Decision 2020: Racing Towards November

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John Buckingham
PRINCIPAL
PORTFOLIO MANAGER

Jason R. Clark, CFA®
PRINCIPAL
PORTFOLIO MANAGER

Christopher Quigley
SENIOR RESEARCH
ANALYST

Zack Tart
PORTFOLIO &
RESEARCH ASSOCIATE

KOVITZ.COM

As the 2020 presidential election campaign heats up and polls show Joe Biden holding a lead of 9.1 points (51.3% to 42.2%) over President Trump, while the betting odds suggest a wider spread, we must caution that the race is far from over. Indeed, pollsters and oddsmakers are hardly infallible as just four years ago, Hillary Clinton led Donald Trump in the presidential race by four or five percentage points one month before Americans cast their ballots. Market historians, and perhaps everyone, should be thrilled to see the page turn to 2021, even as the winner of the Oval Office will still be dealing with COVID-19, political and economic uncertainties.

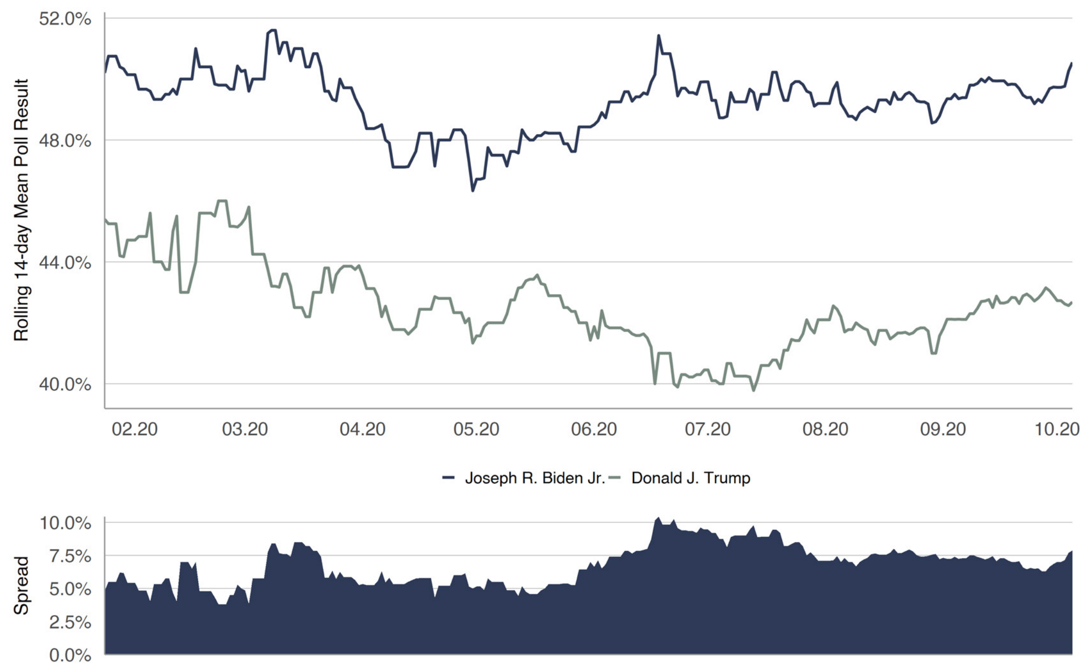


Figure 1: Presidential Polling
From 01.11.2020 through 10.05.2020. Rolling 14-day average poll result. Source: Kovitz using data from RealClearPolitics

No doubt, COVID-19 and more than 200,000 U.S. deaths now attributed to the disease, not to mention the economic fallout from the Great Lockdown and efforts to control the pandemic, have not helped President Trump, and while additional debates are up in the air, there will be plenty of news on health and wealth between now and Election Day. We realize that some investors are concerned that a Biden victory could hit them in the pocketbook, but Figure 2 shows that Value stocks have performed very well with Democratic control of the White House and Capitol Hill, although it is hard to draw grand conclusions from a relatively few data points.

THE STOCK MARKET DOES NOT HAVE A PARTY

Of course, others are worried that a win for the incumbent could also spell trouble for U.S. equities. President Trump has proven to be even more unconventional than initially thought. For example, many businesses benefitted from a significant corporate tax cut and reduced regulation, even as shifting views on trade and tariff skirmishes have made it difficult for companies to make long-term planning decisions. We do not mean to suggest that a President Hillary Clinton would have proved better for equity markets, nor do we give much credence to today's assertions that a President Biden would take a more aggressive COVID-19 stance, whatever that means, that would somehow ensure more favorable medium-to-long term domestic growth at the expense of shorter-term prospects.

