



## **COVID-19 UPDATE: S&P 500 Mega-caps not a "bubble" as Top 5 earnings share = top 5 market cap share. San Diego CFA poll shows CFA holders bearish.**

**THIS MESSAGE IS BEING SENT SOLELY TO CLIENTS OF FS INSIGHT**

Thursday was a rough day in the markets, with a fierce sell-off and S&P 500 down >1%. The carnage was in the mega caps and there is a growing chorus that the S&P 500 is distorted by the outsized market cap of the Big 5 tech names. We have seen multiple citations of the "craziness" of this market as the top 5 are now 22% weight of the S&P 500. We discuss this at length below, but we just don't see the bubble. The top 5 stocks (AAPL, MSFT, AMZN, FB, GOOG) are 18% of earnings and like >80% of 2020 EPS growth. So, their 22% market cap share does not seem so out of line with their nearly 20% net income share. After all, aren't these franchise cos?

It looks like this is the week that definitely saw US case surge finally plateau (and hopefully turn into a decline this weekend). It looks like all the mitigation measures taken in the past few weeks are working. And the White House is now endorsing mask use. Thus, we see the economy risks diminishing.

And as we have commented in the past, as the national disease panic fades, local behavior recovers. In fact, our survey of San Diego CFA members conducted this evening (see last bullet) shows how CFA members perception of national trends governs their own personal decisions.

This is why we are not too alarmed at seeing economic data stall in the past week. Virus spread started accelerating in early June and the media and skeptics and policymakers have been quite alarmed -- appropriately, actually. But this had the effect of dampening economic momentum. If cases are now peaking, economic momentum will resume. And our policy strategist, Tom Block, expects a stimulus package passed and signed by early August.

Thus, the set up for stocks, in our view, is extremely attractive right now:

- disease is plateauing (again)
- economic momentum should recover
- fiscal stimulus coming
- sentiment remains very negative (see San Diego CFA survey below)
- \$5T cash on sidelines

And many are ringing the bell (top of market).

**STRATEGY: The Top 5 stocks earnings share = market cap share. Not a "bubble"**

**5 sentences on the reminisces of the 1999 dot-com bubble, my early career experience...**

I was a wireless analyst in 1999, working at Salomon Brothers, which at that time, was the "firm" for wireless and telecom IPOs and investment banking. We had Jack Grubman running the Telecom group and he was a giant among short-statured telecom research franchises. So, suffice it to say, I was a ground zero witness to that dot-com bubble. The dot-com bubble fueled a "get rich quick" mentality as tech IPOs saw tremendous gains, any renaming to "internet" caused a surge and investors were funding and throwing money at any new telecom/internet idea. I don't have enough space in this daily commentary to describe the mania that was prevalent then, but one of the realities is this environment created a mismatching of pricing because:

- Companies that raised money in IPOs use that money to invest/fund/buy products from other start-up --> pyramid-like
- Venture funds were returning 100X-500X, so new funds were funded with massive profits from legacy funds --> pyramid-like
- Internet was growing so fast, but capital requirements so high, companies that were growing were losing tons of \$\$\$ --> shift away from EPS

Bottom line, equity prices rose faster (straight up) than earnings (straight down). So, there was a growing and visible disconnect between asset prices and EPS. This was the bubble. If these dot-com companies were highly profitable, nobody would have called it a bubble.

**Fast forward --> 2020. Those seeing "echoes of 1999"**

Over the past few weeks, there has been a growing chorus of investors calling this equity market ultra concentrated, pointing to the outsized gains of the top 5 largest stocks in the S&P 500. In fact, even this morning, there were a few clients who shared with me this email from a broker. The message is all the same:

- the S&P 500 market is "unhealthy" because the top 5 stocks are too big
- many even point to this mirroring the 1999 "dot-com" bubble

From [redacted] this AM:

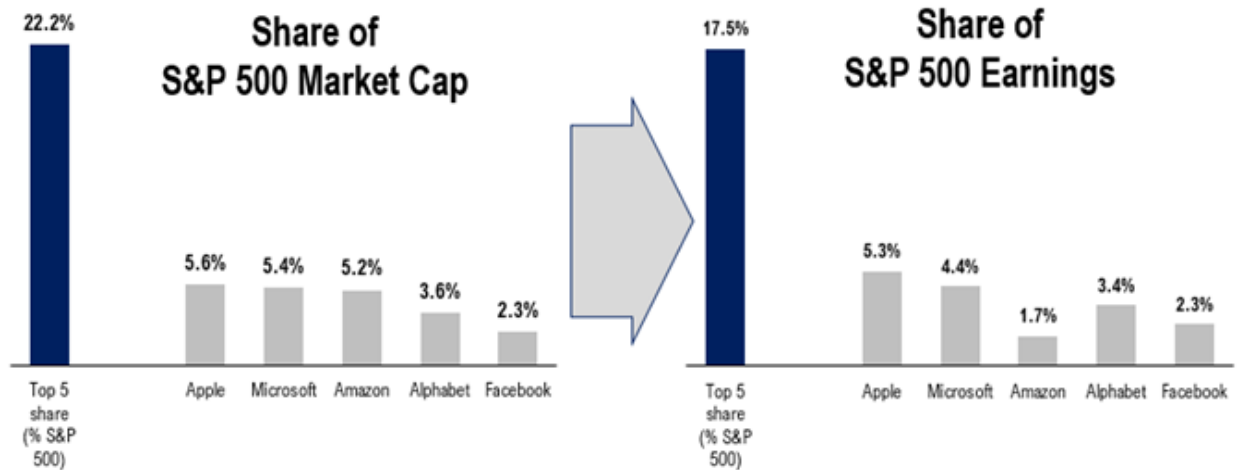
Strategy: FB, AMZN, AAPL, MSFT, and GOOGL, the five largest US stocks, now account for 22% of S&P 500 market cap, up from 19% in January 2020 and 16% a year ago. These stocks have returned 35% YTD, compared with -5% for the remaining 495 S&P 500 stocks, and each of the five set a new record high this month. [redacted] notes that the exceptionally large index weights of the top firms make the S&P 500 vulnerable to an idiosyncratic shock that drives any of those stocks lower.

Source: sell-side broker AM note

**Top 5 "Market Cap share" about the same as "Earnings share"**

Below is a comparison of the market cap of the top 5 largest stocks in the S&P 500 (AAPL, MSFT, AMZN, FB, GOOGL) and their corresponding earnings share:

- Market cap share is 22%
  - EPS share is 18%
- So, one can see the valuation of the top 5 is not necessarily distorted.



