

Seismic Shift

2020 has been... I don't need to tell you. Its been an *incredible* year! And it's not done yet.

There are political, social, fiscal, and economic cycles shifting from one direction to another. Many times cyclical changes happen smoothly, this year doesn't seem to be one of those years. This paper is going to focus on a shift that may be going on in the market, from Growth to Value stocks. As we have seen so far this year, cyclical shifts can be turbulent. First, let's define the terms.

Growth Stock

Investopedia defines it this way: *A growth stock is any share in a company that is anticipated to grow at a rate significantly above the average growth for the market. These stocks generally do not pay dividends. This is because the issuers of growth stocks are usually companies that want to reinvest any earnings they accrue in order to accelerate growth in the short term. When investors invest in growth stocks, they anticipate that they will earn money through capital gains when they eventually sell their shares in the future.*

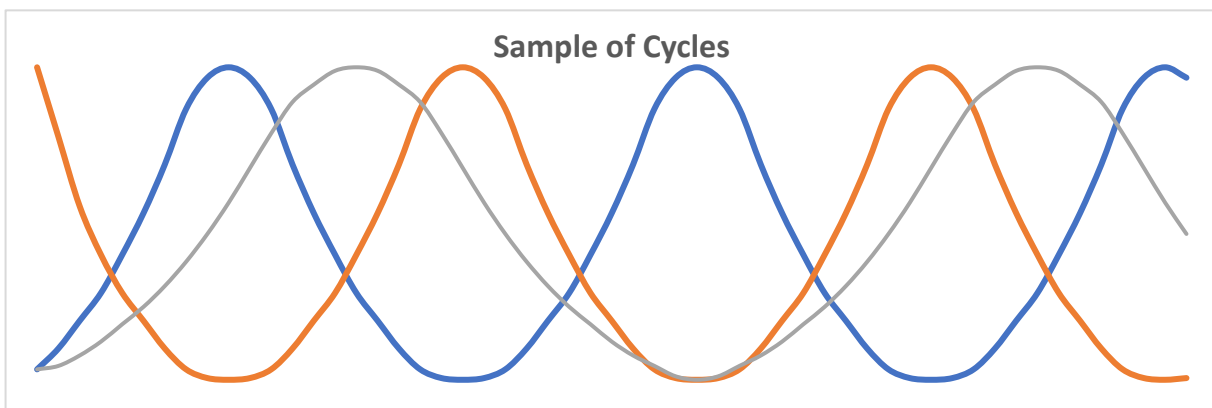
When investors think of Growth stocks, they may think of young companies, usually in high tech. However, we have a sample list of companies considered Growth stocks, many of which are neither young nor in the tech area. Growth stock can be a bit more volatile due to the lack of dividend and high PE multiples.

Value Stock

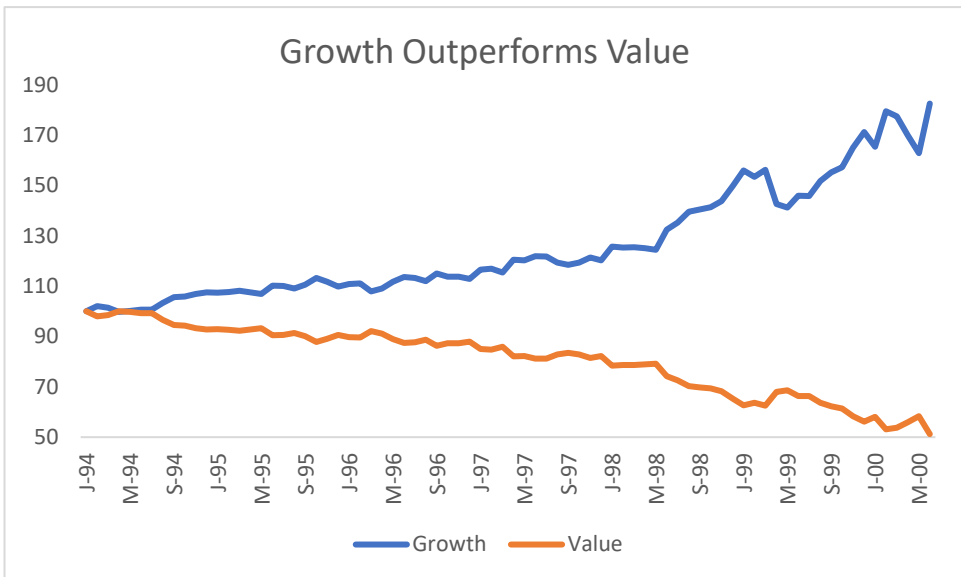
Investopedia defines it as follows: *A value stock is a stock that trades at a lower price relative to its fundamentals, such as dividends, earnings, or sales, making it appealing to value investors.*