Despite President Trump's colorful governing style, it remains challenging to attribute rising or falling markets to individual presidents, their parties or the makeup of Congress given the multitude of factors that drive performance. Historical evidence suggests that performance is very much a mixed bag, with investment success as dependent on the equity category as a political party. Despite trials and tribulations along the way, Figure 3 shows that the U.S. stock market has been better off at the end of eleven of thirteen presidencies since World War II, Richard Nixon and George W. Bush the exceptions.

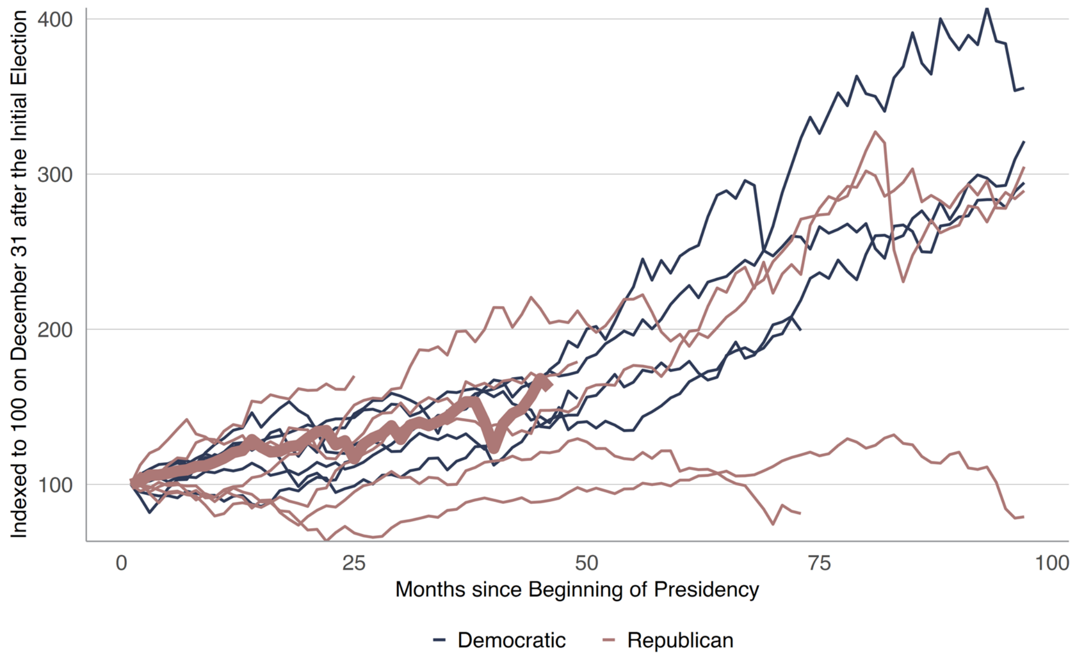
Figure 2:
Parties in Power & Annualized Returns

From 12.31.1928 through 12.31.2018. Annualized total return. Performance segregated by presidential and congressional party. SOURCE: Kovitz using data from the U.S. House of Representatives, Morningstar and Professors Eugene F. Fama and Kenneth R. French

Presidential Performance					
Presidential Party	Congress Party	Fama-French Value Stocks	Fama-French Growth Stocks	Fama-French Dividend Payers	Fama-French Dividend Non-Payers
Democratic	Democratic	20.6%	16.5%	14.1%	20.7%
Democratic	Republican	15.6%	9.9%	14.8%	10.1%
Democratic	Split	14.5%	14.9%	15.3%	15.3%
Republican	Democratic	10.7%	6.7%	9.8%	2.2%
Republican	Republican	-2.4%	-4.2%	-2.2%	-7.7%
Republican	Split	10.7%	1.9%	6.7%	-3.5%
Democratic President		**19.0%**	**14.9%**	**14.3%**	**18.0%**
Republican President		**6.1%**	**2.0%**	**5.1%**	**-2.3%**

Figure 3:
S&P 500 Index Performance by President

From 12.31.1944 through 09.30.2020. Total return. President Trump's return is indicated by a thicker line. SOURCE: Kovitz using data from Morningstar, Professors Eugene F. Fama and Kenneth R. French



EQUITY MARKETS "PRESIDENTIAL CYCLES"

We must always be careful about drawing significant conclusions from a small number of data points, but it is interesting to look at equity market returns in each of the four years of the presidential cycle. Given that the Commander in Chief often makes tough choices early on, while doing everything possible to spur the economy late in the four years to ensure personal or party re-election, we suppose Figure 4 could be unsurprising, with equities on average having not performed as well in the first couple of years of the presidency and much better over the last two years.

