to the outlook, including the virus spread, timing of additional fiscal aid, and the Georgia Senate run-off elections on January 5, 2021. But the intermediate-term backdrop is becoming more bullish for equities than it was just one week ago.

The most significant opportunity for the near term will be rotation to the lagging stocks and sectors (those that were most affected by the pandemic). These include the small caps, along with sectors like the Financials, Energy, Industrials, Materials, and some Consumer Discretionary areas. As of 11/06/20 (pre-Pfizer news), 231 (46%) S&P 500 stocks were at least 15% below their 52-week high and 112 (22%) were 30% or more below their 52 weeks high. For the small caps, 283 (47%) of S&P 600 stocks are at least 30% below their 52-week highs.

Style investing is also an opportunity given the S&P 500 Value Index is 8% below February (pre-pandemic) highs, whereas the S&P 500 Growth Index is 18% above the February 2020 high. We are not implying the Value Index will reach a level in line with the Growth Index, but it does highlight that plenty of upside remains.

Investors sitting on the sidelines with cash and a longer-term investment time frame (beyond 12-24 months) should ignore all the potential near-term noise (Georgia run-off/Senate control, Covid surge/economic headwind, and political battle over stimulus- smaller package could disappoint) and invest a percentage of their idle cash in some of the lagging areas. Invest additional capital in the coming days and weeks as the market moves through the normal ebb-and-flow pattern. For investors who want to be timely when deploying capital, be ready to purchase any pauses or pullback periods in the coming days. With 125 S&P 500 stocks up 10% or more today (as of 9:30 a.m. CT), some give back in the coming days could transpire.

Kevin Giddis, Chief Fixed Income Strategist

The fixed income market is following the equity market, especially with the hopes that a COVID-19 vaccine is on the way. The news from Pfizer this morning, along with the increasing certainty of the US presidential election is pushing investors away from 'safer' assets like Treasurys into riskier assets like equities that are not 'stay at home' centric. The 10-year note yield pushed as high as 0.97% this morning, and it closed the day at 0.93%. This is consistent with our 1% year-end forecast since the early part of the pandemic. The premise was that if the US economy could bounce back AND positive steps toward a vaccine could be achieved, then the combination of growth, plus a 'hint' of inflation would push Treasury yields back up.

Today's price action suggests that could be true, but it may be a bit premature. We are seeing what looks to be a second wave of the virus and we don't know when or how many Americans will take the vaccine should it become available this year. The Fed will likely continue to stand by, providing the necessary accommodation needed to restore jobs, with the hope that they can hold the US economy in place until COVID-19 is eradicated.

While today's news is very good for most equities, the rise in yield on the 10-year note could be the spark that Financials, specifically the banks, needed to play a larger role in the US recovery. If inflation can be held at bay, then there is a possibility to see a win-win for the markets in 2021.

Chris Bailey, European Strategist, Raymond James Investment Services, Ltd.*

European and Asian financial markets initially traded notably positively on Monday in anticipation of a calmer global trade and diplomatic backdrop from the administration of President-elect Biden over the next four years. These are important considerations for both Asia and Europe as typically countries in both regions are relatively open, meaning that exports and imports are important components of economic growth rates.

With Europe in particular currently feeling the impact from a second wave of Covid-19 restrictions and lockdowns, today's news concerning vaccine progress has been enthusiastically embraced, pushing indices up further. Whilst nothing is guaranteed, this news has provided new hope and unsurprisingly has particularly positively impacted areas which have fallen out of favour during the past nine months. European indices have substantial weights in Financial, Energy, and Industrial sectors as well as in travel, all of which would be positively correlated with a return to pre-pandemic economic activity norms and these sectors have outperformed today.

European and Asian indices have struggled to attract substantial flows from American fund managers over recent years, as returns have struggled to match those by the various US markets. Additionally the dollar has been firm against many other global currencies. A less fraught trade/diplomatic backdrop and a return to pre-pandemic economic norms have the potential to encourage more investors to look at European and Asian markets which typically are trading at lower earnings multiples and offering higher dividend yields.

Pavel Molchanov, Director, Energy Analyst, Equity Research

While the Pfizer vaccine news is certainly encouraging, the challenge of large-scale logistics and distribution is only getting started. Normalization of daily life – including transportation and travel activity – is not realistic until a large portion of the population is successfully vaccinated, which will probably take until mid or even second half of 2021. That means it will be 2022 before global oil demand can plausibly return to pre-pandemic levels. For aviation full recovery is unlikely until 2023. In the meantime, the economy as a whole and the oil market will need to get through the pandemic's very difficult wintertime period. The second and third waves of COVID around the world have already led to the return of lockdowns across large swaths of Europe, and to a lesser extent North America, the Middle East, and South/Southeast Asia. The vaccine's timetable is such that it will not be able to put much of a dent in COVID case count metrics over the next two to three months.

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