Many investors view Value stocks as their grandmother's stocks, old electric utilities and railroad stocks. The sample list below may surprise you. There are some tech stocks that are considered Value stocks.

The reason we are doing this exercise is to show that Growth stocks are not better than Value, and Value are not better than Growth. They have cycles, relative to each other, which shows the market goes through long periods when Growth outperforms Value and then long periods when Value outperforms Growth. And the shift from one to the other can be explosive!



Many investors are aware that there are Growth and Value stocks, but few have given much thought to what they actually mean and the difference. Psychology shows that people tend to project whatever the current environment is, good, bad, bull, bear, boom times, recession, into the future - forever. If things are bad, they are always going to be that way, if things are good, same thing, it's never going to change.

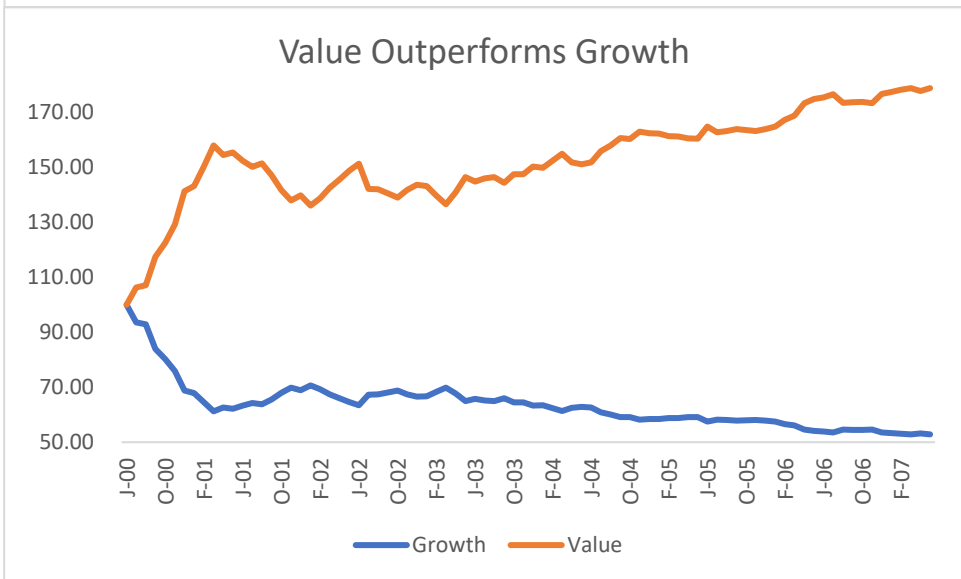


The world doesn't work that way. Many of the things we experience are cyclical. Don't like the President? Wait, a different one will take his place. Stuck in a recession? Wait, good economies are born in recessions.

Making money in the Bull market? Be careful, a bear market always follows a bull.