The more than 60% price gain for the S&P 500 since Election Day 2016 has been terrific, especially as so many supposed market experts were predicting that a Trump victory would lead to big losses in the equity markets. We'll see what 2021 brings, but nine decades of market history show that the S&P has managed a solid average annual return of 7.7% in the first calendar year of the Presidential Cycle, though 2001's 11.9% drop is a weight on that figure. Happily, Value Stocks have beaten Growth by 5.6 percentage points in the first-year performance derby, while Dividend Payers, on average, have gained 3.3 percentage points more than Non-Dividend Payers.

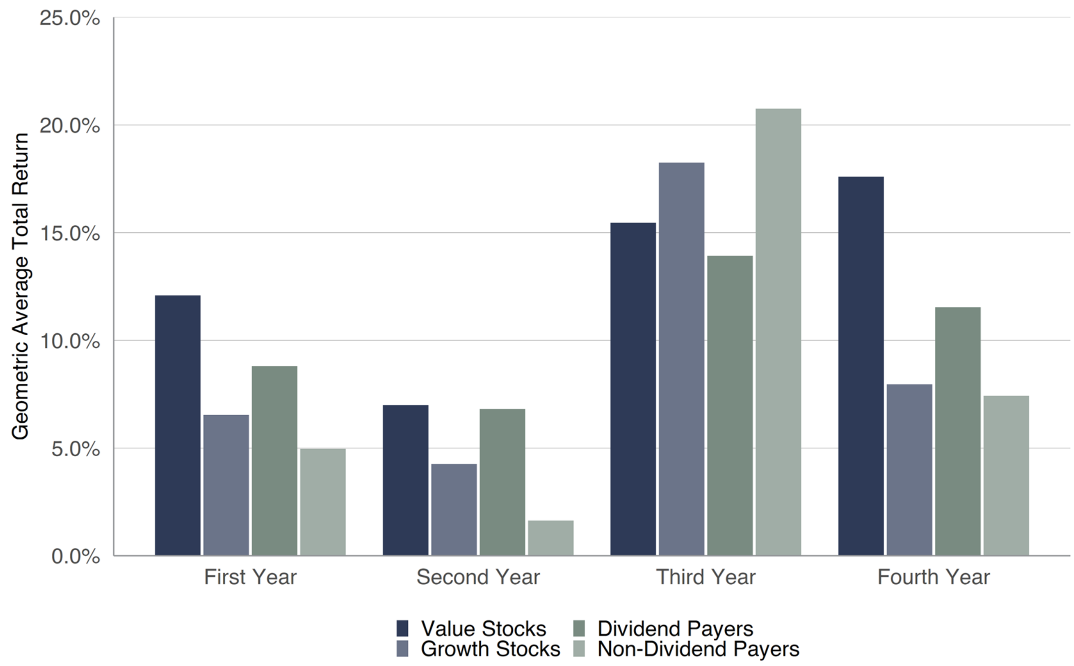
We recognize that past performance is no guarantee of future performance or even profitability, but market historians who favor Value strategies should be thrilled to see the page turn to 2021, even as the winner of the Oval Office will still be dealing with COVID-19, political and economic uncertainties.

OUR VOTE

We believe that we are likely to encounter additional volatility on both sides of the election, as America chooses a direction for the next four years. But Washington is just one of numerous factors that drive stock market gyrations, so we would never recommend major alterations to a long-term asset allocation plan based solely on politics. Therefore, it should come as little surprise that the only endorsement we will offer is in support of a broadly diversified portfolio of undervalued stocks to be held for its long-term appreciation potential, no matter who is in power in D.C.

