CONGRESS ASSET MANAGEMENT COMPANY

DECEMBER 2021 BRIEFING

Pandemic variants and Powell pivot fail to faze markets. Holiday shopping is looking more like a marathon than a sprint. Earnings accelerate for mid caps.

MTD

	Value	Core	Growth
Large	-3.52	-1.34	0.61
Mid	-3.04	-3.48	-4.23
Small	-3.42	-4.17	-4.88

QTD

	Value	Core	Growth
Large	1.37	5.50	9.33
Mid	2.12	2.26	2.49
Small	0.27	-0.09	-0.43

YTD

	Value	Core	Growth
Large	17.73	21.53	24.95
Mid	20.76	17.77	12.33
Small	23.24	12.31	2.38

	MTD	QTD	YTD
Growth	0.61	9.33	24.95
Momentum	-3.95	4.29	13.45
Quality	-0.11	6.83	22.73
Russell 1000	-1.34	5.50	21.53
Low Vol	-1.97	3.39	13.31
Small	-4.17	-0.09	12.31
Value	-3.52	1.37	17.73

Source: Morningstar as of 11/30/2021. Style box Russell Indices. Low Vol (MSCI USA Min Vol Index), Momentum (MSCI USA Momentum Index, Quality (MSCI USA Quality Index)

November Recap

Volatility came on strong to close out November as Thanksgiving week saw a pile of uncertainties added to investors' plates. The VIX had settled in near a post-pandemic low of 15 to start the month, firmly below its long-term average of 19.5, before the Omicron variant, hawkish Fed forecasts, and declining earnings forecasts combined to send the fear gauge north of 31 for the first time since February 2021, just a few points shy of a two-sigma move.

Momentum suffered and few sectors were spared as only Technology and Consumer Discretionary managed to post gains in November. Investors found shelter in size and profitability across market segments. In comparing the Russell 1000, Russell Midcap, and Russell 2000, the largest quintile of companies by market cap outperformed the lowest quintile of companies by 524 bps, 266 bps, and 354 bps respectively while the highest quintile of companies by ROE outperformed the lowest quintile of companies by 766 bps, 517 bps, and 731 bps respectively according to data from Jefferies.

Trends

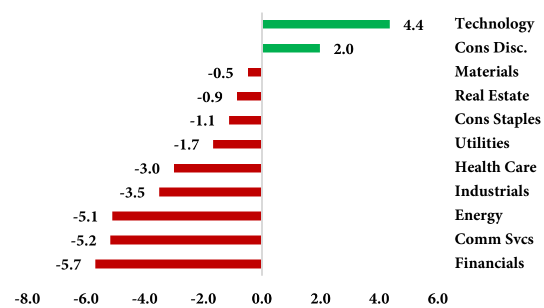
With all eyes turned towards monetary policy, investors and analysts alike may be demonstrating increased resilience to news around new pandemic variants. Data from Google Trends shows that while search interest in the Delta variant remained elevated from June through September, interest in Omicron is looking more like a one-month phenomenon. Action in the VIX supports the sentiment with the gauge trending toward its long-term average in mid-December.

Analysts' earnings estimates also show little concern over the ramifications of Omicron's impact on corporate profitability thus far. Heading into Q3 earnings season, analysts had reduced forward 1yr earnings estimates on the S&P 500 by 1.8% in September, contributing to the index's decline of 4.7% for the month. While Q4 earnings estimates dropped 1% in November, estimates have held steady in December, and 1yr forward earnings estimates are up 0.43% through December 14th, according to data from FactSet. Further upside looks likely given Q4 estimates of $51.09 are still anchored more than 5% below Q3 results of $53.86 despite fairly unanimous expectations for mid to high single-digit GDP growth in Q4 versus the more pedestrian 2.1% experienced in Q3.