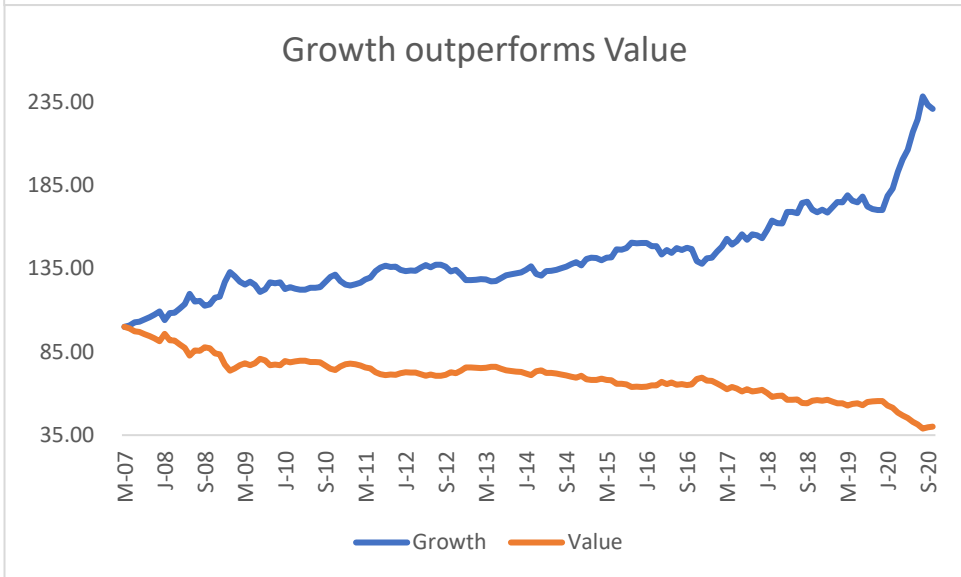
The charts to the left show the relative performance of Growth stocks and Value stocks.

The top chart shows that from 1994 through 2000, Growth stocks significantly outperformed Value stocks.



(A note about the charts, they are relative performance charts. It compares how they did against *each other*. This means if a value stock was up 20% and a growth stock was up 10%, the relative performance of the value stock was *10% better* than the growth stock, and the relative performance of the growth stock was *-10%* compared to the value stock. Even though the growth stock went up, compared to the value stock, it under performed.)

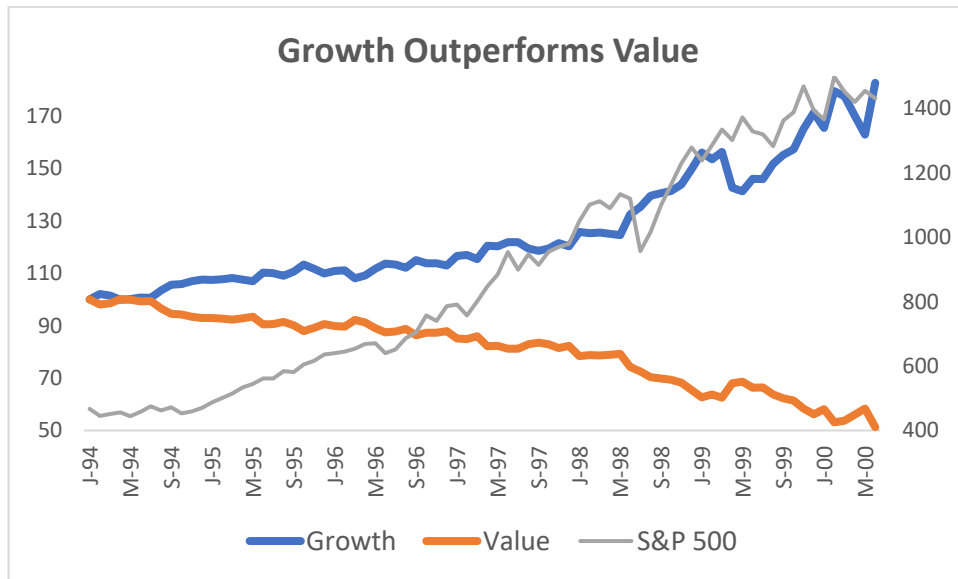
A switch happened in 2000. Value all of a sudden outperformed Growth. After a quick burst, Value continued to outperform growth through 2007. So for 7 years, Value was the place to be.



But then there was another shift. Starting in 2007, Growth started to outperform Value. It stayed that way for over a decade, and since the Crash in 2020, Growth has spiked up relative to Value.

The reasons for the changes will be apparent on the next page, and will give investors an idea on their next move.

