



## Fear of Flying<sup>1</sup>

**Equity markets are flying. So is COVID. So are corporate reactions to Congressional objectors.**

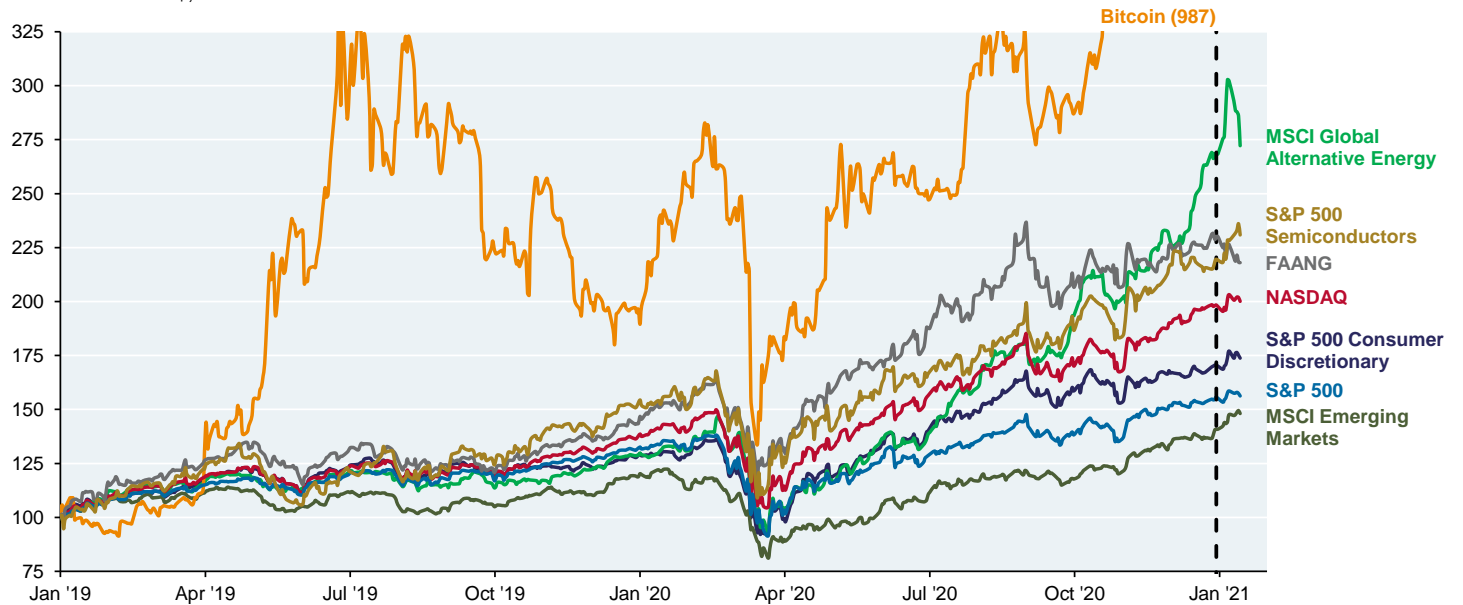
Today’s note covers the following topics, mostly through charts:

- Soaring equity markets, fully-invested market participants and a collapse in risk aversion
- Icarus Moment: Megacaps stocks run into headwinds and the nightmarish id of American internet users
- COVID is taking off again as mutations increase while vaccinations are creeping higher at a slower pace (please join me this Thursday on a webcast with Moderna CEO Stéphane Bancel)
- Jan 6<sup>th</sup> Capitol Building riot aftermath: the fly, corporate PACs and Congressional objectors
- While there’s still a fear of actual flying, oil consumption and oil related stocks are recovering
- The flightless moa: European equities

Since last April, equity markets have been on a tear with many of the indexes below rising at 90%-130% on an annualized basis. **We expect a global rebound in growth, corporate profits and employment this year but investors should be wary of one-directional markets after last year’s rally, and given uncertainties on COVID mutations and vaccine efficacy.** Keep some dry powder around: our view for 2021 is rising markets with bouts of intense profit-taking at points along the way.

### All Systems Go

Total return in US\$, Jan 2019 = 100



Source: Bloomberg. January 15, 2021.