Source: Fundstrat

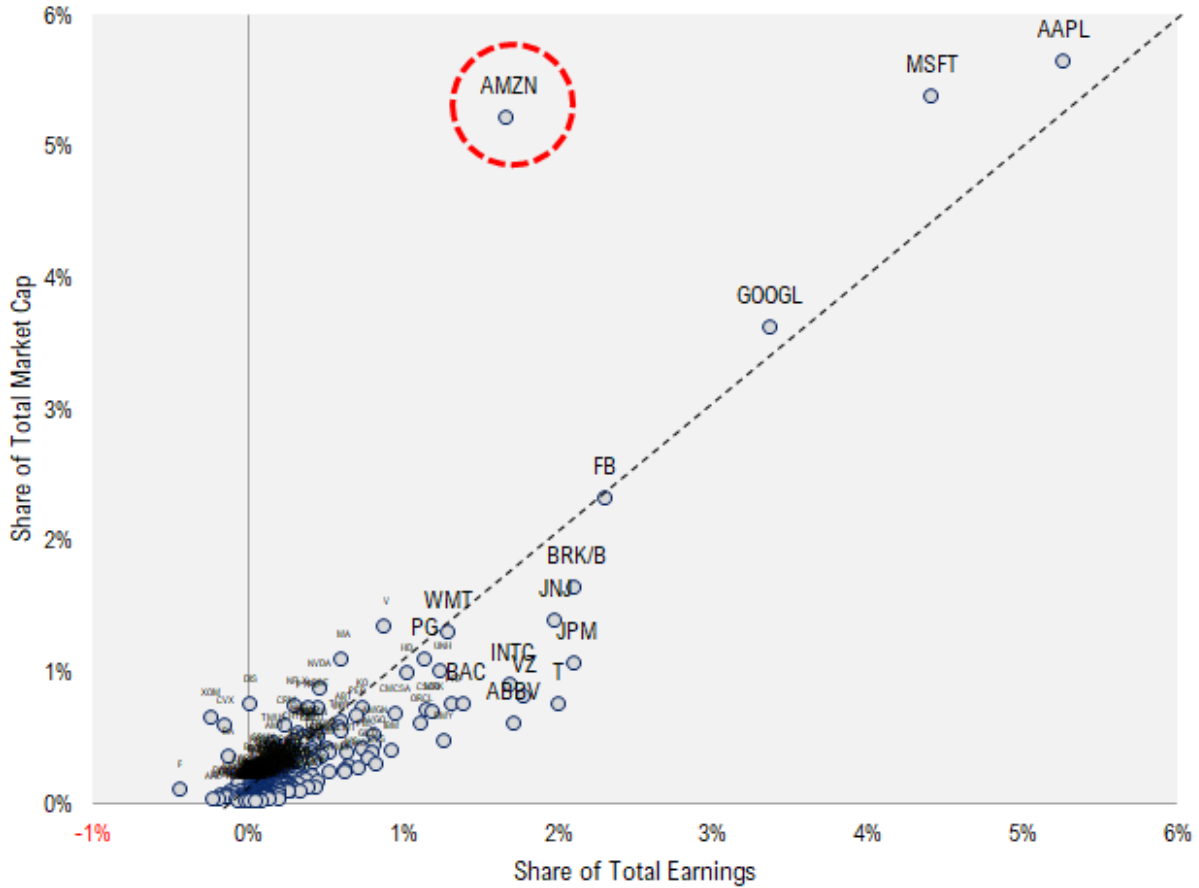
This is actually true for the top 10 largest stocks in the S&P 500 as well. The earnings share is grey and the market cap share is blue. With the exception of Amazon.com, the relative proportions are not that far off.



Source: Fundstrat

And stepping back, below is the earnings share vs market cap share of each constituent in the S&P 500. The x-axis is net income share and y-axis is market cap share. Any significant deviation above the trendline is an outlier. As indicated, only Amazon.com is an outlier.

- One can argue these top 5 companies have higher revenue and EPS growth, and thus, deserve to have a higher valuation.
- And their market positions are considerably more dominant, which warrants a smaller equity risk premia (higher PE) as their incremental profitability should be higher.

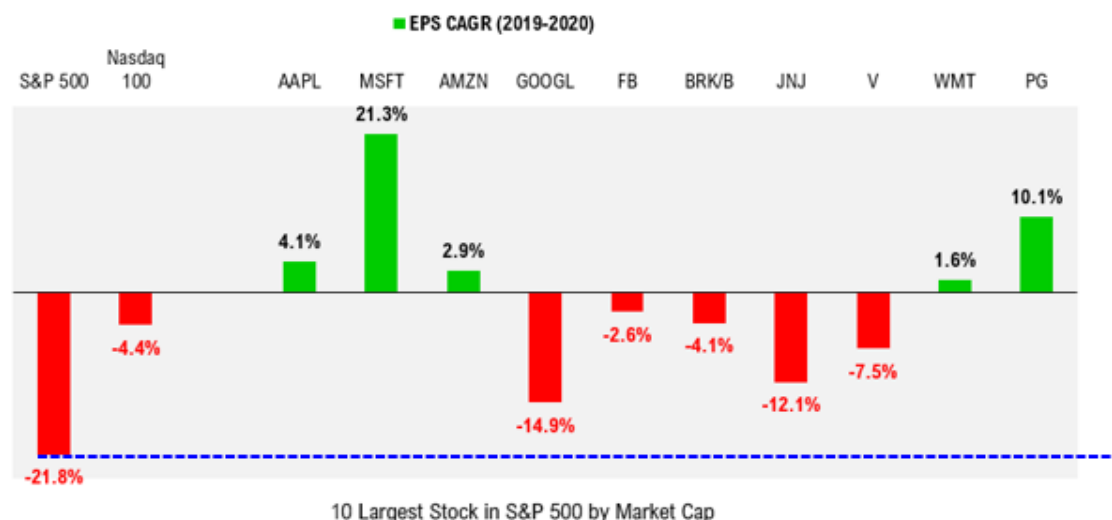
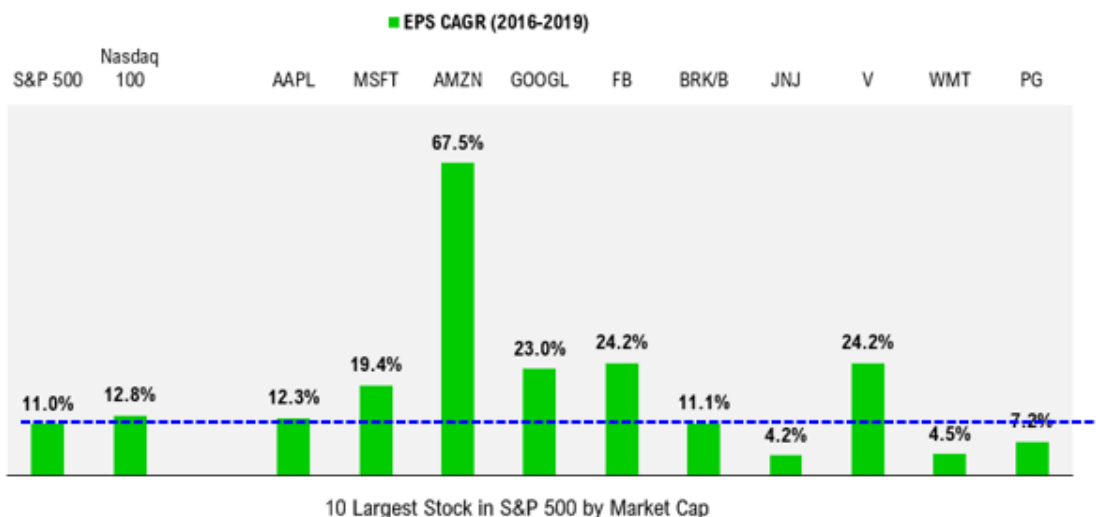


Source: Fundstrat

**Top 5 stocks have superior EPS growth = higher P/E**

Take a look at both the 3-yr EPS CAGR (2016-2019) and 2020 EPS growth. The Top 5 are all growing far faster than the S&P 500 overall. Thus, if one believes higher EPS growth warrants a P/E premium, this is what we see today.

- more importantly, we hardly see the S&P 500 price distorted by the influence of the top 5.

