

US Strategy Comment

Coronavirus Positioning and the Next Bull Market

Three Rational Scenarios to Cope With the Irrational and Unknown

There is no denying that a cyclical bear market has begun. Only two primary questions remain: duration and depth of the pain. At this point, another 10-20% downside is not out of the question, especially considering the growing number of disparaging forecasts and the crisis in confidence of governments. As such, we caution investors against seeking support levels, fiscal or monetary policies let alone symbolic events or gestures (e.g., corporate buyouts) to foretell or solidify a traditional bottom or capitulation. Given the irrational and fear-laden nature of the current stock market, historical precedence and traditional bottoming signals carry little to no weight, in our view. Instead, markets and society likely need to see less negative (second derivative) headlines and actualities surrounding coronavirus (COVID-19 virus) to become reality before a bottoming process is likely to ensue.

Again, this too shall pass. And when it does, there is no reason to believe that US stocks will not see similar daily upside moves relative to the exacerbating weakness of the past few weeks. While we acknowledge that history does not support such an explosive recovery (e.g., markets sell off like an elevator, but recover like an escalator), there has been no precedent to the downside and we believe the same will hold true of the upside. Furthermore, while monetary and fiscal policy is unlikely to secure the market's bottom, there is no denying of the massive fuel both will provide the eventual recovery. Granted, akin to other bear market recoveries, any rebound will likely be hated, distrusted, mocked, and ridiculed. But all bear markets, no matter how severe or painful, eventually end and give way to new bull markets. While we are admittedly exposing ourselves to "Pollyanna" labels for our longer-term optimism, we simply believe in the fundamental construct of US companies and the wherewithal, strength, perseverance and innovation that has and will always define our society. The next bull market is coming, one whose duration has yet to be determined, but whose first 12-18 months could see as much as a 40-50% recovery.

Main Points:

- **Three Scenarios for US Stocks**
 - 1) COVID-19 Case: Next 1-3 Months-Defense and COVID-19 Centric Themes
 - 2) Base Case: Next 12-18 Months-Recovery and Defining the Next Bull
 - 3) Secular Case: Next 3-5 Years-Another Doubtful Bull
- **Transitioning Targets to 12-month Rolling – Staying the course and NOT panicking**
 - S&P 500 Price Target: 3,400; EPS: \$160
 - Suspending CY2020 S&P 500 Price and Earnings Targets
 - CY2020 Targets Will Carry More Merit, In Our View, Once the Bottom and Recovery Take Shape

Investment Strategy

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Major US Indices Price % Performance

Sector	1M	YTD	6M	12M
DJ Industrial Average	-34.4	-32.8	-28.8	-25.5
DJ Transportation	-38.0	-37.3	-34.6	-32.6
DJ Utilities	-32.2	-26.5	-25.1	-16.2
NASDAQ 100	-27.4	-19.9	-10.6	-5.2
NASDAQ Composite	-29.4	-23.3	-15.3	-11.0
Russell 1000	-32.6	-29.3	-23.8	-19.4
Russell 1000 Growth	-29.8	-23.9	-16.8	-11.0
Russell 1000 Value	-35.7	-35.1	-31.0	-27.9
Russell 2000	-40.2	-39.2	-35.0	-34.3
S&P 500	-31.7	-28.7	-23.0	-18.4
S&P 500 Growth	-29.6	-24.1	-18.7	-13.9
S&P 500 Value	-34.1	-33.8	-27.8	-23.6
S&P Mid Cap 400	-40.2	-39.0	-35.3	-33.2
S&P Small Cap 600	-40.8	-40.8	-37.4	-35.7

Source: BMO Capital Markets Investment Strategy, FactSet. Performance figures reflect close prices as of 3/20/20

S&P 500 GICS Sector Price % Performance

Sector	1M	YTD	6M	12M
Communication Services	-27.9	-23.9	-19.0	-13.1
Consumer Discretionary	-32.1	-27.9	-25.0	-20.2
Consumer Staples	-22.1	-20.2	-16.6	-8.8
Energy	-52.8	-57.5	-57.1	-60.8
Financials	-39.3	-38.9	-33.0	-28.0
Health Care	-23.8	-22.9	-14.0	-13.9
Industrials	-39.0	-37.3	-34.3	-30.8
Information Technology	-29.8	-22.3	-11.3	-2.7
Materials	-33.2	-34.1	-30.6	-26.8
Real Estate	-35.1	-30.1	-30.8	-23.4
Utilities	-32.5	-26.7	-25.8	-17.5