The charts below have the S&P 500 added to show what the market was doing. (Grey line) The psychology of investors has a lot to do with how the markets trade. If they are feeling upbeat, the market rises, if they are concerned, the market drops. We've all seen how news headlines can drive the market. It is said that greed and fear drive the markets short term. This is why many strategists refer to short term volatility as "market noise". It is irrelevant to the long term trend.

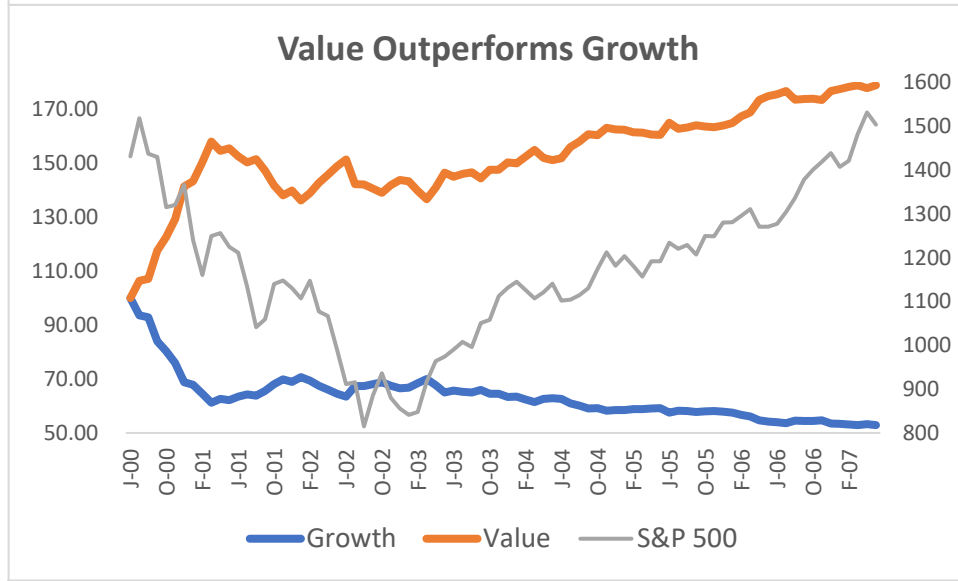


So what tells investors to shift from Growth to Value or Value to Growth? This is more than just a simple short term shift in sentiment.

Growth was chugging along in 2000, handily beating Value for the previous 6 years. The market was going up nicely. Why the change?

You can see why in the 2nd chart. The market fell into a multi-year bear market in 2000.

Investors who had enjoyed the ride up in Growth stocks got crushed and those that had camped out in Value stocks saw their relative performance soar.

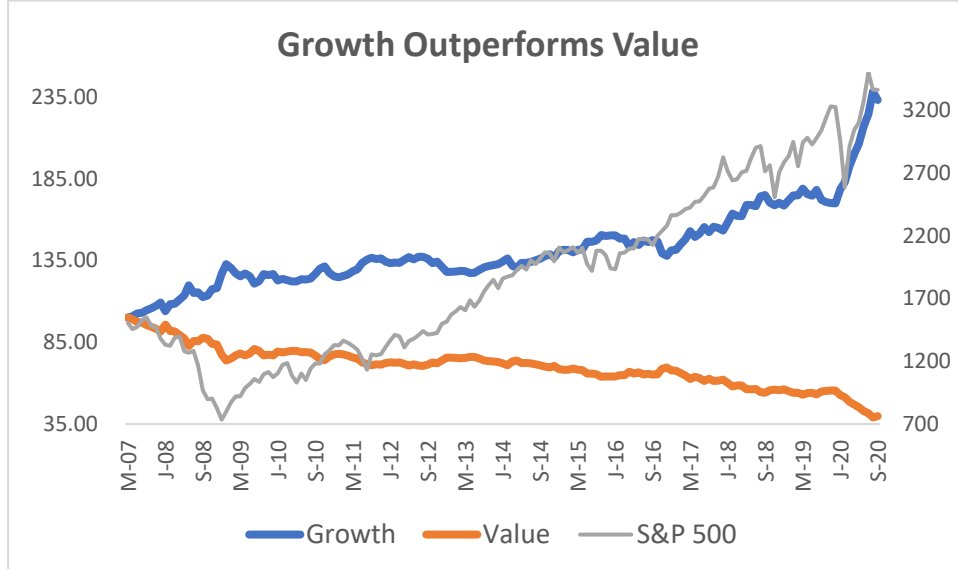


In the first year of the bear market, Value stocks outperformed Growth stocks by almost as much as Growth had beaten Value the previous 6 years combined.

