KINGS POINT
CAPITAL MANAGEMENT LLC

INVESTING IN A COVID/POST-COVID WORLD
PART II – ON-THE-JOB TRAINING

Chart I

Source: Strategas

Living through a global pandemic is (hopefully) a once in a lifetime experience. Because the last one occurred in 1918, virtually all of us are dealing with this for the first time. Concurrent with this new environment is the ongoing expansion of the "online" digital internet experience. It has been said that the Covid-19 lockdown had the effect of accelerating the development and growth of the online experience to the point of compressing the next five years of online development into the span of only six months. For those corporations already positioned for this, growth has been outstanding. For those rapidly adjusting, growth is emerging. For those companies that have not adapted, growth has been stagnant or declining.

Companies, and society in general, are learning to adjust to this new digital world. In many respects, this is literally – On-the-Job (OTJ) training. The stock market is also continuing to adjust to this rapid change in global economic activity. While the initial reaction was almost an instantaneous bear market at the end of the first quarter of 2020 (Chart I), the market began to rapidly recover after the global central banks initiated unprecedented financial support packages to ensure stability in the financial systems.

At current levels, the market is clearly discounting 2020 results and is now focused on 2021. Historically, this is a normal pattern. The equity market tends to look forward six months, particularly after Labor Day. We think 2020 is no exception. While equity valuations are at rich levels based on current 2020 earnings estimates, the expectation of a strong rebound in corporate profits in 2021, concurrent with extremely low interest rates and inflation, make valuations generally acceptable. Add to this mix a very accommodating Fed, the anticipated impact of another significant financial stimulus package for Americans in the near term and the expectation of a vaccine by end of this year, we have a stock market that is likely to move higher in 2021.

MANAGING THE ECONOMY IN A COVID/POST-COVID WORLD

For the U.S. government, trying to manage through a pandemic is truly OTJ training. Both the Fed and Congress have combined to create a massive stimulus package to replace lost personal income, give out forgivable loans to small businesses and massively inject liquidity into the system. As illustrated in Chart II, the Fed has dramatically expanded the money supply because of Covid-19.

Chart II

Source: Strategas

This money supply expansion is dramatically more powerful than during the financial crisis of 2008-09. What we find astounding is that inflation continues to act very benign. Indeed, another part of the Fed's OTJ training has been a change in the targeted inflation rate. Prior to the change that occurred this summer, the Fed maintained a 2% inflation target. This new change is looser, allowing inflation to run "hot" above the 2% historical target in order to allow for economic expansion to continue without negative interest rate influences. Congress has also responded in an unprecedented fashion. It has passed $5 trillion in relief programs and is pending another $2-3 trillion injection into the economy before 2020 year-end. These are critical financial lifelines to unemployed Americans, state and local governments and small to medium-sized businesses. It is clear that the new playbook by both Congress and the Federal Reserve is not to underreact but take the risk of overstimulating our economy during this pandemic period.

Chart III

Source: Strategas

A good part of the reasoning is the unprecedented collapse in employment in the country (Chart III). The restaurant, hotel and leisure industries were severely impacted. Many who lost jobs had low income positions and have suffered the most from the pandemic crisis. Thus, Congress and the Fed had devised a new playbook. The next round of stimulus is likely to target specific industries, as well as individuals and social support programs. The groundwork for this overall strategy of excessive stimulus was clearly based on the successful efforts to deal with the global financial crisis of 2008-09.

Chart IV

Average Inflation, Treasury Yields, Valuation, Tax Rates & Nominal GDP by Decade						
	CPI Y/Y % Change	S&P 500 Operating P/E	10 Year Treasury Yield	Dividend Tax Rate	Capital Gains Tax Rate	Nominal GDP
1950s	2.1%	12.6	3.0%	91.0%	25.0%	7.1%
1960s	2.3%	18.1	4.7%	80.3%	25.4%	7.0%
1970s	7.1%	12.5	7.5%	70.2%	36.0%	10.2%
1980s	5.6%	11.7	10.6%	48.4%	23.6%	7.8%
1990s	3.0%	19.5	6.6%	37.0%	26.0%	5.6%
2000s	2.6%	20.1	4.4%	23.4%	16.8%	4.0%
2010s	1.8%	17.7	2.4%	21.2%	21.2%	4.1%
Average	**3.5%**	**16.X**	**5.6%**	**53.1%**	**24.9%**	**6.6%**
Current	**1.3%**	**28.6X**	**0.7%**	**23.8%**	**23.8%**	**-32.8%**

Source: Strategas

As Chart IV indicates, the current 10-year government bond rate is ~0.7%. By comparison, the average yield for the 10-year has been ~5.6%. As such, it is clear that the average S&P 500