Source: BMO Capital Markets Investment Strategy, FactSet. Performance figures reflect close prices as of 3/20/20

COVID-19 Virus Positioning and the Next Bull Market

COVID-19 Case – Time Frame: Next 1-3 Months

Bottom Line: The Virus That Killed the Bull Market

There is no denying that a cyclical bear market has begun – hard to ignore the ~34% freefall from the S&P 500’s recent all-time high. In our view, two primary questions remain: duration of the crisis and depth of the market weakness. Therefore, another 10-20% downside is not out of the question. As such, we caution investors against seeking absolute support levels, end-all-be-all fiscal or monetary policies or symbolic events (e.g., multiple corporate buyouts) to foretell or solidify a traditional bottom. Given the irrational and fear-laden nature of the current stock market, historical precedence and traditional bottoming signals carry little to no weight, in our view. Instead, markets and society need to see less negative (second derivative) headlines and actualities surrounding COVID-19 virus to become reality before a bottoming process is likely to ensue.

Suspending Our 2020E S&P 500 Targets

Given the COVID-19 virus uncertainty and the havoc it has wreaked on financial markets around the globe, we believe there is minimal rational method for predicting the path of US stocks given the rapidity and volatility of data, forecasts, and emotions on a nearly daily basis. As such, for the first time in our collective careers, we have decided to suspend our year-end S&P 500 price and EPS targets in favor of rolling 12-month forecasts. We continue to believe US stocks will eventually stage a strong rally when outbreak fears begin to subside; but acknowledge the impossible task of trying to time this outcome. Similarly, we believe it is far too early to assess the potential impact of the COVID-19 virus response/precautions on the economy and corporate profitability until more data is released in the coming months. Therefore, our new rolling target will provide us with flexibility to make adjustments as necessary during these fast-moving markets and also continue to provide investors with insight as it relates to our market outlook. With that being said, we maintain our previous levels for both forecasts – 3,400 for price and \$160 for EPS.

Strategy: Defense and COVID-19 Virus Theme Related

- Preferred positioning should be a mix of defense (Staples, REITs and Utilities) and COVID-19 virus-related topical themes (Health Care, Communication Services, and Technology)
- Consumer Discretionary Overweight? Our work shows that the sector has historically exhibited its best relative performance during recessions (e.g., 2008).

Sector	Opinion	%Weight	Theme
Communication Services	OW	14%	We are home streaming content and accessing our internet, wireless and all devices
Consumer Discretionary	OW	10%	On-line sales have become a necessity, while essential supplies are increasingly mandatory
Consumer Staples	OW	9%	Discretionary staples, food and household products are defining the hording
Energy	UW	2%	Yield only
Financials	UW	10%	Yield and essential big institutions only
Health Care	OW	16%	Biotechs and Pharma are on a race for a cure; instruments and devices for delivery
Industrials	UW	7%	Defense and yield; freight to deliver on-line goods
Information Technology	MW	21%	We are home streaming content and accessing our internet, wireless and all devices
Materials	UW	1%	Not a necessity
Real Estate	OW	5%	Yield and cash flow
Utilities	OW	5%	Yield and defense; necessity; need to provide power to all the homes