Disruption

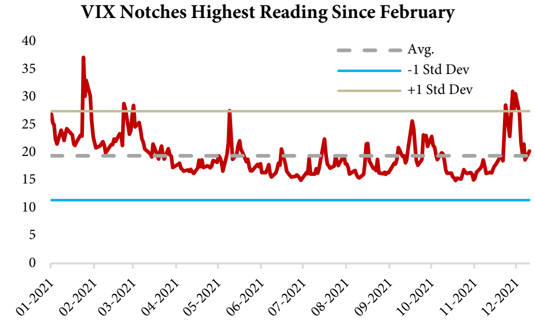
November marked the one-year anniversary of China's regulatory crackdown that began with the postponement of the Alibaba-backed Ant Group IPO. While the dust has yet to settle on a series of wider-ranging regulatory policies introduced since, the impact on Chinese and Emerging Market indices is increasingly clear." While tech executives in the US have faced pressures of their own, the divergence in profitability for the S&P 500 versus the MSCI China is telling as the latter's return on equity hit a decade-plus low in November. The decline of China's tech champions is making its mark on the broader emerging market indices as well. Though China still represents over one-third of the MSCI Emerging Markets index, concentration in the index's top constituents declined from 26.7% to 19.6% in the 12-month period ending November 2021.

S&P 500 Sector Returns: November 2021



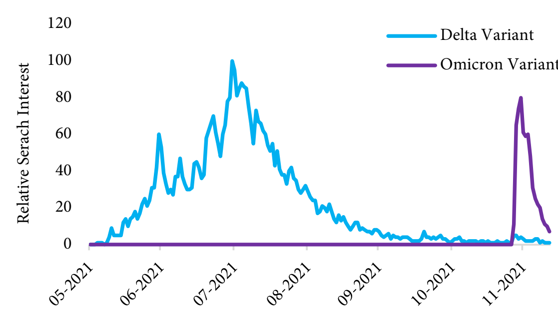
Source: Morningstar Direct as of 11/30/2021

VIX Notches Highest Reading Since February



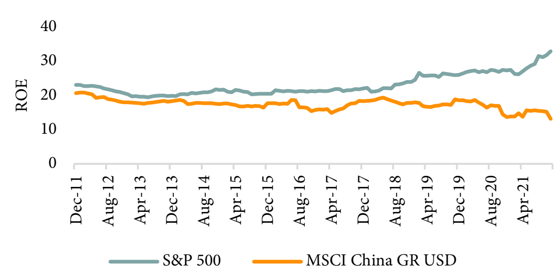
Source: Federal Reserve Bank of St. Louis, Chicago Board of Options Exchange

Search Interest in Omicron Looking Shortlived



Source: Google Trends as of 12/14/2021

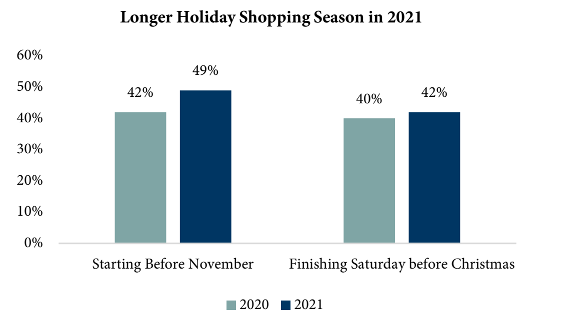
ROE for MSCI China & S&P 500 Headed in Separate Directions



Source: Morningstar Direct as of 11/30/2021

Large Cap

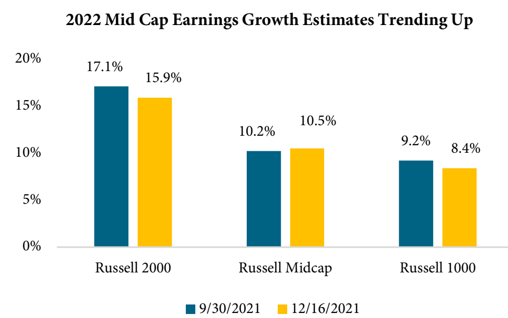
Supply chain constraints do not appear to have blunted consumer appetites in 2021 as the holiday shopping season is shaping up to look more like a marathon than a sprint. November retail sales results came in softer than expected as October's blowout numbers were revised upwards, fitting the narrative that early sales events would pull holiday sales forward. Data from the National Retail Federation's December survey however shows that year over year holiday spending estimates have been revised upwards to as high as 11.5%, growth from October's estimate that ranged between 8.5 to 10.5%. 148 million people still plan to shop in-store and online on the last Saturday before Christmas. With 57% and 47% of survey respondents planning to make holiday purchases online or at major department stores, versus 24% planning to make a purchase at local or small businesses, the preference for large and online retailers continues to look like a tailwind for large caps.



