Argent Capital Management LLC

Market Overview – November 2020

This was a headline story from FactSet, a data service we use regularly:

November was a big month for stocks, particularly value and cyclicals:
US equities rallied sharply in November. The Dow posted its biggest monthly gain since 1987 while the S&P gained the most since April when it emerged from the depths of the coronavirus crisis. Rally was largely chalked up to coronavirus vaccine optimism. This helped to unleash a powerful pro-cyclical rotation as value outperformed growth by nearly 350 basis points. Reopening/epicenter plays such as airlines, aerospace, cruise ships, hotels, casinos, department stores and apparel and accessories saw outsized gains. Energy stocks, banks and industrial metals were some of the other standouts. At-home plays (work, learn, stream, play, eat, exercise, clean, furnish) largely underperformed but did seem to find support from worsening coronavirus trends.

As the COVID-19 pandemic spread we were frequently asked if we were adding any stocks to the portfolio that would benefit both from the pandemic and from the changes it was forcing in our lives. Of course, we always try to be mindful of a changing world, but the general answer to that question was 'No' because many of those stocks had already risen quickly and fully reflected the benefit from COVID-19.

Today, what we hear more often from our clients is whether we have stocks in our portfolio that will benefit from reopening. The answer to that question is a resounding 'Yes.' Chief among those stocks is The Walt Disney Company. Disney has been impacted mightily from the pandemic. Its theme parks were closed, its cruise line shuttered and its movies not shown because theaters were under lockdown. ESPN had no sports to broadcast, because no sporting events were taking place.

To put numbers on the impact, in July of last year consensus sales estimates for Disney were nearly $90B. Today, expected sales for Disney are under $70B, or a decline of 23%. While sales estimates have dropped considerably, earnings have fallen significantly further, declining from $7.14 per share last July to today's $1.97, a drop of over 72%. This results from an impact from what investors call 'operating leverage', where a decrease in sales has a much larger decrease in earnings. Think of all the facilities that Disney continues to service even though the use of those properties are curtailed or closed. Those are costs Disney must bear *without* commensurate sales.

The good news is that the reverse is also true. Once the world opens and tourists return to Disney venues the company will begin to see its sales rise. This will allow Disney to initially cover its costs and later to increase its profits dramatically. That change has not been lost on investors, as Disney rose from $119 per share on November 11 to close the month at nearly $150 per share and even higher as I write this in December. We believe there is more upside to be had in the stock, both from improvements from reopening, as well as its much better-than-expected success in its Disney+ streaming service.

Disney is just one example of a world-class company we hold that will see dramatic improvements in its operations as vaccines become available across the globe and restrictions from the COVID-19 pandemic ease.

We are open for business and welcome your interest in Argent Capital. We have four successful equity strategies – Large Cap, Dividend Select, Mid Cap and Small Cap. If you have questions on any of these options, please call us.

Sincerely,

Ken Crawford

Ken Crawford, Senior Portfolio Manager