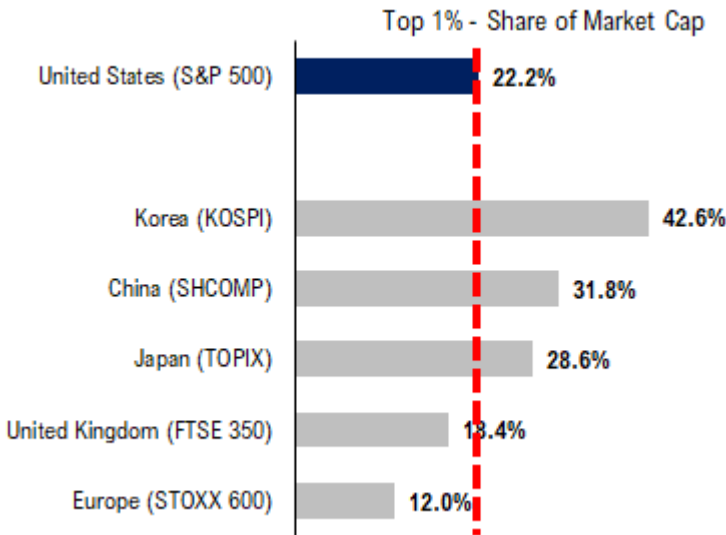


Source: Fundstrat

**US Top 5 stocks share at 22% is about in line with the Rest of the World...**

Moreover, the high market cap share of the top 1% largest companies in an index should be disproportionately high. Take a look at the S&P 500 compared to 5 major global stock indices.

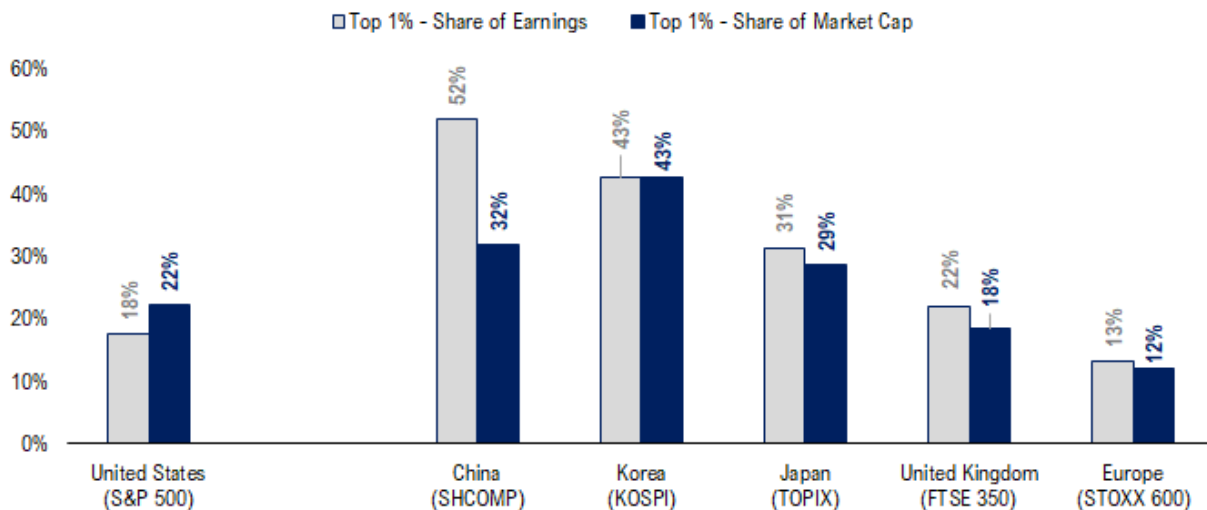
- Korea, China and Japan top 1% largest stocks are massively higher market cap share
- While this is not necessarily true in UK and Europe to the same extent, the top 1% of companies are 12X-13X larger in market cap.



Source: Fundstrat

**Earnings share = market cap share for RoW just like USA**

The earnings share and market cap share show about the same relationship. It is essentially the same.



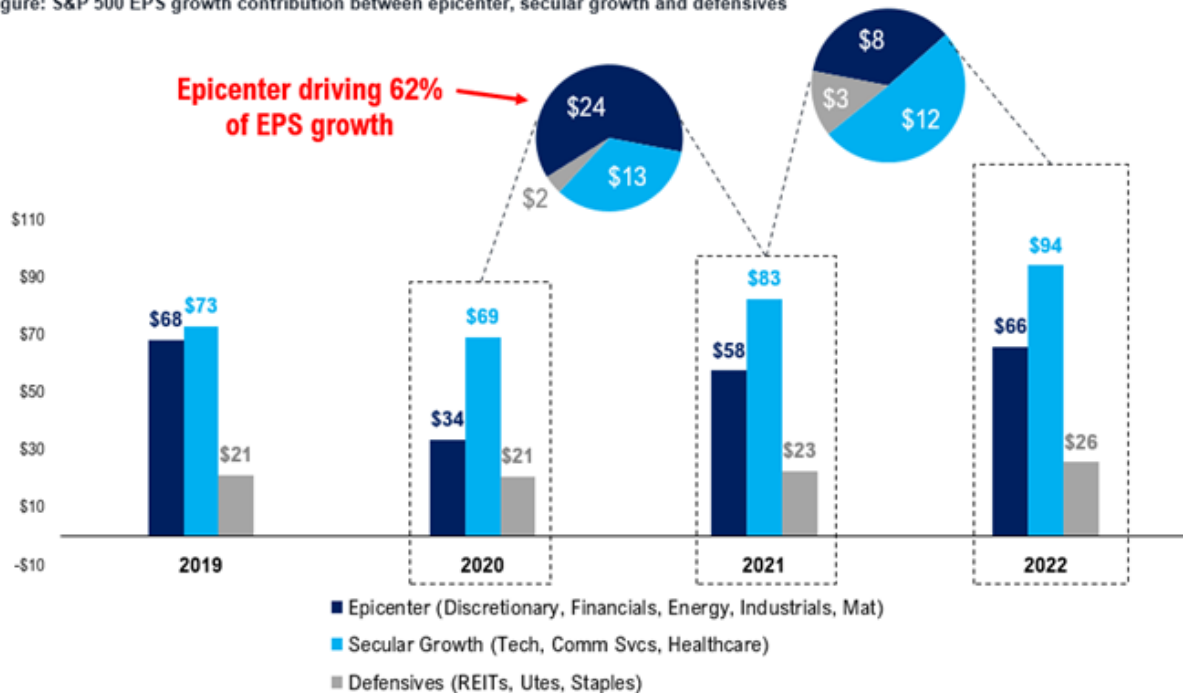
Source: Fundstrat

**But 2021 EPS growth is primarily driven by Epicenter stocks = OW Epicenter...**

We are not saying that secular growth/FANG/bond proxies are going to continue to outperform. Rather, we are saying the S&P 500 is not necessarily "irrationally priced" which many top-callers might assert. Moreover, look at EPS growth contributors in 2021, based on consensus forecasts.