COVID-19 Virus Induced Theme List

COVID-19 Induced Theme List

Ticker	Company	Price	BMO Rating*
Communication Services (14% target weight vs. 11.1% index weight)			
ATVI	Activision Blizzard, Inc.	\$52.05	OP
CMCSA	Comcast Corporation Class A	\$33.37	NR
DIS	Walt Disney Company	\$85.98	OP
GOOGL	Alphabet Inc. Class A	\$1,068.21	Mkt
NFLX	Netflix, Inc.	\$332.83	OP
T	AT&T Inc.	\$28.45	NR
VZ	Verizon Communications Inc.	\$51.80	NR
Consumer Discretionary (10% target weight vs. 9.9% index weight)			
AMZN	Amazon.com, Inc.	\$1,846.09	OP
HD	Home Depot, Inc.	\$152.15	NR
LULU	Lululemon Athletica Inc	\$165.01	Mkt
TGT	Target Corporation	\$97.40	Mkt
Consumer Staples (9% target weight vs. 8% index weight)			
COST	Costco Wholesale Corporation	\$290.42	OP
GIS	General Mills, Inc.	\$53.37	Mkt
PG	Procter & Gamble Company	\$102.43	NR
WMT	Walmart Inc.	\$113.97	OP
Energy (2% target weight vs. 2.6% index weight)			
XOM	Exxon Mobil Corporation	\$32.74	NR
Financials (10% target weight vs. 11.1% index weight)			
BAC	Bank of America Corp	\$19.67	Mkt
BLK	BlackRock, Inc.	\$354.72	Mkt
C	Citigroup Inc.	\$38.06	OP
JPM	JPMorgan Chase & Co.	\$83.50	Mkt
MS	Morgan Stanley	\$29.67	OP
Health Care (16% target weight vs. 15.3% index weight)			
DGX	Quest Diagnostics Incorporated	\$75.24	NR
GILD	Gilead Sciences, Inc.	\$73.26	OP
JNJ	Johnson & Johnson	\$119.89	NR
PFE	Pfizer Inc.	\$29.01	NR
REGN	Regeneron Pharmaceuticals, Inc.	\$438.45	Mkt
TMO	Thermo Fisher Scientific Inc.	\$278.37	NR
UNH	UnitedHealth Group Incorporated	\$206.59	Mkt
Industrials (7% target weight vs. 8% index weight)			
LMT	Lockheed Martin Corporation	\$291.22	NR
MMM	3M Company	\$124.89	NR
UPS	United Parcel Service, Inc. Class B	\$93.46	Mkt
WM	Waste Management, Inc.	\$98.31	OP
Information Technology (21% target weight vs. 25.3% index weight)			
AAPL	Apple Inc.	\$229.24	NR
AKAM	Akamai Technologies, Inc.	\$82.37	NR
CTXS	Citrix Systems, Inc.	\$119.33	NR
INTC	Intel Corporation	\$45.83	Mkt
MSFT	Microsoft Corporation	\$137.35	OP
PYPL	PayPal Holdings Inc	\$86.68	OP
SMAR	Smartsheet, Inc. Class A	\$42.10	OP
VZ	Visa Inc. Class A	\$146.83	OP
ZM	Zoom Video Communications, Inc. Class A	\$130.55	NR
Materials (1% target weight vs. 2.4% index weight)			
ECL	Ecolab Inc.	\$141.88	Mkt
Utilities (5% target weight vs. 3.4% index weight)			
ED	Consolidated Edison, Inc.	\$72.59	NR
EXC	Exelon Corporation	\$31.00	OP
NEE	NextEra Energy, Inc.	\$191.75	OP
Real Estate (5% target weight vs. 2.9% index weight)			
EQIX	Equinix, Inc.	\$506.52	OP
PEAK	Healthpeak Properties, Inc.	\$20.96	OP
PLD	Prologis, Inc.	\$62.82	OP

Source: BMO Capital Markets Investment Strategy. Prices as of 3/20/2020.

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Investment Strategy Base Case – Time Frame: Next 12 Months

Bottom Line: Prepare for the recovery – because it is coming with a vengeance

This too shall pass. And when it does, there is no reason to believe that US stocks will not see similar daily upside moves relative to the exacerbating weakness of the past few weeks. While we acknowledge that history does not support such an explosive recovery (e.g., markets sell off like an elevator, but recover like an escalator), there has been no precedent to the downside and we believe the same will hold true of the upside. Furthermore, while monetary and fiscal policy is unlikely to secure the market's bottom, there is no denying the massive fuel that both will provide the eventual recovery. Granted, akin to other bear market recoveries (especially 1987 and 2009, in our view), any rebound will be hated, distrusted, mocked, and ridiculed. But again, all bear markets eventually end and typically when the negativity is at its greatest. Welcome to the next bull market, whose duration has yet to be determined, but whose first 12 months could see as much as a 40-50% recovery.

Strategy: The US remains the home for stability and consistency.

