CONGRESS ASSET MANAGEMENT COMPANY

NOVEMBER 2021 BRIEFING

November 2021 Briefing: Markets snap back in October as margins show pricing power intact in Q3. Inflation and index concentration head higher. Consumers fuel up for holiday spending.

MTD

	Value	Core	Growth
Large	5.08	6.94	8.66
Mid	5.32	5.95	7.01
Small	3.81	4.25	4.68

QTD

	Value	Core	Growth
Large	5.08	6.94	8.66
Mid	5.32	5.95	7.01
Small	3.81	4.25	4.68

YTD

	Value	Core	Growth
Large	22.03	23.18	24.20
Mid	24.54	22.02	17.29
Small	27.60	17.19	7.64

	MTD	QTD	YTD
Growth	8.66	8.66	24.20
Momentum	8.57	8.57	18.11
Quality	6.95	6.95	22.86
Russell 1000	6.94	6.94	23.18
Low Vol	5.47	5.47	15.59
Small	4.25	4.25	17.19
Value	5.08	5.08	22.03

Source: Morningstar as of 10/31/2021. Style box Russell Indices. Low Vol (MSCI USA Min Vol Index), Momentum (MSCI USA Momentum Index, Quality (MSCI USA Quality Index)

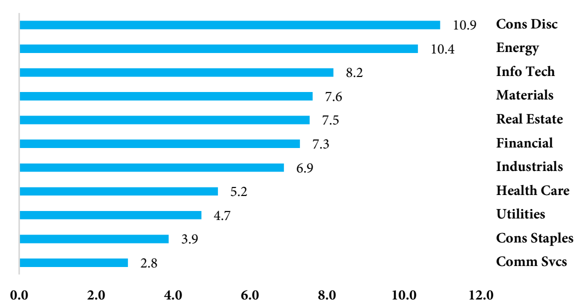
October Recap

Markets snapped back in October following the September slump which saw investors grapple with valuations against the prospect of peak earnings. September's steepening yield curve paired with analysts reducing their bottom-up earnings estimates for the first time in 2021 was enough to send the S&P 500 down 4.7% for its worst monthly return since March 2020's decline of 12.4%. With the S&P 500 trading over 20X forward earnings investors needed proof earnings were still heading higher and Q3 results provided it.

Q3'21 earnings estimates jumped 7% from $48.89 to $52.31 in October as results rolled in and the S&P matched the gain. The market rally was broad with Growth and Momentum leading the way against the backdrop of a flattening yield curve. Bigger translated to better as the highest quintile of companies by market cap outperformed the lowest quintile by 465 bps, 509 bps, and 422 bps across the Russell 1000, Russell Midcap, and Russell 2000 respectively.

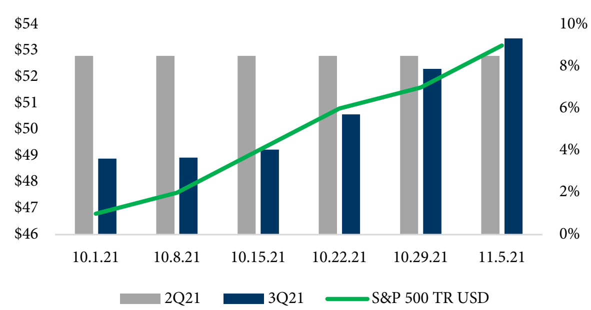
With 92% of S&P 500 companies having reported earnings through November 12th, Q3 results are set to safely eclipse Q2 results of $52.81 per share according to data from FactSet. A familiar setup lies ahead with Q4 earnings estimates of $51 now anchored below Q3 results.

S&P 500 Sector Returns: October 2021



Source: Morningstar Direct as of 10/31/2021

S&P 500 Follows Q3 Earnings Revisions Higher



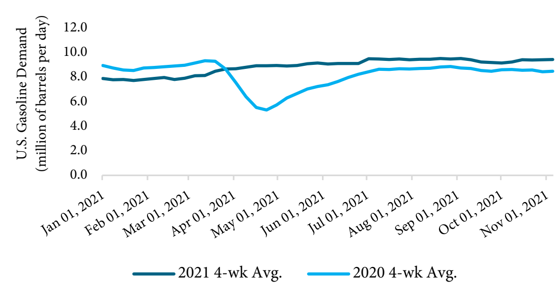
Source: FactSet as of 11/12/2021

Disruption

October's CPI reading came in hotter than expected at 6.2%, dealing a blow to camp transitory as markets adjusted their views on the path of monetary policy. In the four-week period ending November 12th the probability of three or more rate hikes in 2022, as measured by Fed Fund Futures, more than doubled to 53.5% from 20.7%. The commotion wasn't contained to the corners of derivatives markets as inflation was mentioned a record 285 times on S&P 500 company earnings calls, more than double the 5-year average of 137 per FactSet.

On the whole, margins have withstood supply chain pressures thus far with earnings growth still outpacing revenue growth. Looking at Q3 results, 75% of S&P 500 companies beat revenue expectations by an average of 2.9% while 81% of companies beat earnings estimates by an average of 10.3%. Markets are increasingly willing to punish companies missing expectations, however, as deteriorating growth narratives amidst increasing interest rate expectations are proving to be a costly combo. Companies that reported negative earnings surprises in Q3 were subject to an average price decline of -3.3% compared to the 5-year average of -2.3%.