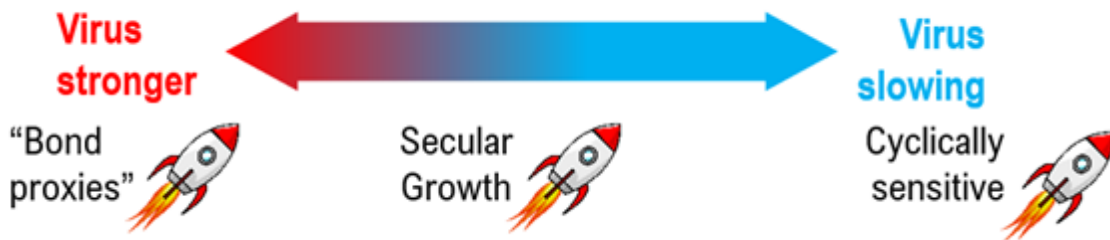
- the epicenter, Industrials, Discretionary, Financials and Energy, will account for 62% of EPS growth
- they are only 26% of market cap today

Figure: S&P 500 EPS growth contribution between epicenter, secular growth and defensives



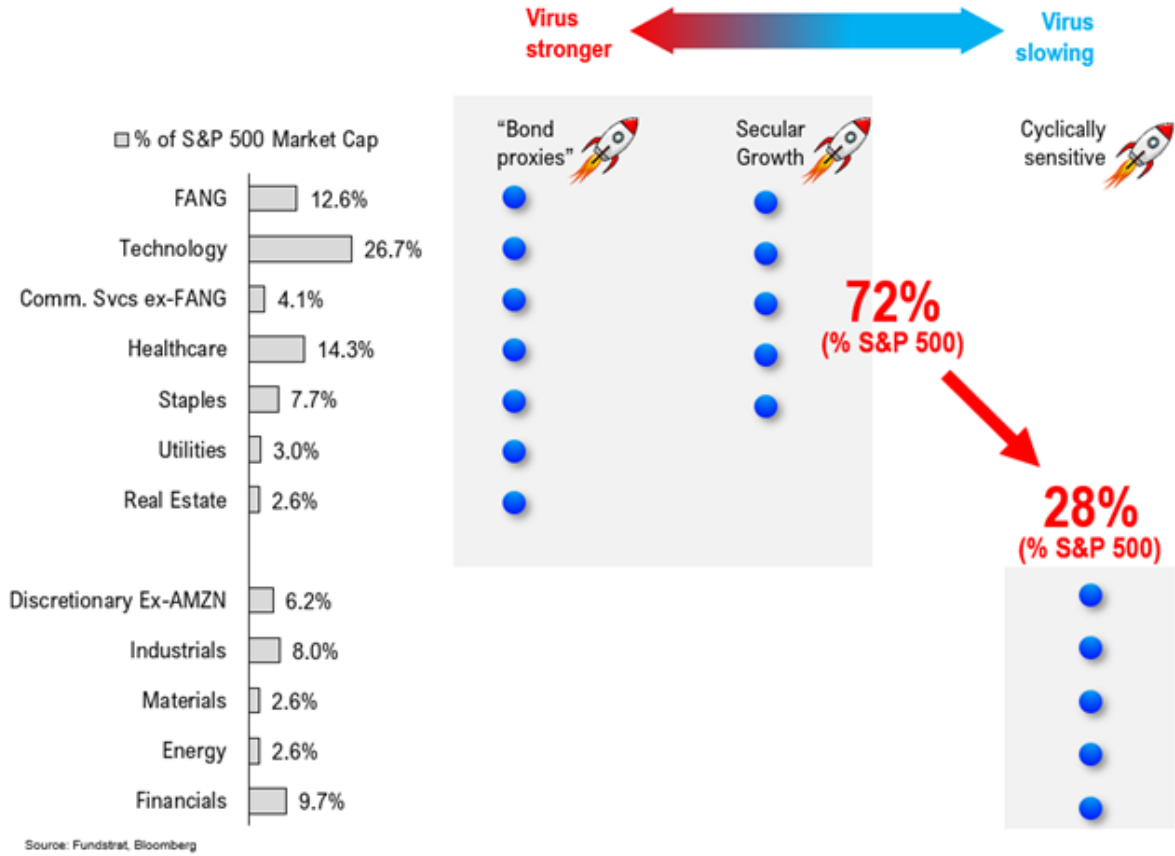
Source: Fundstrat, Bloomberg, Factset

And going back to our prior observation, if the virus is weakening (our view), we want to OW cyclically sensitive.



And cyclically sensitive are the epicenter groups. And as shown below, this is a lot market cap rotation from 72% of the market to 28%. Thus, should it be any surprise if these stocks see a massive surge?

**Figure: Sector Composition of S&P 500**  
Bloomberg, as of 7/20/2020





Below is our Granny Shots list. This is a hybrid core/epicenter/thematic list.

