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Sector rotation is a sign of a healthy equity market

♦ Cyclical and small-cap stocks made big gains on Monday, as investors considered the possibility of an economic reopening in a few months.

♦ The Russell 2000 had its best day since May, advancing 3.7%.

♦ Travel and leisure stocks were the biggest gainers in the S&P 500.

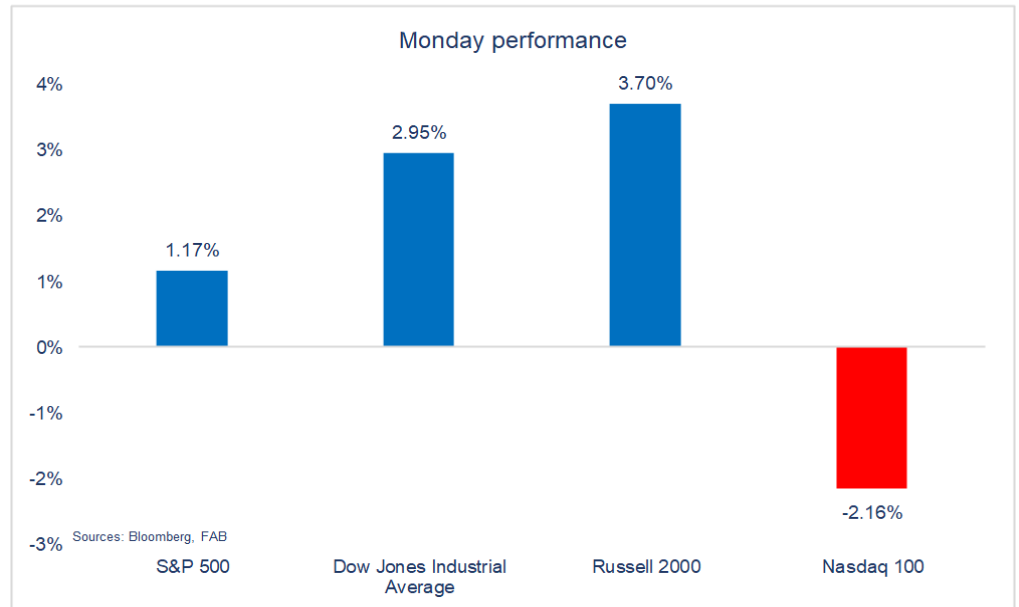
♦ Technology stocks were the laggards as investors looked away from stay-at-home beneficiaries amid positive coronavirus vaccine news.

♦ The FAB AAC remains marginally underweight in stocks and overweight in EM and IG bonds.

If you ask stock investors, a coronavirus vaccine has already been approved and is starting to be distributed. That is not the case yet, but markets in the US yesterday behaved as if it were. With the caveat that there still could be hurdles along the way, it makes sense for the market to start discounting a brighter future.

Once coronavirus vaccines and treatments are widely available, it is fair to think that people will start traveling, going to the cinemas and taking cruises again. In fact, data from China have shown that there is pent-up demand for doing all the things that have been restricted for so long.

While many will have more limited resources for these activities given the high levels of unemployment, those who can could in time rush back to airplanes, ships and theaters. These were exactly the stocks that led the gains yesterday, when two companies announced positive news about vaccines being developed.



The Russell 2000 small-cap index had its best day since May, and rallied 3.7%. This is a cyclical move, as smaller companies tend to perform better in an economic recovery than their large-cap counterparts. The best performers in the Russell 2000 were Hersha Hospitality Trust, a hotel company, which gained 51.72%, movie theater operator AMC Entertainment, up 51.41%, and charter airline operator Hawaiian Holdings.

The Dow Jones Industrial Average, which as the name suggests has a larger component of old economy members, gained 2.95%, led by American Express, up 21.39%, Boeing, which closed 13.71% higher, and JPMorgan Chase, which ended 13.54% better. The S&P 500 was paced by travel stocks too, with cruise operator Carnival rallying 39.29%.

Naturally, at this stage, many of these stocks are still a punt, and any reversals in the approval and testing process of vaccines could reverse these gains.

The Russell 2000 small-cap stock index was the best performer yesterday in the US

Carnival, for instance, burned through US\$2.85 billion of cash in the third quarter, after having reported negative operating cash flows of US\$2.72 billion in the second quarter. That means that roughly every day longer it takes for the vaccine to be available costs the company more than US\$31 million. Hence the risk of recent gains being reversed on any bad news.

While the stock moves in evidence of yesterday could be called a bit premature by some, it is a sign that investors are seeing a continuation of the bull market that began on 26 March. If stocks are really to take off and log new highs over the next few years, the rally has to widen away from the supersized technology companies that have fueled it so far.

Investment Strategy Update

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