Growth under performed Value by about 60% in the first year, and continued to under perform through 2007.

So what happened? Investors got burned by Growth and as we mentioned before, since the current environment dictates many investors future outlook, they abandoned the Growth sectors and piled into Value, driving its performance up.

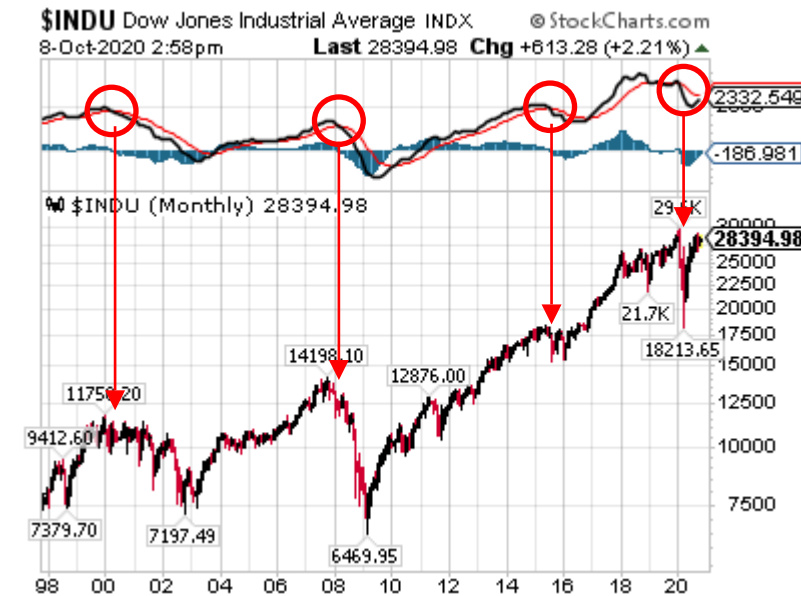
But then another shift back to Growth happened. The Crash of 2008 actually started in 2007. This is when Growth started to out perform Value.



For the next 13 years, Growth has beaten Value. Investors plowed their dollars into Growth stocks with the blessing of a very accommodative Fed.

And since the Crash in 2020, Growth stocks have skyrocketed, outperforming Value by the widest margin ever.

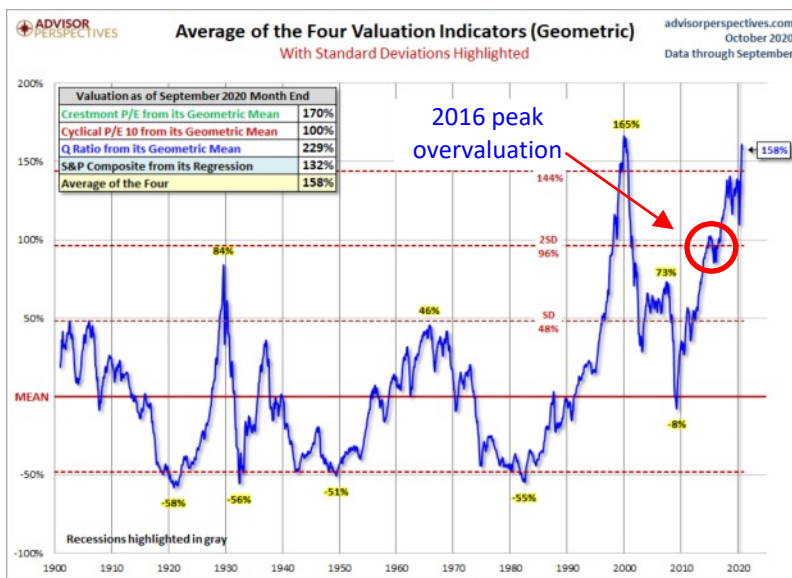
But let's go back a few steps. Prior to the 2016 election, the market was giving a rare macro-sell signal. The chart below shows the Dow Jones Industrials with its MACD (Moving Average Convergence/Divergence) chart above it. It is a monthly chart so it does not give signals often.