**Figure: Granny shots – recommended across at least two investment strategies for 2020**

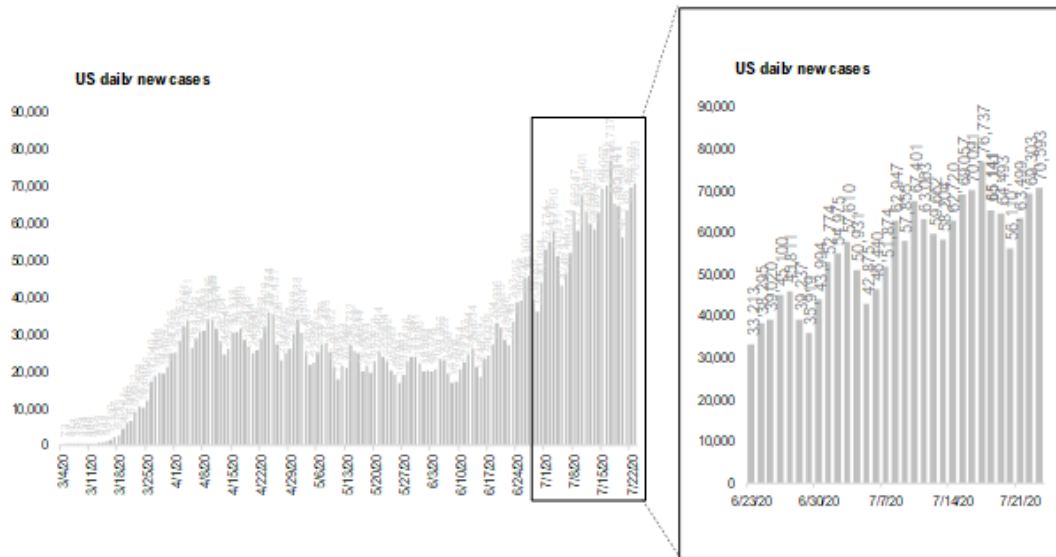
Per Fundstrat

Company information					Analyst Ratings					Fundament
Ticker	Company name	Current Price	Mkt cap (\$ mm)	YTD perf (relative to S&P 500)	FC Mean (5=Buy 1=Sell) <sup>(1)</sup>	Mean implied upside <sup>(2)</sup>	Dividend Yield	Issuer Rating	Short interest % of float	2020E sales growth <sup>(3)</sup>
1	AAPL	\$388.00	\$1,681,722	31.3%	4.19	-4%	0.9%	AA+	0.9%	1%
2	GOOG	\$1,558.42	\$1,063,001	15.7%	5.00	2%	0.0%	AA+	0.8%	5%
3	GRMN	\$99.81	\$19,065	1.5%	3.20	-10%	--	--	3.2%	-10%
4	CSCO	\$47.02	\$198,532	-2.8%	3.79	5%	3.1%	AA-	1.0%	-5%
5	XLNX	\$102.15	\$24,842	3.7%	3.35	-2%	1.5%	NR	3.2%	-6%
6	LOW	\$145.00	\$109,475	20.3%	4.53	-0%	1.7%	BBB+	1.1%	6%
7	BKNG	\$1,711.71	\$70,062	-17.5%	3.76	-3%	--	A-	3.4%	-53%
8	EMR	\$63.79	\$38,113	-17.2%	3.48	1%	3.2%	A	1.3%	-10%
9	HPQ	\$17.48	\$24,996	-15.8%	3.24	2%	4.3%	BBB	1.5%	-8%
10	BWA	\$37.70	\$7,816	-13.9%	4.18	4%	1.8%	BBB	9.7%	-20%
11	LEN	\$68.35	\$20,693	21.7%	3.95	7%	0.5%	BB+	3.0%	-5%
12	CF	\$29.80	\$6,371	-38.4%	4.05	21%	4.1%	--	2.7%	-12%
13	MXIM	\$69.00	\$18,401	11.4%	3.32	3%	2.8%	BBB+ **	2.1%	-6%
14	AMZN	\$3,138.29	\$1,565,304	69.0%	4.75	-5%	--	AA-	0.9%	24%
15	EBAY	\$56.59	\$39,765	55.9%	3.55	-3%	1.1%	BBB+	3.0%	-4%
16	PG	\$125.07	\$309,629	-0.7%	3.96	6%	2.5%	AA-	0.6%	4%
17	NVDA	\$413.14	\$254,081	74.8%	4.50	-3%	0.2%	A-	1.2%	34%
18	MSFT	\$208.75	\$1,583,043	31.6%	4.78	5%	1.0%	AAA	0.6%	12%
19	MINST	\$75.00	\$39,492	17.2%	3.89	-6%	--	--	1.7%	2%
20	TSLA	\$1,568.36	\$290,948	274.1%	2.61	-45%	--	B-	9.5%	12%
21	PYPL	\$175.58	\$206,159	61.5%	4.52	1%	--	BBB+	1.2%	14%
22	AXP	\$96.33	\$77,543	-23.4%	3.63	9%	1.8%	BBB+	1.7%	-14%
23	BF/B	\$67.11	\$31,181	-1.5%	2.56	-8%	1.0%	A-	2.9%	-3%
24	PM	\$75.92	\$118,217	-11.6%	4.56	13%	6.3%	A	0.5%	-3%
<b>Average</b>			<b>\$324,935</b>	<b>22.8%</b>	<b>3.89</b>	<b>-0%</b>	<b>2.1%</b>		<b>2.4%</b>	<b>-2%</b>
<b>Median</b>			<b>\$73,802</b>	<b>7.5%</b>	<b>3.92</b>	<b>1%</b>	<b>1.8%</b>		<b>1.6%</b>	<b>-4%</b>
<b>% of stocks positive</b>				<b>58%</b>		<b>54%</b>				<b>42%</b>

Source: Fundstrat, Bloomberg, Factset

**POINT #1: More and more likely cases "peaking" -- 4 days cases flat week over week...**

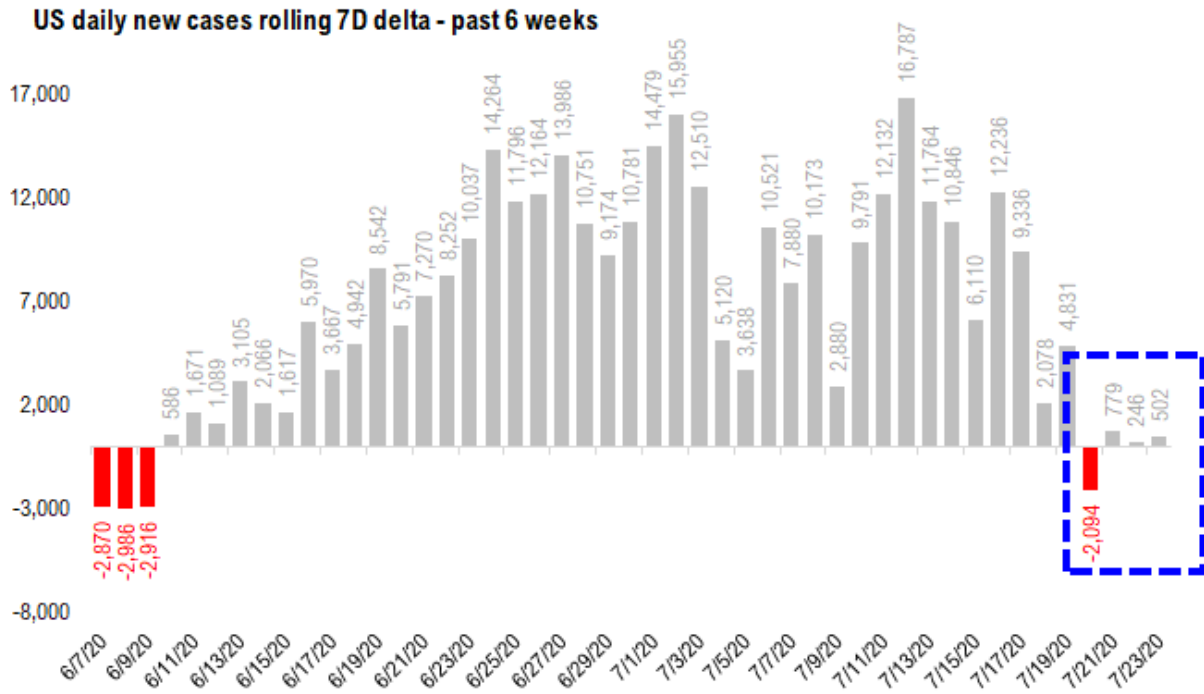
Total USA cases came in at 70,593 which is flat with the case figures a week ago (see second chart) and this is looking more and more likely that USA cases have plateaued. The case figures for Friday (7/24) will be the decider as that is 7D past the all-time high of 76,737 seen on 7/17.



Source: COVID-19 Tracking Project

Increasingly, the chart below is becoming way more useful. This is looking at the daily cases vs same day 7D ago. This smooths out seasonality and is a crude proxy for R0 value. If the 7D is flat to negative, the disease is slowing.

- Notice for the past 4 days, the 7D delta in cases is flat
- this is a huge contrast to the surge seen in the past 3-4 weeks and looks more like the situation in early June.



Source: COVID-19 Tracking Project

**6 states saw large 1D increases**

Georgia	4,286 vs 3,314 (1D)	+972
Alabama	2,399 vs 1,455	+944
Iowa	841 vs 319	+522
Florida	10,249 vs 9,785	+464
Arkansas	1,013 vs 591	+422
Arizona	2,335 vs 1,926	+409
<b>Total 6 states</b>		<b>+3,733</b>

**6 states saw large 1D declines**

California	12,040 vs 12,807 (1D)	-767
Mississippi	982 vs 1,547	-565
Louisiana	2,296 vs 2,771	-475
Texas	9,507 vs 9,879	-372
Oklahoma	668 vs 975	-307
North Carolina	1,892 vs 2,140	-248
<b>Total 6 states</b>		<b>-2,734</b>

**Daily Case Increases (by State) (07/23)**

% total new cases (state cases/ total US cases)  
% total US pop (state population/ total US population)