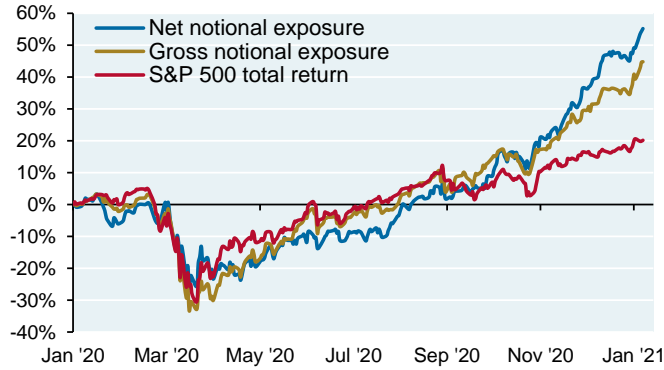
<sup>1</sup> In 1973 a novel entitled “**Fear of Flying**” by Erica Jong was popular in many households. Jong’s novel might just seem like a predecessor to the “50 Shades” books, but at the time it was praised by authors John Updike and Henry Miller, and was also well-received by New York Times Book Review critic Christopher Lehmann-Haupt. I think my parents had a copy, but I was 11 and did not read it.



**Why are equity markets soaring? Everyone is invested**

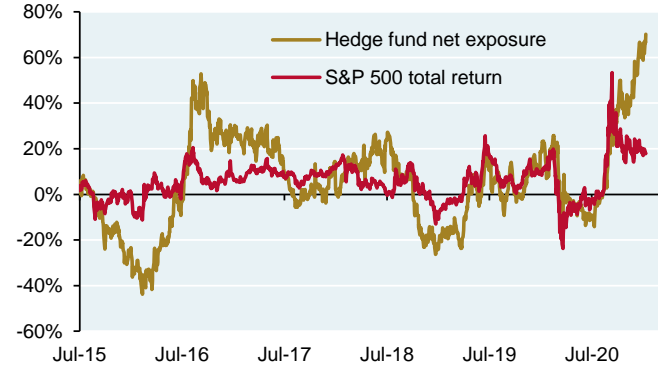
In our 2021 Outlook we discussed the high level of optimism of individual investors and equity mutual fund managers. Today, we round out the picture with data from JP Morgan’s Prime Brokerage group which covers hedge funds. As you can see, **gross and net hedge fund exposures have been rising rapidly as well**. Towards the end of last year, exposures were rising faster than the market itself.

**North America hedge fund exposures vs S&P 500**  
% change since January 2020



Source: J.P. Morgan Positioning Intelligence. January 13, 2021.

**Hedge fund net exposure and S&P 500 returns**  
6-month % change



Source: J.P. Morgan Positioning Intelligence. January 13, 2021.

**There has also been a painful short squeeze:** the chart on the left shows how the 50 stocks in the Russell 3000 with the greatest degree of short interest have been soaring, suggesting a lot of **forced short covering**. Also at the highest level since 2000; the # of stocks that have doubled in the last 3 months that now trade at over 10 times sales (there are 59 of them). On the right: a collapse in the “put/call” ratio, which indicates a decline in risk aversion and portfolio insurance.

**Short squeeze**

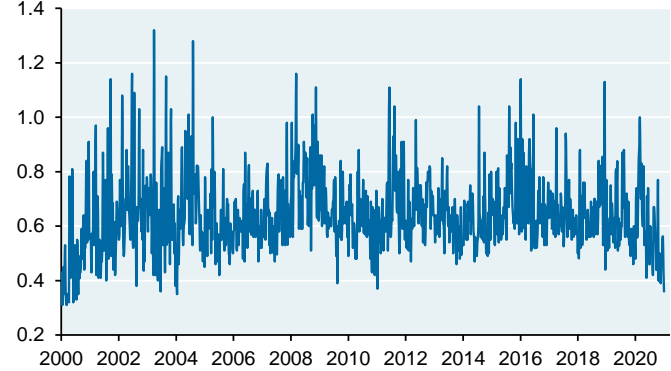
Index level, 50 highest short interest names in the Russell 3000



Source: Bloomberg. January 15, 2021.