The Red circles are the sell signals. Each one, except the one before Trump's election, indicated a major sell off.

Below that is a chart from Dshort. It shows the Average of 4 different valuation metrics. Besides showing that today's overvaluation is as bad as it was in 2000, (the previous all time high), it shows that in 2016 the valuation was ready to reverse and head lower - another indicator that a bear market was on the horizon.

The election of Trump was a shock to the political system and economic system. Few knew what to expect. Except everybody on Wall Street. They were prepared for a pro-business, deregulation wave, and that is what they got. So immediately, after Trump's election, the market took off.



What would have happened if Trump had not been elected? The Sell signal was in place, Valuation had started to decline, and if you look at chart 3 on the previous page, you can see that in 2016, Value started to outperform Growth. All of the pieces were in place for a significant pullback and a shift from Growth to Value. But that is not what happened.

Now we have to look at today. The sell signal given back in March of 2020 is still active. Growth stocks have entered what appears to be a "blow-off top" relative to Value. The market valuation is just about at the highest level ever. But there is still a piece of

the puzzle missing. What did the other shifts have in common? Politics.

In 2000 there was a major shift in the political landscape. The change in the political winds was accompanied by geo-political unrest, a bear market, and a violent shift from Growth stocks to Value stocks.

In 2007, the real estate market collapsed and it was apparent Washington was going to change again. Out went the old regime and in came the new. And the bear market that lasted from 2007 to the 1st quarter of 2009 violently shifted investors from Value stocks to Growth stocks.

2016 was setting up to be another big shift and then we got the shift nobody expected. With Trump's win, the market gathered itself back together and kept on its previous trends - no big bear market, no shift from Growth to Value.

Now we look at the election of 2020. Will it be Biden? Will it be Trump? (As I have said many times in the past, I have nothing but disdain for all politicians, so I do not have a horse in this race) Polls say one thing, but they were wrong last time. But maybe they will be right this time. Who knows. But here's the thing, if Biden wins, is he a pro-business candidate? No. Is he for more or less regulation? More. Will taxes go up or down? Up. Is any of this good for the economy or market?

Many say the market is rallying in anticipation of a Biden victory. I'm not so sure. You don't cheer for the guy taking away your dessert. I think many investors are hoping the polls are wrong and Trump gets in again.

Adding up what we have so far: a strong technical sell signal from the Dow Jones' MACD, just about the most overvalued market ever according to Dshort's analysis and the potential for regime change in Washington - this all adds up to a very likely shift from Growth stocks to Value stocks during a violent market decline.

We at Cornerstone are positioning our portfolios to take advantage of the shift to Value. Below are some samples of Growth stocks, Value stocks and some that are considered both Growth and Value. (These are NOT recommendations.)