*Sorted*  
Last 3-day trend growth rates

*MA stats is not available as of Thursday 8PM...*

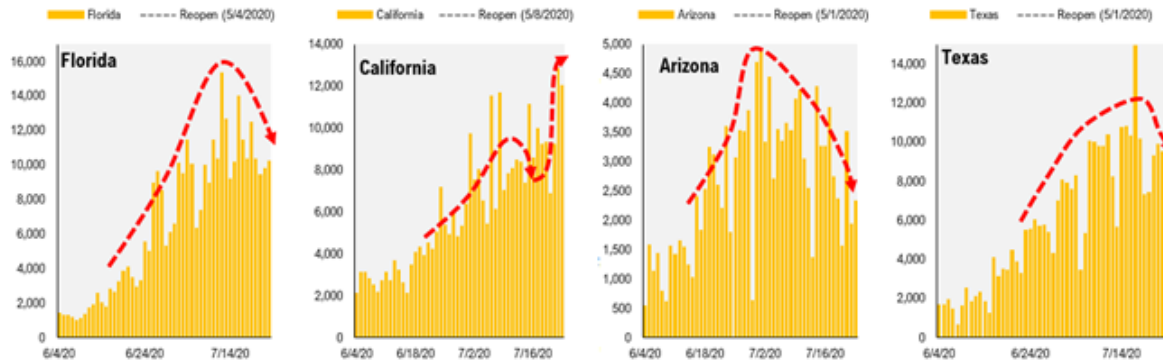
	7/21/20	7/22/20	7/23/20	
United States	63,499	69,303	70,593	+1,290
<b>States:</b>				
1 California	9,231	12,807	12,040	
2 Florida	9,440	9,785	10,249	
3 Texas	9,305	9,879	9,507	
4 Georgia	3,413	3,314	4,286	<-higher
5 Tennessee	2,190	2,473	2,570	
6 Alabama	1,467	1,455	2,399	<-higher
7 Arizona	3,500	1,926	2,335	
8 Louisiana	1,691	2,771	2,296	
9 North Carolina	1,815	2,140	1,892	
10 Missouri	1,138	1,301	1,637	<-higher
11 Illinois	955	1,598	1,624	
12 South Carolina	1,892	1,705	1,564	
13 Ohio	1,047	1,527	1,444	
14 Nevada	815	1,129	1,262	
15 Wisconsin	1,117	712	1,052	
16 Arkansas	728	591	1,013	<-higher
17 Mississippi	1,635	1,547	982	
18 Pennsylvania	1,027	631	962	
19 Indiana	710	757	929	<-higher
20 Virginia	996	1,022	844	
21 Iowa	308	319	841	<-higher
22 New York	855	705	811	
23 Minnesota	350	504	760	<-higher
24 Michigan	573	523	699	<-higher
25 Washington	797	832	672	
26 Oklahoma	893	975	668	
27 Maryland	860	627	664	
28 Colorado	493	639	616	
29 Kentucky	646	480	607	
30 Utah	486	566	521	
31 Idaho	556	500	414	
32 New Mexico	302	311	335	
33 Nebraska	343	296	332	
34 Oregon	292	254	320	
35 Puerto Rico	244	75	244	
36 New Jersey	293	389	242	
37 Delaware	122	46	132	
38 North Dakota	81	160	126	
39 Montana	94	104	97	
40 West Virginia	57	262	89	
41 Connecticut	41	127	83	
42 Rhode Island	82	86	76	
43 South Dakota	76	58	66	
44 Alaska	92	91	60	
45 Wyoming	51	50	58	
46 Hawaii	25	17	55	<-higher
47 District of Columbia	88	102	42	
48 Maine	12	28	24	
49 New Hampshire	13	33	23	
50 U.S. Virgin Islands	4	12	16	
51 Vermont	5	2	11	
52 Guam	8	3	2	
53 Northern Mariana Islands	1	0	0	
54 Massachusetts	244	287	0	
55 Kansas	0	770	0	
56 American Samoa	0	0	0	

Source: COVID-19 Tracking Project

**POINT #2: F-CAT cases almost certainly peaked in FL, AZ and TX and waiting for CA**

The trends in F-CAT are quite positive as well. This has been the case for the entire week and as we finish this week, it looks like this remains the case:

- FL, cases peaked last week
- CA, cases still high but looking definitely peaked in Los Angeles
- AZ, cases peaked 3 weeks ago
- TX cases peaked last week

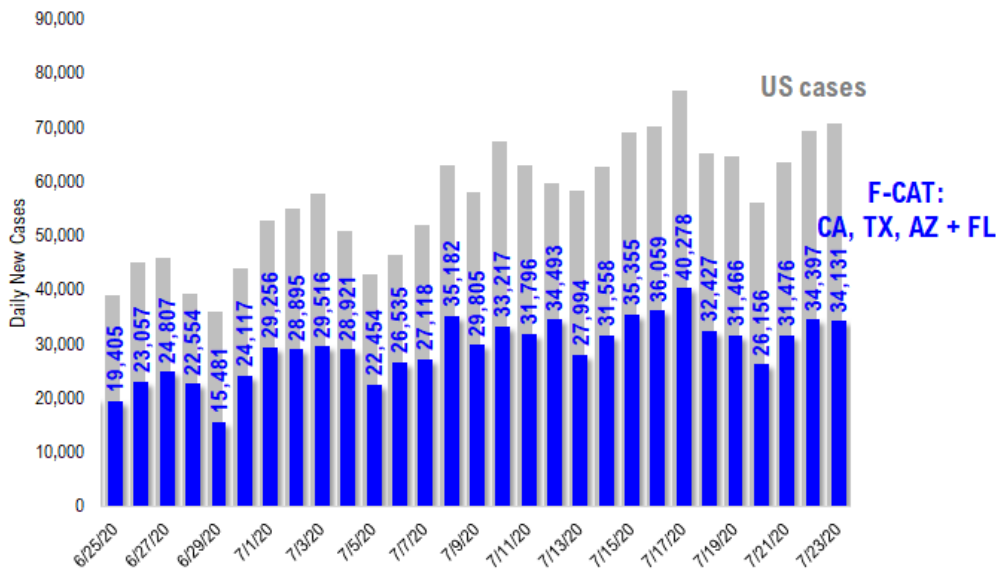


Source: COVID-19 Tracking Project

And in total, F-CAT remains about half of US cases and as shown, it has been 7 days since the record 40,278 reported. More importantly:

- F-CAT cases have been down vs 7D ago in each of the last 3 days
- if F-CAT has peaked, along with NY tristate and VIMMP, 60% of the US is past wave 1.
- many other states like GA and SC are experiencing a contemporaneous surge, not any renewed wave

Thus, if F-CAT is peaking, the case growth in the US is largely peaked.

