

NASHVILLE NOTES

Rocket fuel

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By Jeff K. Davis

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A couple of years ago I heard a T. Rowe Price Group Inc. portfolio manager who ran a tech fund speak on investing through market and tech product cycles. One comment he made struck me regarding market turns. Whenever a new bull market started, he wanted to make sure he had "rocket fuel" — excess cash or liquid names that could be sold — to reinvest in beaten down shares in order to generate outperformance on the way up.

One rocket-fuel financial (if owned in size the past three months) that would drive outperformance is CIT Group Inc., whose shares have more than doubled as of Dec. 23. An out-of-the blue merger announcement with First Citizens BancShares Inc. was the primary catalyst. There are plenty of other outperformers over the past three months such as Cadence Bancorp., Discover Financial Services and SVB Financial Group. Each has a specific catalyst beyond the world is not going to end after all.

Nonetheless, what a strange year 2020 has been. The market saying that bear markets take the freight elevator down and the escalator up seems only half right. March was a freight elevator down but since then a broadening cross section of the market has joined tech and work-from-home stocks on an express escalator.

While there are multiple accelerants, two are particularly noteworthy in my view.

One is the Federal Reserve, obviously.

The head of U.S. debt syndication at Goldman Sachs Group Inc. was quoted in the *Financial Times* on Dec. 22 as saying the Fed's decision to purchase corporate debt is "the most important piece of central bank policymaking I have seen in my career." Or more succinctly, it was unprecedented and required some legal maneuvering to do so.

According to his LinkedIn profile, the Goldman executive's Wall Street career spans 25 years, a period that covers a lot of firefighting by the Fed, but not the early 1980s when the Fed under Paul Volcker used fire in the form of unimaginably high short-term rates to corral inflation.

The Fed crossed the Rubicon with its decision to buy corporates, a decision that almost immediately reopened the corporate debt market before the Fed bought any securities. We will never know for sure what the outcome would have been had the Fed let the market clear, in which falling prices eventually attracted enough capital to stabilize prices. Both decisions have costs and benefits. The financial calamity was avoided but at the cost of a system that probably is much more fragile with distorted pricing and an expectation that the Fed will step in whenever there are rough waters.

The other Fed policy with long-running implications is huge open-ended purchases of U.S. Treasuries. The federal government's massive deficits are now being monetized by the Fed, as is the case in many developed countries. Politicians have a free hand to do what they do best: spend other peoples' money until the market or central bank says no.

The second market accelerant is an obvious one, too, and a decidedly positive one: the development of vaccines for COVID-19 that are effective and easy to administer. Pfizer's Nov. 9 announcement was the catalyst that sent travel and leisure, banks and other value stocks sharply higher.

Markets are not solely ruled by fundamentals, especially over shorter time frames. Liquidity and human emotions matter

a lot, too. Markets are now juiced with liquidity and optimism. Nonetheless, I think the market is clear that the economy in 2021 will be strong even though the disruption this year created long-term damage to employment, the demand for office space, retail and other subsectors of the economy.

A strong economy does not necessarily imply a strong market, however.

Perhaps corroborating my interpretation of the market's strength is comments I hear made by friends in Nashville who are involved in entertainment and tourism related businesses. They are gearing up for what is hoped to be an epic second half of 2021 in which every act that has not performed and every home-bound tourist will travel in mass next year.

Keep in mind that I heard those comments before the Christmas morning bombing in downtown Nashville, in which the bomb-laden RV was situated in front of a key AT&T hub. Let us hope the perpetrators are caught and the incident proves to be a sick one-off event and not part of a larger domestic or international dispute.

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