Growth Stocks	Industry		Value Stocks	Industry		Growth & Value	Industry
ADOBE INC	Info Tech		3M	Industrials		ALTRIA GROUP INC	Cons Stpls
AMD	Info Tech		AFLAC INC	Financials		AMERICAN EXPRESS	Financials
ALIGN TECHNOLOGY INC	Health Care		ALLSTATE CORP	Financials		AM WATER WORKS	Utilities
ALPHABET INC (Google)	Comm		AMERICAN AIRLINES	Industrials		AMGEN INC	Health Care
AMAZON COM INC	Cons Disc		AM ELECTRIC POWER	Utilities		APACHE CORP	Energy
APPLE INC	Info Tech		ADM	Cons Stpls		ADP	Info Tech
AUTOZONE INC	Cons Disc		AT&T INC	Comm		BOEING	Industrials
BROADCOM INC	Info Tech		BANK OF AMERICA	Financials		BRISTOL MYERS	Health Care
CARMAX INC	Cons Disc		CHEVRON CORP	Energy		CAMPBELL SOUP	Cons Stpls
CHIPOTLE MEXICAN GRILL	Cons Disc		CISCO SYSTEMS INC	Info Tech		CATERPILLAR INC	Industrials
CONOCOPHILLIPS	Energy		CITIGROUP INC	Financials		COCA-COLA	Cons Stpls
DOLLAR GENERAL	Cons Disc		CITIZENS FIN GROUP	Financials		COLGATE-PALMOLIVE	Cons Stpls
DOMINOS PIZZA INC	Cons Disc		CLOROX	Cons Stpls		DEERE	Industrials
DOW INC	Materials		CON ED	Utilities		DISCOVER FINANCIAL	Financials
EBAY INC	Cons Disc		CVS HEALTH CORP	Health Care		ELI LILLY	Health Care
ESTEE LAUDER	Cons Stpls		DOLLAR TREE INC	Cons Disc		EQUIFAX INC	Industrials
FACEBOOK	Comm		EXXON MOBIL CORP	Energy		FREEPORT MCMORAN	Materials
HESS CORP	Energy		FEDEX CORP	Industrials		HERSHEY FOODS	Cons Stpls
HILTON WORLDWIDE	Cons Disc		FORD MOTOR CO	Cons Disc		HOME DEPOT INC	Cons Disc
INTUIT INC	Info Tech		GENERAL DYNAMICS	Industrials		HONEYWELL INT'L INC	Industrials
LOCKHEED MARTIN	Industrials		GOLDMAN SACHS	Financials		INTEL CORP	Info Tech
MARRIOTT INT'L	Cons Disc		HASBRO INC	Cons Disc		JOHNSON & JOHNSON	Health Care
MASTERCARD	Info Tech		IBM	Info Tech		JPMORGAN CHASE	Financials
MICROSOFT CORP	Info Tech		KELLOGG	Cons Stpls		LAS VEGAS SANDS	Cons Disc
MOODYS CORP	Financials		KRAFT HEINZ	Cons Stpls		MCDONALDS CORP	Cons Disc
NETFLIX INC	Comm		MARATHON PETROL	Energy		MERCK & CO INC	Health Care
NORTHROP GRUMMAN	Industrials		METLIFE INC	Financials		MGM RESORTS INT'L	Cons Disc
NVIDIA CORP	Info Tech		MOLSON COORS	Cons Stpls		NIKE INC CLASS B	Cons Disc
OREILLY AUTOMOTIVE	Cons Disc		OCCIDENTAL	Energy		NORFOLK SOUTHERN	Industrials
PAYPAL HOLDINGS	Info Tech		PFIZER INC	Health Care		ORACLE CORP	Info Tech
ROSS STORES INC	Cons Disc		PRUDENTIAL FIN	Financials		PAYCHEX INC	Info Tech
SALESFORCE.COM INC	Info Tech		RALPH LAUREN	Cons Disc		PEPSICO INC	Cons Stpls
SHERWIN WILLIAMS	Materials		SOUTHWEST AIRLINES	Industrials		PHILIP MORRIS INT'L	Cons Stpls
STARBUCKS CORP	Cons Disc		TEXTRON INC	Industrials		RAYTHEON TECH CORP	Industrials
TIFFANY	Cons Disc		TWITTER INC	Comm		SEAGATE TECH	Info Tech
VISA INC CLASS A	Info Tech		VERIZON	Comm		TARGET CORP	Cons Disc
WESTERN UNION	Info Tech		WALMART INC	Cons Stpls		UNION PACIFIC CORP	Industrials
WYNN RESORTS LTD	Cons Disc		WESTERN DIGITAL	Info Tech		UPS	Industrials
YUM BRANDS INC	Cons Disc		WHIRLPOOL CORP	Cons Disc		WALT DISNEY	Comm

This list is based on the iShares S&P 500 Value and S&P 500 Growth ETFs which are designed to mirror the indices

We are far from alone in our assessment that Value may soon outperform Growth. Below are a number of recent headlines:

Value stocks are poised to crush growth stocks after the presidential election - Oct. 12, 2020 at 8:29 a.m. ET By Michael Brush, MarketWatch