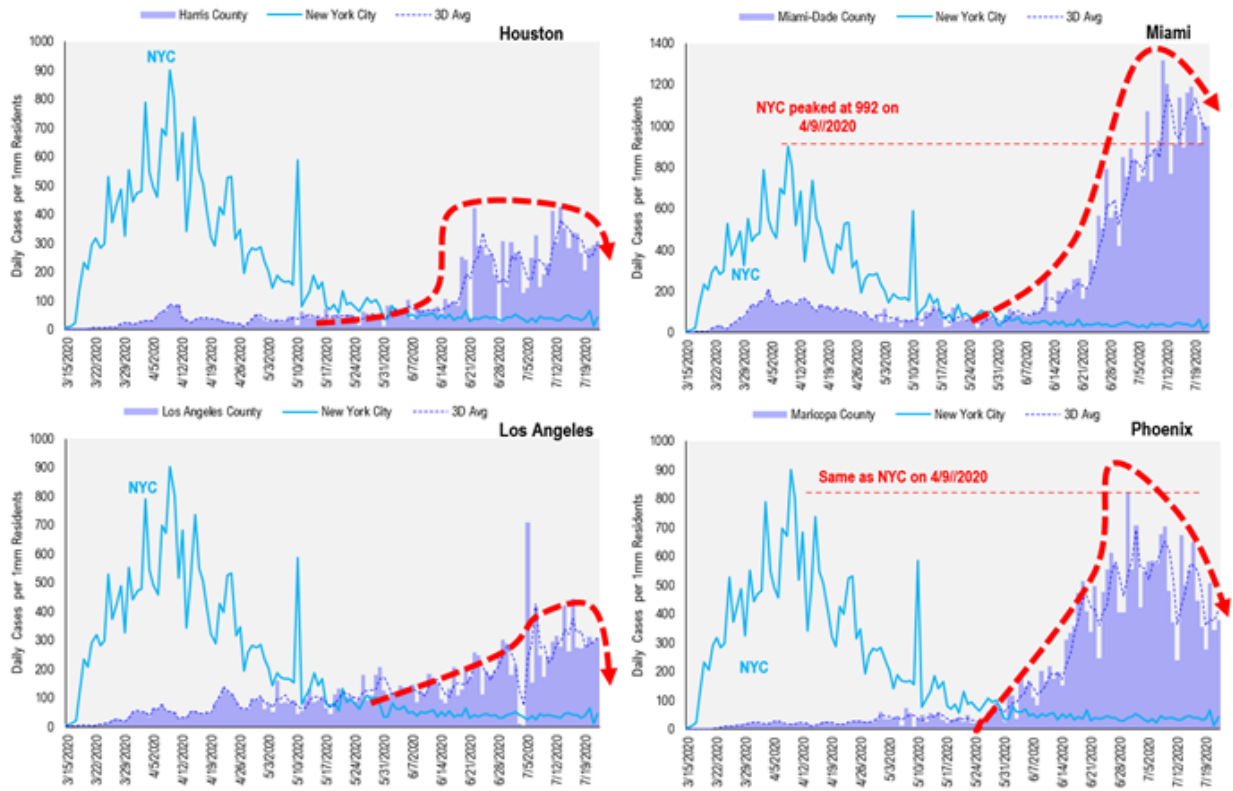


Source: COVID-19 Tracking Project

**The "nucleus" cities are still not showing a re-acceleration of cases = confirming peak**

The good news is the 4 nucleus cities are not showing a resurgence in case growth. While CA case counts remain elevated, it appears to be taking place outside of Los Angeles but still within SoCal.

- LA daily cases are flat and not nearly the levels implied by CA state reflecting 12,000 cases per day.



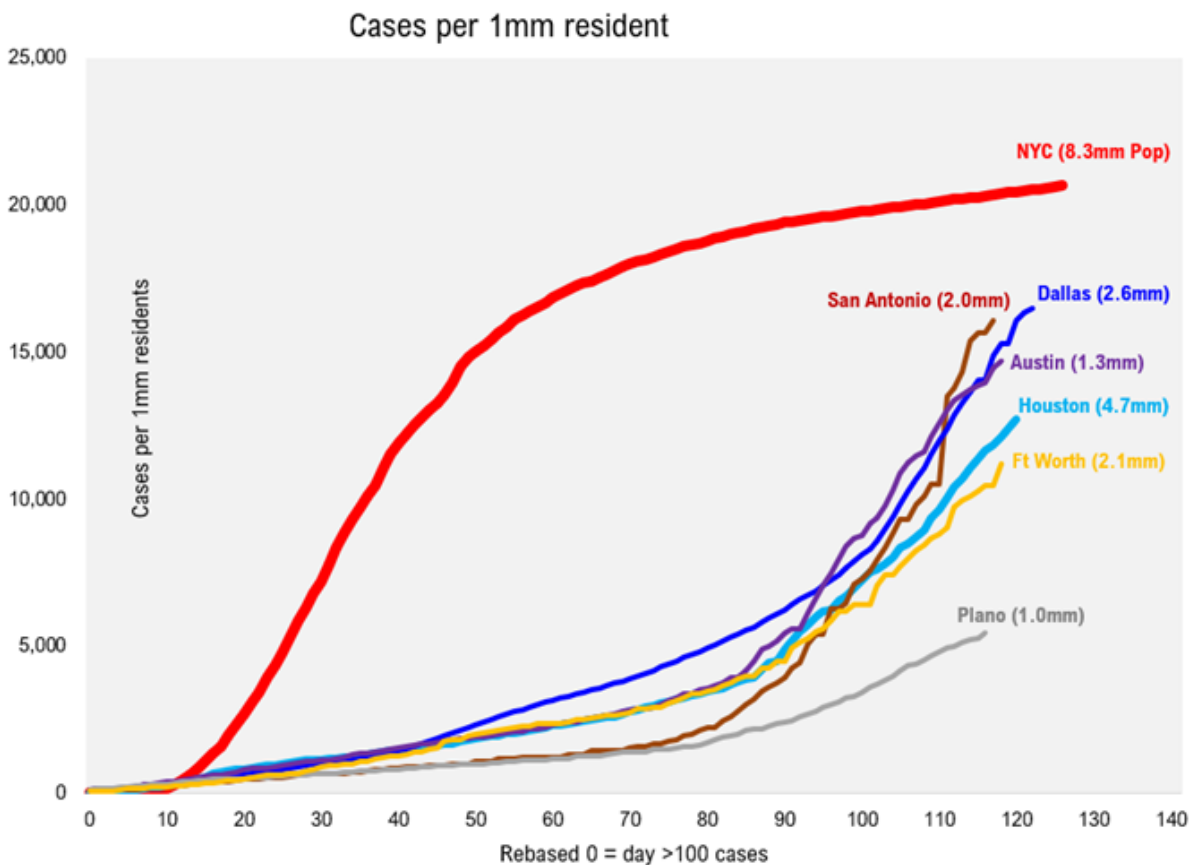
Source: Johns Hopkins

**Texas: Dallas + San Antonio + Austin are nearing NYC level of prevalence... Houston + Plano slowing...**

Below is the updated "rebased" cumulative cases per 1mm residents for Texas. We have plotted NYC for reference as well. As many of our clients know, Houston was the original center point for the post-June explosion of cases in TX (which we believe largely stems from Houston being the first focal point for BLM protests). But take a look at the prevalence curves now:

- in the past few weeks, Dallas, San Antonio and Austin have soared past Houston.
- at this pace, these 3 cities will soon match NYC for COVID-19 prevalence

If this plays out in this manner, it does lend credence to the notion that COVID-19 sees a level of uncontained spread. And then suddenly, hits a break point and the infection rate slows.