Figure 4:
Equity Performance by Year of Term

From 12.31.1927 through 12.31.2019. SOURCE: Kovitz using data from Morningstar, Professors Eugene F. Fama and Kenneth R. French



TEN PICKS FOR THE 2020 ELECTION

Our approach focuses on broadly diversified investments in undervalued stocks for their long-term appreciation potential. Does that mean we build portfolios of 20 stocks…30…? More like 50 and up. We like stocks. And we like a lot of 'em. We don't rely nearly as much on "how many" as we do "in which," but we tend to invest in far more names than most. This expansive diversification, we find, potentially serves us well in two ways: we can further minimize the risk of individual stock ownership, while maximizing the likelihood of finding the truly big winners among the undervalued masses.

As for the "in which" part, readers should know we discriminate among potential investments primarily by their relative valuation metrics and our assessments of stock- specific risk. We buy only those stocks we find undervalued along several lines relative to their own trading history, those of their peers or that of the market in general. The prices at which we'll buy and sell stocks incorporate a range of fundamental risks (e.g. credit, customer and competitive dynamic) that we believe the companies may face over our normal 3-to-5-year investing time horizon.

Each stock is trading for a significant discount to our determination of long-term fair value and/or offering favorable risk/reward profiles. Note that, while we always seek substantial capital gains, we require lower appreciation potential for stocks that we deem to have more stable earnings streams, more diversified businesses and stronger balance sheets. The natural corollary is that riskier companies must offer far greater upside to warrant a recommendation. Further, as total return is how performance is ultimately judged, we explicitly factor dividend payments into our analytical work.

Figure 5:
Ten Dividend-Paying Picks

As of 10.06.2020. SOURCE: Kovitz using data from Bloomberg Finance L.P.

Election 2020 Stock Picks

Company	Ticker	Industry Group	Current Price	Long-term Target Price
Acuity Brands	AYI	Capital Goods	109.69	175.57
Comcast	CMCSA	Media & Entertainment	44.51	55.44
CVS Health	CVS	Health Care Equip/Srvcs	58.23	108.59
Hewlett Packard Enterprise	HPE	Technology Hardware	9.56	16.29
World Fuel Services	INT	Energy	22.52	42.78
Kimco Realty	KIM	Real Estate	11.95	18.11
Leggett & Platt	LEG	Consumer Dur & App	42.30	50.03
Morgan Stanley	MS	Diversified Financials	47.74	75.52
Tyson Foods	TSN	Food, Bev & Tobacco	58.61	88.09
Westrock	WRK	Materials	36.11	57.85

ACUITY BRANDS (AYI)

Acuity Brands is a leading light manufacturer that designs, produces and distributes a full range of indoor and outdoor lighting and control systems for commercial, industrial, infrastructure and residential applications. Shares are off nearly 20% year-to-date as lower demand due to the pandemic pushed revenue down 18% in the most recent quarter, while many have become worried about exposure to commercial real estate. Financial results have beaten analyst expectations in recent quarters, although the firm has tempered expectations in the near-term due to anticipated weakness in nonresidential building activity based on current construction indicators. We really like Acuity's conservative financial posture, with a balance sheet that boasts more cash than debt and flexible operating structure where generally two-thirds of costs are variable. The firm inked a recent partnership, exclusive in North America, with Ushio America to offer filtered excimer lamps that generate 222nm of far UV-C light capable of inactivating viruses and bacteria on indoor surfaces. In addition, Acuity's opportunities in the Internet of Things appear promising as its indoor location services data platform provides navigation, way-finding, asset tracking, occupant behavior data and asset analytics using a connected lighting platform, a real plus as businesses are busy reconfiguring space for hygiene and social distancing purposes. At 14.5 times, shares trade at discount to their 5-year average forward P/E multiple, and yield 0.5%.

COMCAST (CMCSA)

Comcast is a global media and technology company with two primary businesses, Comcast Cable and NBCUniversal. The former is one of the nation's largest video, high-speed internet and phone providers to residential customers under the XFINITY brand and also provides these services to businesses. The latter operates news, entertainment and sports cable networks, the NBC and Telemundo broadcast networks, television production operations, television station groups, Universal Pictures and Universal Parks and Resorts. We like that Comcast sports a diverse, yet complimentary revenue stream. And while coronavirus-related theme park closures and a reduced sports lineup have been headwinds on the NBC side of the house, a strong core cable business continues to produce more than half of the firm's revenue. We also expect the company to benefit from elevated ad-spending around a raucous election season and robust consumption of paid programming as many shelter-in-place this winter. Comcast is available at a slight discount to the peer median EV-to-EBITDA multiple, while shares yield just over 2%.