Jeremy Siegel sees value stocks outperforming in 2021 as economy reopens, investors look for yield - SEP 18 2020 5:05 PM EDT By Kevin Stankiewicz, CBBC

The Start of Something Big When a Lovely Thing Dies? The classic dichotomy of growth stocks versus value stocks may be at a pivot point. - October 12, 2020 By Dave Gilreath, CFP, HCP Live

Value stocks will soar when the economy recovers, top strategist David Rosenberg says - Theron Mohamed Oct. 6, 2020, 03:06 PM, Business Insider

Value Stocks: The Cornerstone of a Strong Portfolio - By Matthew Makowski Originally posted September 15, 2020; Updated on September 21 at 4:46 pm, InvestmentU

7 reasons investors should favor value stocks over growth, according to BofA - Matthew Fox, Sep. 29, 2020, 06:33 PM Business Insider

Why There Might Be A Value Stock Renaissance On The Horizon - Nick Stonnington, Forbes Councils Member, Sep 28, 2020, 01:02pm EDT, Forbes

Why you're not getting the premium from value stocks, 4 reasons people bail out of value investing — and why they shouldn't - Published: Sept. 16, 2020 at 11:03 a.m. ET By Paul A. Merriman, MarketWatch

Growth stocks enjoying best year-to-date outperformance since 1979 - but value can soon bounce back, Bank of America says - Ben Winck, Oct. 4, 2020, 06:57 PM, Business Insider

Hedge Funds Sidestepped Tech Selloff And Tilted Toward Value Stocks - SEPTEMBER 16, 2020 • LU WANG, Financial Advisor

Why a Biden victory will lift a group of beaten-down stocks at the expense of market leaders, according to JPMorgan, The bank said value stocks could outperform growth stocks after the election. - Matthew Fox, Oct. 5, 2020, 09:09 PM, Business Insider

The champ's big comeback: Why beaten-down value stocks are poised to thrive - BY SHAWN TULLY, August 18, 2020 9:22 AM EDT, Fortune

Disclosures and Disclaimers:

When looking closely at the Sample lists of Growth and Value stocks, you might be surprised as to what is on which list. Many of the Growth stocks are just what you would expect, Adobe, Align, Google, Apple... And the many of the Value stocks are what you would expect, 3M, Allstate, AT&T, Clorox, Citigroup... But isn't Growth supposed to be mostly tech companies? What is the oil company, ConocoPhillips, doing there? And in the opposite direction, how are Twitter and Cisco considered Value stocks? Even more interesting, Dollar General is considered Growth, while Dollar Tree is considered Value.

The process for comparing the relative performance of the Growth and Value indices was as follows: We used monthly data from S&P. We calculated the monthly change, plus or minus, as a percentage. We then subtracted the Growth change from the Value change to determine how much the Value outperformed the Growth. We then subtracted the Value from the Growth to determine how much the Growth outperformed the Value. We then took these results and starting at 100, multiplied one column by the results of the Growth's performance difference and the other column by the results of the Value performance difference.

When plotting the charts, we could see when one column's out performance started to give way to the other's out performance. It was at these points we determined a shift from one to the other was occurring and started the new chart at 100 and continued as before. By starting at 100, we were able to flatten out any differences in the index price and focus solely on the relative performance.

If Growth gained 20% and Value gained 15%, Growth had a relative performance of plus 5%. Value had a relative performance of negative 5%. So even though Value was up, relative to Growth, it was down.

Past performance is no guarantee of future performance.

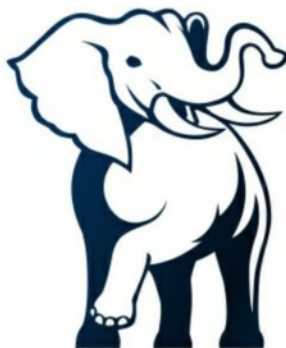
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[Various indexes were chosen that are generally recognized as indicators or representation of the stock market in general. Indices are typically not available for direct investment, are unmanaged and do not include fees or expenses. Some indices may also not reflect reinvestment of dividends.]



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