No Seasonal Slowdown for Gasoline Heading Into 2022



Source: US Energy Information Administration as of 10/31/2021

Trends

While work from home has demonstrated stronger staying power than many had anticipated, trends at the gas pump may signal green shoots of workers returning to the office. Gasoline demand shows Americans are hitting the road more often so far in Q4 than they did in 2020. Gasoline demand was both lower overall and declining in October 2020, dropping from 8.6 to 8.5 million barrels per day. Conversely, October 2021 witnessed meaningfully higher demand that accelerated from 9.2 to 9.4 million barrels per day throughout the month. Consumers have additional reasons to fill up for the holidays in 2021 according to Deloitte's 2021 Holiday Retain Survey. Shoppers are indicating a greater willingness to venture out of the home this season with those reporting health and safety-related concerns down to 40% from 51% in 2020. Spending on experiences such as socializing, travel, and entertaining is expected to rise 15% while overall holiday spending is expected to average $1,463 per household, up 5% from 2020.

Large Cap

Concentration in the Russell 1000 Growth index hit an all-time high in October 2021 with the top ten holdings now accounting for a 46.7% weight in the index of 622 constituents. Unsurprisingly, the fate of the index's return has become increasingly tied to its top holdings with the top 10 names accounting for 57% of October's 8.7% monthly return and 54% of 2021's 24.2% year to date return through October.

Mid Cap

There has been little noticeable difference between mutual fund and ETF returns versus their benchmarks for midcaps in 2021. Through October the average US Mid Cap Value fund outpaced its benchmark by 43 bps while the average US Mid Cap Blend and US Mid Cap Growth funds trailed their benchmarks by 120 bps and 34 bps points respectively. A sizable dispersion of returns amongst category constituents exists beneath the surface, most notably in Mid Cap Growth where the top 5% of managers are outperforming the bottom 5% by 2,000 bps on average. The value-conscious are faring well regardless of style in midcaps with the lowest quintile of stocks by P/E outperforming the highest quintile of stocks by P/E by 1,055 bps, 865 bps, and 1,947 bps across the Russell Midcap, Russell Midcap Growth, and Russell Midcap Value Indices, respectively.

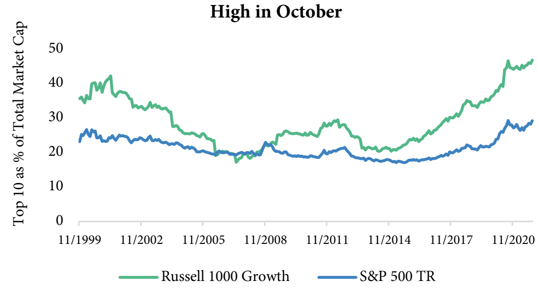
Small Cap

While the Russell 2000 remains ahead of the S&P 500 coming off the pandemic bottom in March 2020, the longer picture suggests small caps may still have some catching up to do. While the Russell 2000 has outpaced the S&P 500 by 25% coming off the March 2020 market bottom, the index still tails the S&P 500 by 341 bps per annum over the 5 years ending in October with small caps currently representing just 4.5% of the US equity market versus their historical average of 7.5% according to data from Jefferies. The environment for active management continues to look favorable with pairwise correlations amongst Russell 2000 constituents trending below their long-term average of 0.28 since June 2021.

Fixed Income

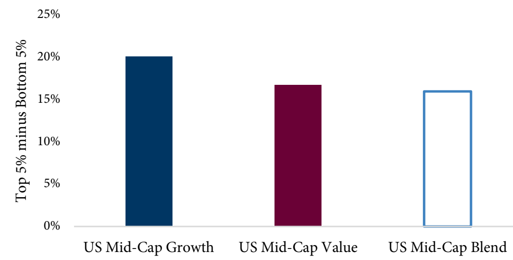
The inflation-adjusted return on 10 year US Treasuries as measured by TIPS hit their 21st consecutive month of negative inflation-adjusted returns in October, extending their lead against the same dubious distinction they achieved for 18 months following the Global Financial Crisis. With the 5 year breakeven inflation rate now north of 3%, real returns in fixed income appear increasingly harder to come by.

Concentration in Russell 1000 Growth Hits All-Time High in October



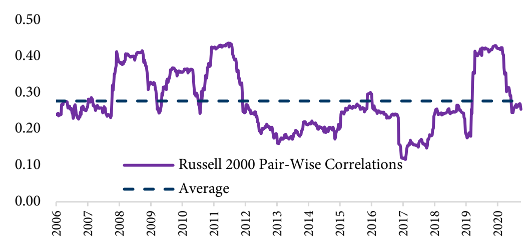
Source: Morningstar Direct, as of 10/31/2021

Dispersion of Returns Widest for Growth Funds in Mid Caps



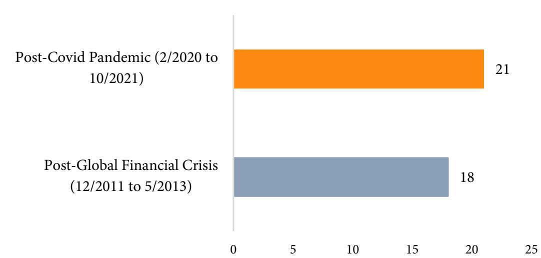
Source: Morningstar Direct, as of 10/31/2021

Lower Pairwise Correlations Set Backdrop for Active Management in Small Caps



Source: FactSet, CAM, as of 10/31/2021

Consecutive Months of Negative Real Yields in 10 yr Treasuries Surpass Global Financial Crisis Recovery



Source: Federal Reserve Bank of St. Louis as of 10/31/2021

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