CVS HEALTH (CVS)

CVS operates one of the largest domestic retail pharmacy networks and is a leading pharmacy benefits manager. CVS also serves an estimated 38 million people through traditional, voluntary and consumer-directed health insurance products and related services (via its Aetna merger. Shares have fallen hard this year as coronavirus fears fueled widespread selling early in the year, from which CVS never totally recovered. Although management initially whacked guidance as a result, full-year adjusted EPS guidance has inched up recently to a range of $7.14 and $7.27, with cash flow from operations in the range of $11.0 billion to $11.5 billion. Although the competitive landscape is challenging, the regulatory environment presents questions and the opioid litigation threat remains front and center, we continue to believe that CVS is a free-cash-flow generating behemoth with strong potential to evolve its business to a broader health care delivery model. Shares trade for 9 times NTM adjusted earnings estimates and yield 3.4%

HEWLETT PACKARD ENTERPRISE (HPE)

Hewlett Packard Enterprise offers enterprise security, analytics and data management services to businesses worldwide. Split off from Hewlett-Packard in 2015, HPE is focused on Hybrid IT, a combination of in-house data centers and private or public cloud environments. The company is in the middle of a transition to a subscription or "as-a-service" model, which accelerates cloud growth and helps companies right-size and scale with ease. Major strategic acquisitions, including flash memory manufacturer Nimble Storage in 2017 and supercomputer manufacturer Cray in 2019, have added to the firm's cloud capabilities, while the internally built platforms like GreenLake Hybrid Cloud work nicely with SAP HANA, AWS and Microsoft Azure. We added HPE to our portfolios in Q3 because we think HPE has been unfairly punished this year, as COVID-19 caused IT budgets to be slashed and upgrades postponed, but management believes that the pandemic has "validated the firm's strategy," as August's estimate-beating earnings report might attest. We think the company's diverse offerings, including 5G networking, and potential to grow subscription revenue put HPE in a strong competitive position, yet the stock can be had for less than 7 times forward earnings, while offering a yield of 5.0%.

WORLD FUEL SERVICES (INT)

Born out of a merger between International Recovery Corp and Trans-Tec in 1995, World Fuel is an aggregator and reseller of fuels for its many customers in the aviation, marine and land transport markets around the globe. As fuel tends to represent a significant portion of client operating expense, the firm can pass along significant savings by aggregating orders. Through nearly two-dozen acquisitions over the past two decades, INT has grown into a leader in a highly fragmented market. While the company was still able to produce profitable quarters this year, shares are down nearly 40% year-to-date as the pandemic has put a dent in volumes within the aviation segment (which typically represents close to 50% of revenue). Aside from brokering fuel, we like that World Fuel Service also provides value-added technology and services, which include flight planning and logistical support, and the stock gives us "picks and shovels" exposure to travel without the risk of the transportation companies as the balance sheet is conservatively financed with just $450 million of net debt and no material maturities until 2024. Shares trade for around 11 times the current 2021 consensus earnings estimate and the yield is 1.8%.

KIMCO REALTY (KIM)

Real estate investment trust Kimco has interests in 400 U.S. open-air shopping centers, comprising 70 million square feet of leasable space concentrated mostly in major metropolitan markets. After a fantastic 2019 for KIM shares, 2020 has been miserable with the stock off more than 40% on concerns about the near- and long-term impact of COVID-19 and the Great Lockdown. Of course, Kimco has a very diverse mix of tenants with only 14 chains (led by TJX, Home Depot, Ahold Delhaize and Albertson's) each representing more than 1% of annualized base rents, while 77.4% of ABR is from grocery-anchored centers. We also note that after falling to 71% in Q2, rent collections improved to 84% in July and 86% in August, with essential retailers at 98%. At the end of April, only 56% of tenants were open for business, but in mid-September that metric stood at 97%. We are constructive on Kimco's improved liquidity and note that it has a sizeable stake in Albertson's, which is publicly traded again. The retail environment isn't without strong headwinds, but we like the company's foray into mixed-use redevelopment of some of its properties and its focus on better markets with higher barriers to entry. We also think the stock is cheap, trading below book value and presently yielding 3.4% after the recent dividend reinstatement.

