Market Comment:

Equity market valuations. A reason for worry?

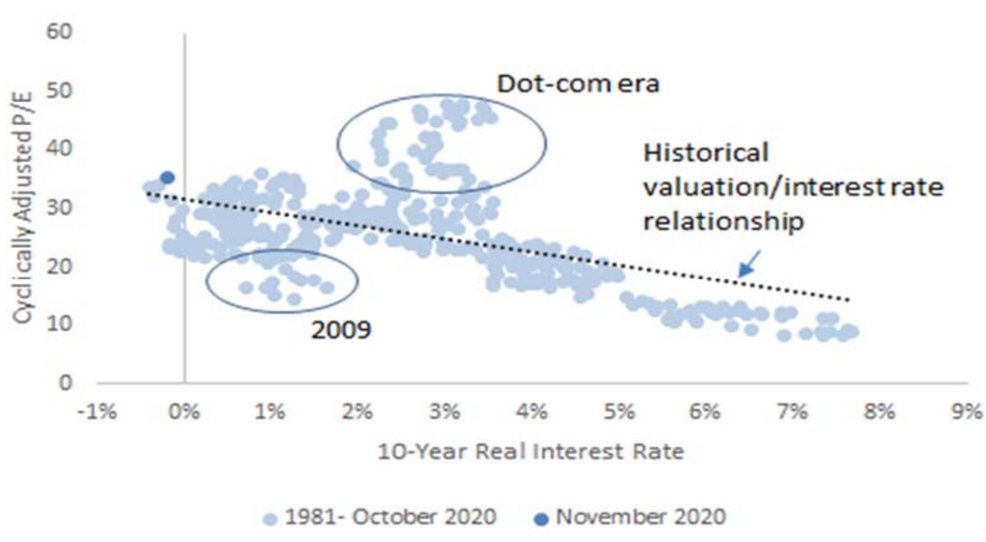
As we've recently discussed, the post-lockdown economic recovery has been stronger and faster than expected. The same can be said about the equity market recovery. We went from the fastest 30% drawdown in history to new all-time highs within five months. The US market continued to perform well through the election and is now up 12% on the year.

Alongside new market highs come questions about valuations. Forward-looking valuations are particularly untrustworthy in the current environment, but even measures that don't require precognition, like the Shiller CAPE (cyclically-adjusted price to earnings ratio), clearly show valuations have increased this year. Are higher valuations justified during a pandemic? The surprising answer is probably yes.

In response to COVID-19, the Federal Reserve engaged in a wide range of accommodative actions and dovish forward-looking guidance that committed to a low-interest rate environment for the foreseeable future. What do those actions mean for equities? The fundamental value of an investment is the present value of its future cash flows. When interest rates fall (as they have this year), future cash flows become more valuable, resulting in higher present values (i.e. valuations).

Sometimes equity valuations are clearly too high, as they were during the dot-com era, or too low, as they were immediately following the financial crisis. Today, however, valuations are roughly in-line with the historical trend based on current interest rates (Fig. 1). Investors can find plenty of things to worry about heading into the winter, but it is not obvious that valuations should be one of them.

Fig. 1: Equity market valuations and real interest rates, 1981-2020



Source: Federal Reserve Bank of Cleveland, Shiller Data Library, Mill Creek

Updated Benchmark Performance:

Benchmark Performance by Asset Class	Week-to-Date	Month-to-Date	Year-to-Date
U.S. Large Cap Equities	-0.19%	9.47%	13.67%
U.S. Small Cap Equities	2.38%	16.15%	8.28%
International Developed Equities	1.87%	14.42%	2.06%
Emerging Markets Equities	1.76%	9.62%	10.58%
Global Equities	0.62%	10.71%	9.50%
U.S. Bonds	0.59%	0.94%	7.31%
Intermediate Municipal Bonds	0.33%	0.71%	3.73%
High Yield Bonds	0.61%	3.23%	4.40%
Oil	4.52%	17.27%	-40.35%
Gold	-0.78%	-0.44%	19.86%
Key Rates	**11/20/2020**	**12/31/2019**	**11/20/2019**
U.S. 2 Year Treasury Note	0.16	1.58	1.56
U.S. 10 Year Treasury Note	0.83	1.92	1.73

Week in Review:

US equities were choppy last week as investors weighed additional positive vaccine news against expected short-term disruptions as the pandemic continues to surge and potential lockdowns loom. S&P 500 companies reported a fall in profits of 6.6%, on average, for the just-completed third quarter earnings season compared with the same quarter a year earlier, according to FactSet. Retail sales and weekly jobless claims data came in worse than expected, while home sales reached a 14-year high.

The IPO frenzy in America rolls on – several high-profile private companies filed or made plans to go public last week.

- San Francisco-based vacation rental platform Airbnb filed to go public, likely in December, at a valuation near $30 billion.
- Online alternative lending platform Affirm also filed paperwork to go public. The company, which was started by a co-founder of PayPal, is designed to provide an alternative to credit cards.
- Trading platform Robinhood, popular with day traders – especially during pandemic lockdowns, is reportedly seeking advisers for an IPO as soon as Q1 2021. The company was valued at $11.7 billion during a recent round of financing.

- Wildly popular gaming platform Roblox flied to go public on the NYSE under the ticker symbol RBLX. The San Mateo-based company has benefited from a sharp increase in gaming by consumers since lockdowns took effect last March.

Cryptocurrency Bitcoin extended its recent rally last week with a gain of 14%. The price for one Bitcoin, which is currently north of $18,000, is up 160% year-to-date and 75% since early October.

Economic Calendar:

- Consumer Confidence – Tuesday, November 24th
- Third Quarter GDP – Wednesday, November 25th
- Fed Meeting Minutes - Wednesday, November 25th

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Indices Used: U.S. Large Cap equities: Russell 1000 Index, U.S. Small Cap Equities: Russell 2000 Index, International Developed Equities: MSCI EAFE Index, Emerging Market Equities: MSCI Emerging Markets Index, U.S. Bonds: Barclays Aggregate Bond Index, U.S. 10 Year Treasury Note: Bloomberg 10 Yr. Treasury Note, Municipal Bonds: Barclays Intermediate Municipal Bond Total Return Index, High Yield Bonds: Barclays U.S. High Yield Total Return Index, Oil: Bloomberg WTI Crude Sub-Index Total Return Index, Gold: Bloomberg Gold Sub-Index Total Return Index