Source: NRF & Prosper Insight & Analytics 2021 Consumer Holiday Survey

Mid Cap

2022 earnings estimates for mid caps are holding up better than their large and small cap peers as measured by the Russell indices. Estimates for the Russell Midcap Growth index have climbed from 10.2% to 10.5% from the end of Q3'21 through December 16th. Keying in on quality has worked well within mid caps in 2021, a dynamic that may continue to prove profitable in 2022. The highest quintile of names by ROE in the Russell Midcap index have outperformed the lowest quintile by 1,123 bps YTD but still trade at 2.4x sales versus the 7x sales multiple for the lowest ROE cohort.

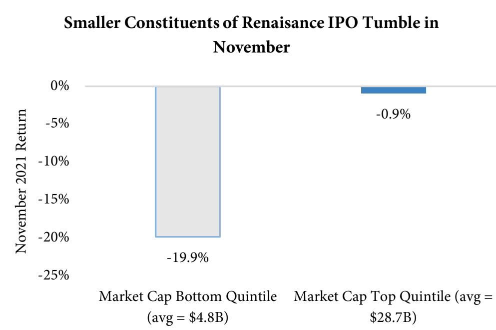


Source: Jefferies, FactSet as of 12/16/2021

Small Cap

The IPO market continues to run red hot, having added a record 1,149 newly public companies to markets in 2021. Though the robust capital formation is a welcome long-term tailwind to markets, November was a friendly reminder that it pays to be prudent with newly issued companies, particularly in the small cap space. The Renaissance IPO ETF dropped 8% in November, good for its worst month since March 2020. Looking under the hood, the bottom quintile of companies by size, with an average market cap of $4.8B dropped 19.9%, versus a 1% decline for the top quintile.

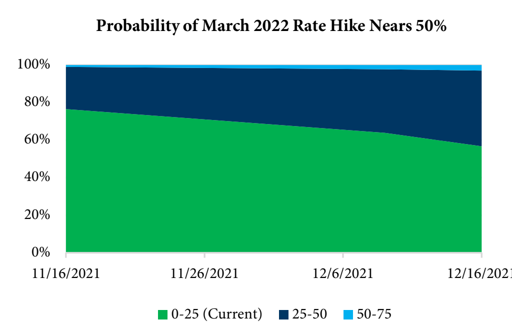
Russell's December rebalance will add 40 names representing just under $50B in market cap to the Russell 2000, bringing the index's total constituents to 2,047. Health Care leads the pack by number of additions (16) and combined market cap ($15B).



Source: Morningstar Direct as of 11/30/2021

Fixed Income

December's FOMC meeting saw Fed Fund futures equate tapering to tightening and markets were largely unfazed. The Fed's announcement to double the pace in reducing its bond purchases saw the odds of a Q1'22 rate hike move closer to a coin toss as the probability of one or more hikes in March 2022 jumped from 36.1% on December 9th to 43.3% as of December 16th. The Fed's dot plot and Fed Fund Futures have both homed in on two to three rates hikes in 2022 and the Fed's latest Summary of Economic Projections pointed to a long-run policy rate of 2.5%, holding steady from September 2021's report. Equities appear comfortable with that call as markets rallied post press conference. Treasury markets remained steady as well, though something will need to give eventually with the 10 yr yield still anchored below 1.5%.



Source: CME Group as of 12/16/2021

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