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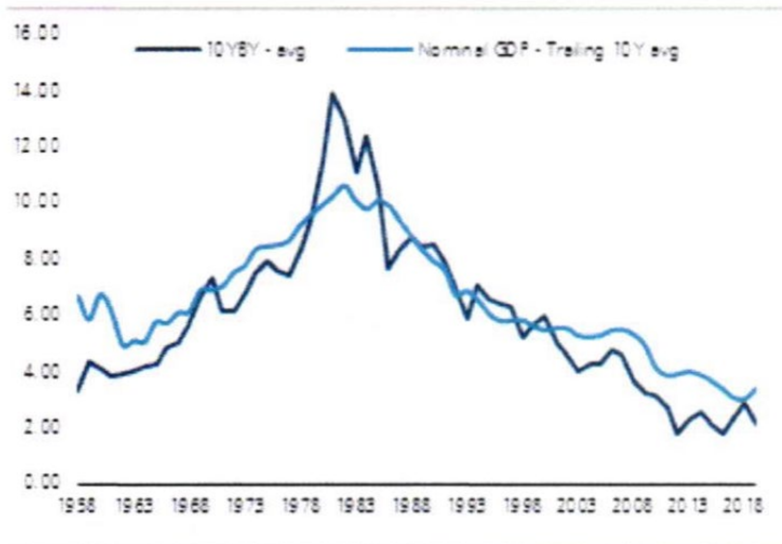
Operating P/E ratio would be higher in the current environment. One concern we would have is how the current P/E would change if the yield increased. Our preference is to look at spread differential between the 2-year and 10-year Treasury. The current spread is ~57 basis points. With the FOMC rate effectively anchored at 0%, we would expect any pickup in GDP to lead to an increase in the 10-year yield (Chart IV). As such, the 2-10 spread would increase and this could lead to a decline in the P/E ratio without an uptick in earnings.

Chart V

US - historical relationship between nominal GDP and 10y bond yields (93% correlation)



Source: UBS

Another bond chart we think is fascinating is the relationship between nominal GDP growth and the 10-year government bond yield (Chart V). The correlation is over 90%. This suggests that as nominal GDP picks up in 2021, we may well see an acceleration on the 10-year government bond yield. Since the current rate is so low, a rise would be a positive indicator that economic growth is likely to show a sustainable expansion. Concurrent with the massive fiscal and monetary stimulus, we may finally see some real inflation. While this would normally be an issue, the extremely low base suggests we view it as a return to more normal patterns of growth.

MANAGING A CORPORATION IN A COVID/POST-COVID WORLD

Corporate America tends to shine the most during intense periods of stress. This was the case in 2008-09 when most domestic non-financial companies retained a strong balance sheet and emerged in a stronger competitive position than many foreign-based organizations. Domestic technology companies also tend to lead in innovation. We believe this will also be the case in the post-Covid environment to come. Corporate profits have been far better than anticipated in 2020, which is the

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foundation base for the strength in the equity markets this year. Profit margins are much higher than original expectations as a result of reduced headcount and significantly lower variable expenses such as advertising, promotion, travel and entertainment. Corporations are in the middle of rewriting how to transact business in the future. This is the key to OTJ training efforts now ongoing. Many consumer sensitive corporations have dramatically shifted to e-commerce (higher growth margin) formats as they shift selling away from standard restaurant and retail channels. Restaurants and fast-food establishments are still adapting to home delivery strategies. Manufacturing companies are rethinking supply chain strategies. All these new initiatives should create a faster, nimbler corporate America in the future. As we enter 2021, we are not sure how profit margins are likely to move. As volume begins to pick up due to America and Europe reopening again, variable expenses may rise at a faster than expected rate as companies spend to gain market share. Earnings comparisons will also be against unusually high profit margins of 2020.

At this juncture, the general consensus is for S&P earnings to reach $155-175 a share up from about $130-140 this year. As a comparison, 2019 S&P earnings reached $158 a share. This puts the market at about 21x 2021 estimates. Thus, given the low interest rate and inflation environment, the market remains attractive at current levels.

NEW ADDITIONS TO OUR CORE AND DIVIDEND GROWTH PORTFOLIOS

We have always focused on individual fundamentals in all our investments. They must meet ROIC targets, positive cash flow, and organic revenue expansion among other critical operational goals. We then overlay thematic trends that we believe create long term tailwinds to overall growth. In the last quarter, we added three new names. All three meet the fundamental and thematic criteria outlined above.

Core Additions

Williams-Sonoma, Inc. (WSM) is an e-commerce leader in its three main retail concepts: Pottery Barn (home furnishings and furniture), Williams Sonoma (upscale housewares) and West Elm (mid-priced furniture). In the last quarter, some 70% of revenue was generated online. This makes the company one of the largest e-commerce retailers in the U.S. Moreover, the company generates over $500 million in free cash flow each year, has well-above average ROIC and is expected to organically grow revenue in the mid to high single-digits long term. This company has an outstanding management team as well.

IQVIA Holdings Inc. (IQV) employs over 67,000 workers in over 100 countries worldwide. It is one of the largest contract research organizations (CRO) in the U.S. The company enjoys a rapidly expanding SaaS (software as a service) business with its proprietary data base of 800 million patient records. The CRO business model enjoys a consistent mid-single digit growth. The company is also expected to generate consistent profit margin improvement as well. We expect a strong recovery in 2021 as many of their clinical labs begin to reopen in 2021 forward after adjusting to the Covid-19 crisis especially due to its powerful presence in its medical proprietary software.

Dividend/Growth Portfolio

Brookfield Renewable Corporation (BEPC) is one of the largest pure-play renewable power companies in the world. Currently, its cash flow comes from hydropower (64%), wind (27%) and solar (9%). We believe this will shift more toward solar in the next few years. The company is in the sweet spot of the global effort to reduce carbon emissions in the next 20-30 years. It is expected to generate 10% FFO growth long term and grow dividends at 6%+ annually during this period. Currently yielding about 4%, this is a great long- term dividend/growth vehicle for our client base.

As always, we request that each client provide us with written notice about any changes to their investment needs, goals, objectives, risk tolerances, or investment restrictions to our advisory team. Should you have any questions, please contact us at your earliest convenience.

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