LEGGETT & PLATT (LEG)

Leggett & Platt is a diversified manufacturer serving an array of industries including bedding (coils used in mattresses, specialty foam used in bedding and furniture, and mattresses), automotive, aerospace, and steel wire and rod. About two-thirds of L&P's steel wire output is used in making its own products. LEG shares were not immune to the deep market selloff early in the year but have nearly doubled since the low in March. Management has a history of disciplined cash use, the company is a leader in most of its markets, with few large competitors, and has increased its dividend for 49 consecutive years. We expect persistently low interest rates to support a strong housing market that was on already on a tear before the pandemic and drive strong results in furniture and residential products segments as many continue to work from their homes. We note that the company has a targeted average annual revenue growth rate of between 6% and 9%. At 18 times analyst estimated earnings, shares trade at a discount to the market's forward multiple and yield nearly 4%

MORGAN STANLEY (MS)

Morgan Stanley is a global financial services firm with leading positions in investment banking (M&A and equity and fixed income underwriting), trading and wealth management, which contributes about 50% of firm-wide revenue. MS also has an asset management business to add to its diversification as the firm has sought a lower overall risk profile since the financial crisis. In February, the company announced the purchase of E*TRADE Financial. We think the acquisition could give MS greater scale in tech, a deeper product and service base, and self-directed investors to complement advisor-assisted wealth-management clients. The Federal Reserve gave its blessing to the union a few weeks ago. In the near-term, we believe MS will benefit from continued strong capital market activities, and we see the opportunity to take larger wallet share in wealth management with $2.7 trillion in client assets already. While financial stocks face headwinds in the low-interest-rate environment, MS has performed well and we are constructive on its lower exposure to consumer and commercial loans, its healthy balance sheet and relatively inexpensive valuation. MS trades for less than 10 times NTM earnings and yields 2.9%

TYSON FOODS (TSN)

Tyson produces, distributes and markets chicken, beef, pork, prepared foods and related allied products. Shares are down more than 35% on the year, in part due to the underperformance of poultry and prepared foods. Of course, while there seemed to be a run on protein products as the coronavirus scare escalated, continued economic weakness could weaken demand for TSN products and the company has to contend with the fallout from the many struggling restaurants across the country. Still, we have been pleased to see the overall strength in the company's Beef and Pork segments, and we see Tyson continuing to benefit from the unfortunate devastation the African Swine Fever has caused to the global pork supply, especially in Asia. We believe that TSN is well positioned to supply China with pork and other proteins and backfill other markets. While the near term is definitely murky, we like the long-term potential across its product lines, including prepared foods and plant-based offerings. Also, we can't ignore the likelihood of increasing protein consumption around the globe, especially in emerging economies. The dividend yield of TSN shares is 2.9%.

WESTROCK (WRK)

One of North America's paper giants, Westrock produces packaging for food, hardware, apparel and other consumer goods. With approximately 12.3 million tons of mill capacity, the company's lineup includes recycled and bleached paperboard, containerboard, consumer and corrugated packaging, and point-of-purchase displays. We have typically viewed WRK as an inexpensive beneficiary of tailwinds from e-commerce (via shipping boxes), but the company has faced margin pressures, while weak demand and pricing early in the pandemic led to a cut of the dividend of more than 50%. That said, the yield is still 2.2%, volume growth in consumer packaging for every-day goods from stay-at-home trends has buoyed operating results and, due to a reportedly tight market in recent weeks, the firm is expected to follow competitors in raising containerboard prices. We think the stock is inexpensive, given long-term EPS potential of more than $4.00.

For more information on working with our financial professionals contact us at wealth@kovitz.com or 312.334.7300.

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All returns are geometric average unless otherwise stated. The geometric average is an mean set of products that takes into account the effects of compounding.

The dividend-weighted portfolio data is from Eugene F. Fama and Kenneth R. French. The dataset is broken into five groups: non-dividend paying, top 30% of dividend payers, middle 40% of dividend payers, bottom 30% of dividend payers and all dividend payers (weighted 30% of top dividend payers, 40% of middle dividend payers and 30% of low dividend payers). The capitalization and factor-based (book value-to-price) portfolio data is from Eugene F. Fama and Kenneth R. French. The dataset is broken into four groups: large value, large growth, small value and small growth. The aggregate Value and Growth porfolios are monthly averages of the two returns.

The Standard & Poors 500 index (S&P 500) is a broad stock market index based on the market capitalizations of the largest 500 companies listed in the U.S. Small company stocks, via Ibbotson Associates, are the bottom twenty percent of the New York Stock Exchange. Large company stocks, via Ibbotson Associates, are represented by the S&P 500 index.

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