Another contentious election cycle is finally behind us (or not?), and the outcome was really a Goldilocks scenario for the markets. Divided government probably means that tax hikes on the uber-wealthy and corporations are off the table for now, as are any changes in the treatment of capital gains. We are likely to see another round of fiscal stimulus, which is something both sides can agree on. The only questions are how much and to whom should it be targeted. We say this, knowing that control of the Senate still rests on two run-off elections in Georgia, which could net the Democrats a working majority with Vice President Harris casting the deciding votes. But most consider that outcome to be improbable, and in any case the margins in both of the legislative bodies are so thin that major policy shifts that would adversely impact the capital markets will be difficult to enact. We should also not lose sight of the positive reaction of international markets in the days following our election, in anticipation of a more constructive trade environment in the years to come.

As if the lifting of election uncertainty wasn't enough cause to celebrate, Pfizer and BioNTech, a German biotech company, announced that their jointly developed vaccine candidate had outperformed expectations in their crucial phase 3 trials, proving 90% effective in stopping symptomatic cases. The vaccine's efficacy in asymptomatic infections is still unknown, and there are still more than a dozen other candidates in phase 3 trials. Of all clinical drugs that reach stage 3 trials, about 60% gain approval for wide spread use, suggesting that the chances of a vaccine approval soon are improving.

As positive as these developments are in solving the public health crisis, the challenges that remain in actually producing and distributing these vaccines seem almost unimaginable. The World Health Organization (WHO) estimates that the world will need at least ten to fifteen billion doses, because most of the Covid-19 protocols will require two doses by injection. By comparison, only 10 billion single doses are injected globally each year across all vaccines and inoculations. Clearly, we do not yet have the capacity to produce a new vaccine at the level that will be required, and there are additional issues to be resolved such as technology transfer, intellectual property protection, temperature-controlled distribution, priority of availability, and price. Determining the order of distribution within a population as well as globally is an important factor in stopping the spread as quickly as possible. A recent analysis by Deutsche Bank of these issues concludes that this will be "one of the biggest logistical challenges ever known to humans."

The significance of Pfizer's announcement lies in the 90% efficacy of its vaccine. Most of the models being used to project a timeline for stopping the spread of Covid had assumed a 75% vaccine effectiveness rate which, at anticipated rates of production and distribution, could inoculate enough of the world's population to stop the spread of the virus (but not the virus, itself) by mid-2023. The Deutsche Bank report referenced earlier estimates that a vaccine that is 90% effective could push that target date back to as early as the end of 2021.

Meanwhile, the economy continues to recover sharply, if unevenly. The most recent reports on jobs, manufacturing and services have been largely positive, and whatever disappointments that were hidden beneath the headline numbers were not enough to cause agita in the hearts of risk investors. It should be noted that the continued strength of our economic recovery, along with improving prospects for a vaccine sooner rather than later, may result in a stimulus package that is more modest than what many investors are counting on. Six months of faster than expected growth has materially narrowed the gaps between current production, income and employment levels, and the levels that would have prevailed absent the Covid shock. A scaled down, “skinny” stimulus may be all that is needed given the Fed’s open ended monetary support.

Lost in all the news about the election and vaccines is the fact that earnings reports have been very strong, and earnings trends are about to improve. With almost 90% of the S&P 500 companies having reported third quarter results, 86% of those have reported a positive earnings surprise. If that trend holds through the end of the reporting cycle, it will mark the highest percentage of companies exceeding estimates since FactSet began tracking this metric in 2008. The high quality of earnings is evidenced by the fact that 79% of companies reported positive revenue surprises, as well. As encouraging as 3rd quarter earnings have been vs. expectations, the year-over-year comparisons are still negative. However, as we enter 2021, comparisons are going to start trending higher against depressed 2020 results, especially for the more economically sensitive sectors of the market. Earnings estimate revision ratios are trending sharply higher for next year, with two upward revisions for each downward revision. This is true across all sectors of the market, but especially in the financial and consumer discretionary sectors as well as small cap companies.

As the markets have rallied on this recent series of positive developments, valuations have been stretched to historically high levels. The total market value of all U.S. stocks now stands at 239% of GDP, an all-time high, and the market’s forward P/E has risen to 22.3x, which is in the 96th percentile of all observations, historically. But we would point out that the variables in those measures (earnings, GDP, etc.), while improving at better than expected rates, are still well below normal levels. And so-called market valuations are inflated by absurdly high valuations of the few mega-cap stocks that were unaffected by Covid, and which accounted for essentially all of the market’s returns through the first three quarters of the year. These stocks have trailed the market during this recent rally, which has been led by financials, airlines, energy, industrials and health care. There is still value in many areas of the market whose fortunes are improving by the news in recent days, and the broadening out of the market to include these sectors is immensely positive. The old saying that it is not so much a stock market as it is a market of stocks has seldom been more valid, or more helpful.

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