- The strength of the US economy remains the consumer – focus on what they are BUYING = Communication Services, Technology, and online retail and select lifestyle discretionary
- While a cyclical rebound will likely be powerful, quality measures such as operating performance and earnings stability should be a primary area of focus within areas like Industrials, Energy, and Materials
- Lower interest rates will undoubtedly help REITs and Utilities, while forcing positions within Financials to be more concentrated (within the big players). As a result, we are neutralizing our positioning within Utilities to Market Weight from Underweight.

Sector	Opinion	%Weight	Theme
Communication Services	OW	12.5%	The three C's = content, cash and cannibalism; wireless and communications are necessities
Consumer Discretionary	OW	10.5%	On-line shopping is safe and so too is casual wear as we work at home
Consumer Staples	UW	6%	Discretionary retail
Energy	MW	3%	Focus on yield and cash flow only; languishing underlying commodity likely to persist
Financials	MW	11.5%	Multi-divisional; biggest of the big are best positioned
Health Care	MW	14%	Biotech, pharma, medical devices are more important than ever
Industrials	MW	8.5%	Will benefit from a cyclical recovery, but stick with high quality
Information Technology	OW	24%	Consumer-driven cash flow and innovators; wireless and broadband budgets to explode
Materials	MW	2.5%	Stay diversified; rebound for metals is coming, but focus on quality
Real Estate	OW	4%	Yield and cash flow; lower for longer interest rates to provide support
Utilities	MW	3.5%	Yield and stability of dividend; lower for longer interest rates to provide support

Investment Strategy Secular Case – Time Frame: 3-5 Years

Bottom Line: Here comes another hated and distrusted bull market

Near zero interest rates take away much of the fixed income competition in our view, while the fiscal and monetary gas should help ignite corporate growth and investment. While it is too early to discern the duration of the bull (as there will be surprise leaders and new industries that prosper), relenting fear of the next black swan will only help stocks climb the wall of worry. As a result, US stocks could once again settle into their traditional annualized return during the initial stages of a bull market that equates to 13-15%. Undoubtedly the stock market will face fundamental resistance in the form of government and corporate debt, the future path of interest rates, global synchronized growth and commodity pressures to name a few. However, this is the natural progression of all stock market cycles – when fear and resistance are at their highest during bear markets, it is typically a signal that a new bull market is around the corner.

Select Themes/Subjects to Consider Heading Into the Next 3-5 Years

Theme/Subject	Byproduct Question
The Mobile Worker	Broadband and wireless capacity? New technology and communications equipment?
Social Distancing	Do office spaces change back from open concepts to offices again? What happens to restaurant spacing and service providers? New regulations?
Energy	US Energy independence versus embargoes? Will M&A be enough to takeout capacity?
Health Care Innovation	Cash and R&D within drugs, biotech, devices and instruments; faster FDA approvals?
Health Care Regulation	Could Health Care go the other way and see increased regulations due to the scarcity of “weapons” to combat a pandemic?
Buybacks and Dividends	Low interest rates have historically fueled both dividends and buybacks. But will shareholder and public fallouts force legislation against buybacks?

Recent US Strategy Research Reports

Date	Title
Comments, Snapshots, and Perspectives	
3/19/2020	US Strategy Snapshot: Avoid the Temptation to “Make the Call”
3/18/2020	US Strategy Snapshot: Unprecedented Times Generate Unprecedented Charts
3/12/2020	US Strategy Comment: Our Conviction is Resolute, Template Notwithstanding
2/27/2020	US Strategy Snapshot: Epidemic of Fear
2/27/2020	US Strategy Comment: Panic Is Not a Winning Investment Strategy
2/24/2020	US Strategy Snapshot: Coronavirus Impact on US Stock Performance and Earnings
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1/22/2020	US Strategy Comment: The Doubtful Bull Returns Yet Again
1/17/2020	US Strategy Comment: Making the Case to Overweight Comm Svcs and Discretionary
1/15/2020	US Strategy Comment: Staying Selective Within Industrials
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Monthly Reports	
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Hold	Market Perform	52.0 %	18.0 %	43.5 %	51.1 %	44.4 %	37.5%
Sell	Underperform	3.7 %	15.0 %	2.6 %	3.1 %	1.1 %	4.8%

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