

MARKET SIGHT | LINES



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Three Forces at Work

With the Thanksgiving holiday next week, many people will take a short break and return the following week to start the month of December, when we'll finish the year and head into 2021. In turn, this upcoming holiday weekend is a good time to reflect on the forces that will drive our economy and markets into 2021. As we see it, three of the forces at work are the momentum of recovery, the expectations of two effective COVID-19 vaccines, and the third wave of new coronavirus cases hitting the country, and the world, as the weather turns colder and people move inside.

In this week's Sight|Lines, we share an update on the recovery of company earnings, some details on the forthcoming vaccines, and some perspective on the third wave.

A Recap of Third Quarter Earnings

Third quarter earnings in the U.S. have been much better than expected. With 92% of the S&P 500 reporting, we've learned that results were surprisingly positive. 84% of the companies, in fact, have posted positive surprises, up from the five-year average of 73%. And, the average surprise was 19.7% better than expected.

As we've discussed before, when we look back to the expectations in late June, the consensus forecast was for third quarter earnings to be down -24.7%, compared to third quarter 2019. But it looks like the final result will be down only about -8%, much better than expected. The momentum of earnings recovery has been higher than originally expected. So the next question? Can the recovery continue? Without question, the availability of a vaccine (or two) will help immensely.

Vaccines

Over the last couple weeks, we learned good news on vaccines from two companies, Pfizer and Moderna. Preliminary results indicate that both vaccines, each using the same messenger RNA technology, look to be highly effective, with Pfizer's testing at 95.0% effective and Moderna's testing at 94.5%. There had been worries that vaccines would be much less effective, so this is good news.

On Wednesday, Pfizer announced that it concluded the Phase 3 study of its vaccine and plans to file within days a request for emergency use authorization (EUA) from the Food and Drug Administration (FDA). Moderna expects to conclude its Phase 3 trial soon and to file a request for EUA in the coming weeks. In terms of production, as part of the government's Operation Warp Speed program, both Pfizer and Moderna have agreed to initially make 100 million doses available. The government can also acquire up to an additional 500 million doses of each vaccine. Following the approval by the FDA, Pfizer has indicated that distribution of the vaccine can start at 20 million doses per month.

Complicated by the fact that both vaccines will require a second booster vaccination, there has been some worry about the complexities of storage and distribution of these vaccines. Here are some details. Pfizer's vaccine must be stored at very cold temperatures (-70 degrees Celsius), and the company has developed a thermal shipping container to store the vaccine for 10 days unopened, or 15 days if opened and refilled with dry ice. Once thawed, the Pfizer vaccine can be kept for five days in a refrigerator at 2-8 degrees Celsius. Storage requirements for Moderna's vaccine are more favorable. Longer term storage requires -20 degrees Celsius, and the vaccine can be kept in a refrigerator at 2-8 degrees Celsius for up to 30 days.

We believe the companies can both implement effective distribution plans even given these cold storage requirements.

The Third Wave

As we wrote last week, the third wave of the pandemic is definitely here. As a result, state and local governments have issued new orders and guidelines to limit interaction and slow the spread. Examples include:

- New York and New Jersey have set a 10 p.m. curfew for bars and restaurants and limited indoor gatherings to 10 people.
- In California, 41 out of 58 counties are in the most restrictive of the four-tier reopening plan that doesn't allow indoor restaurant dining or church services.
- In Colorado, some counties have rolled back indoor events and reduced gym capacity to 10% from 25%.

So, the two questions we mentioned last remain. First, how much does activity have to shut down to stop this wave of infections? And second, how soon can an effective vaccine be approved and released?

We believe, ultimately, that we won't have a shutdown similar to earlier in the year and an effective vaccine will be implemented broadly in 2021.

Market Implications

Markets have been influenced by positive forces recently. First, the reduced uncertainty around the 2020 election, and the outcome of a divided government, have supported the markets. And second, of course, was the positive news on the vaccines discussed above. We believe that despite the risks related to a third wave, the markets will continue to recover into 2021. As a result, we're adjusting asset allocation guidance to overweight areas that have been out of favor, such as large cap value stocks and small cap stocks. Details can be found in our [Allocation Insights](#) publication.

Conclusion

Fortunately, our economy and our stock market appear to be more resilient than consensus expectations earlier in the year. This recovery, coupled with some good news on the vaccine front, has set us up for continued recovery in 2021. We will, of course, continue to monitor the impact of the third wave of the pandemic, and will adjust our guidance accordingly going forward.

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