Source: Johns Hopkins

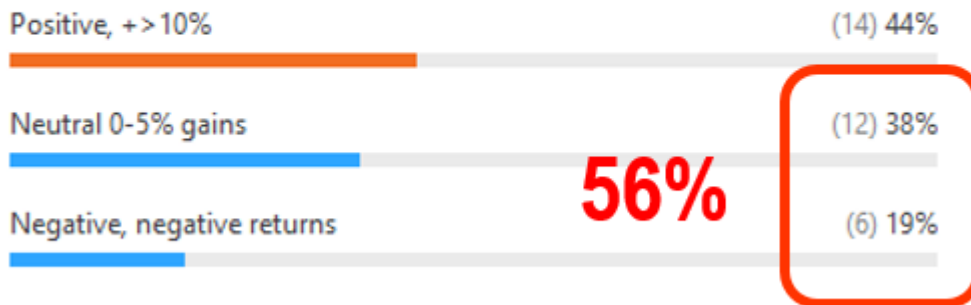
**POINT #3: San Diego CFA Poll confirms investors bearish and waiting for vaccine...**

I presented to the San Diego CFA Society this past evening. It was a remote event, unfortunately, as I would have gladly done this while on the West Coast. The New Mexico CFA Society members also joined. The hosts of the event were gracious enough to let me conduct a poll of the participants of the event. I asked 5 questions and the results are below, along with my annotations.

- CFA members are bearish/neutral, with only 44% seeing >10% upside in stocks
- 59% think Growth outperforms over next 12M --> not a surprise, but it shows how consensus this view is
- 50% say the most important market driver is the disease vs 47% saying Fed.
- 47% see a vaccine in next 12M --> how could they be bearish if they see a vaccine?

Only 44% see 10% upside to stocks in next 12M. This is another survey upon other surveys that highlight how cautious investors are about markets.

**1. What is your outlook for equity market in the next 12 months?**

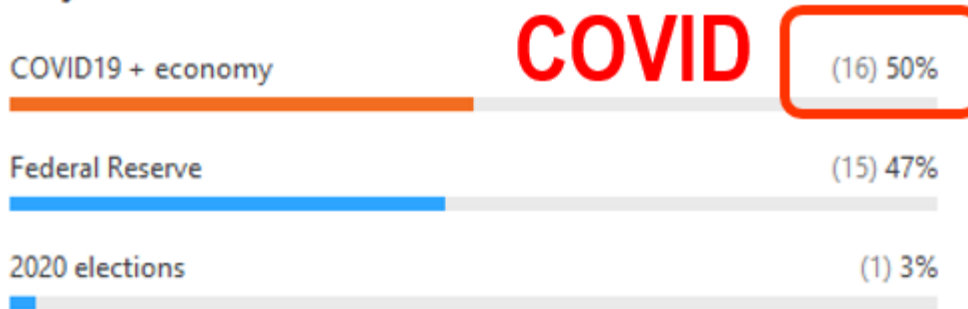


Source: San Diego CFA Society Poll conducted 7/23/2020



This is interesting as disease is seen as more important than Fed. I suspect if we see a decisive breakdown in cases, this would certainly support seeing investor sentiment turn bullish.

**2. What is the biggest influence on stock prices (pick one only)?**



Source: San Diego CFA Society Poll conducted 7/23/2020

Everybody loves Growth at 59% and 22% love Defensives.  
- So only 22% like Cyclical. If a cure is discovered, I am sure this ratio flips 180 degrees.

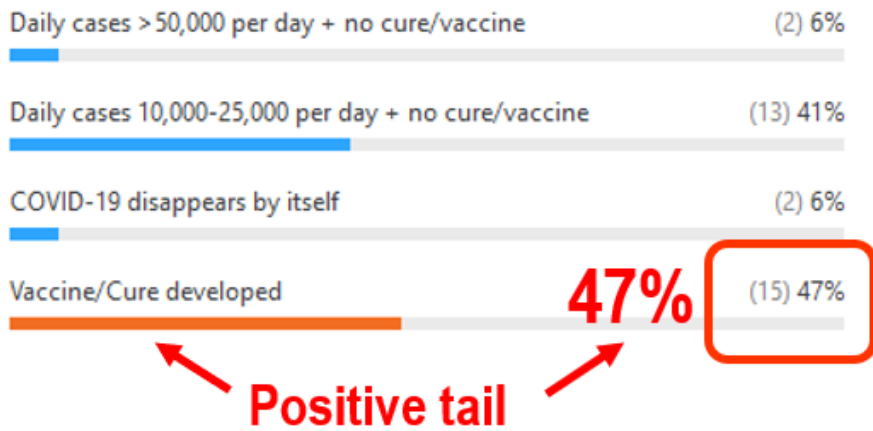
**3. What sector do you see leading next 12M?**



Source: San Diego CFA Society Poll conducted 7/23/2020

And the plurality sees a cure/vaccine in 12M. So, there is inherent optimism on a healthcare solution. Again, I think if this happens, sentiment flips big time = stocks go up.

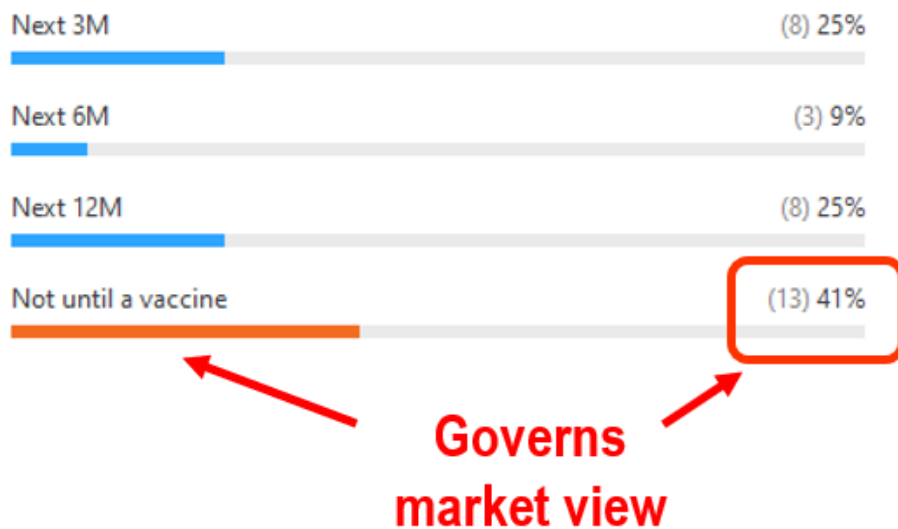
**4. What do you think will be COVID-19 status in 12M?**



Source: San Diego CFA Society Poll conducted 7/23/2020

Lastly, I asked about willingness to get on a plane. Here it shows 41% will not get on a plane until there is a vaccine. So, you can see personal preference is governing market positioning. Again, upside. Because if we see a cure = flip in sentiment.

**5. When will you be willing to get on an international flight?**



Source: San Diego CFA Society Poll conducted 7/23/2020

**RANDOM: Baseball Opening Day is here... NBA end of month...**

Live professional league sports is back, with the MLB (baseball) opening day yesterday and the NBA (basketball) at the end of July. This is a big deal. The cancellation of the NBA season, back in midst of pandemic, was probably the surest sign of how much pain lay ahead for the US.

And the return of sports is important on so many levels. MLB and NBA are distinctly American sports and so central to how Americans socialize, mark seasons and build friendships and entertainment.

The MLB Thursday games are:

Yankees at Nationals  
Giants at Dodgers

So it is both Coasts seeing their teams play.



<https://twitter.com/mlb/status/1286149056088211459?s=12>

 **NBA** @NBA · Jul 21

It's the game you love, like you've never seen before with 22 teams, all in one place, ready to make history. It's a #WholeNewGame 🏀

NBA Restart begins July 30th on ABC, ESPN, TNT, and NBA TV!

  @IssaRae



0:11 1.1M views

 203  643  2.3K 

<https://twitter.com/nba/status/1285743331150979072?s=21>

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