**Equity put-call ratio**

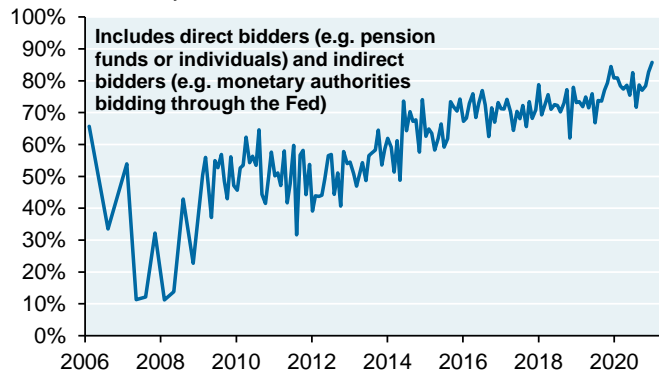
# of put options purchased / # of call options purchased



Source: Chicago Board Options Exchange, Bloomberg. January 15, 2021.

**Investor demand at 30-year treasury auctions**

% of total treasury auction demand



Source: Bloomberg, JPMAM. January 13, 2021.

**While stocks are flying, there’s still demand for long-duration fixed income.** All it took was a 20 basis point backup in yields at the long end to draw in a lot of interest. Investor demand for the 30 year UST reached the highest level since 2006 (i.e., net demand from everyone but broker-dealers). **We expect yields to rise further this year; after all, the US is on a path to a 10% deficit in 2021 and that’s before any future stimulus bills. Biden’s proposal is for another \$1.9 trn in spending, but it faces a long road in Congress.**



**Icarus Moment: Megacaps run into headwinds and into the nightmarish id of American internet users**

The longest section in our 2021 Outlook deals with challenges facing megacap stocks in the form of antitrust issues, rising corporate tax rates, new proposed taxes on low tax jurisdictions and digital service taxes. **We began highlighting these risks last summer, and by Labor Day concluded that the best days of megacap outperformance might be behind them.** Since then, that’s what has been happening. The events of the last 2 weeks are also part of the story: since the early 1900’s, **once companies reach enormous size/scope, there can be a reaction by governments and citizens against such concentrations of power**<sup>2</sup>. Like Icarus, some of these stocks have been flying very close to the sun.

There are other places you can go for legal commentary on the dispute between Amazon Web Services and Parler<sup>3</sup>. But to understand the difficult choices that social media and web hosting companies face in providing a “town square for people to discuss their views”, **pull up an online copy of Amazon’s response to Parler’s lawsuit** (which you can find on Business Insider). Go to pages 4 and 5 for examples of what AWS found on Parler, which is a sampling of the nightmarish id of American internet users.

	Total returns since:		
	Jun '20	Sep '20	Jan '21
Antitrust targets (AAPL, AMZN, FB, GOOGL; equal-weighted)	30.1%	-4.7%	-4.6%
S&P 500 (market cap weighted)	25.1%	8.3%	0.4%
S&P 500 (equal-weighted)	32.0%	18.7%	2.8%

Source: Bloomberg. January 15, 2021. Secular growth stocks: S&P 500 companies with 2018 & 2019 sales growth > 10%; projected 2022 sales growth > 10%; free cash flow margin > 15%; share of GICS subindustry revenues < 33%.

**S&P 500 megacap outperformance**

Performance of market-cap weighted - equal weighted S&P 500, %



Source: Bloomberg. January 15, 2021.

<sup>2</sup> **Senator John Sherman in 1890:** "If we will not endure a king as a political power we should not endure a king over the production, transportation and sale of any of the necessaries of life". Congress passed the Sherman Antitrust Act that same year.

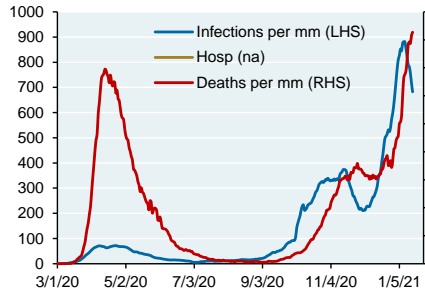
<sup>3</sup> Reuters reports that **Parler** may be back online by the end of the month using an internet protocol address owned by a firm located in **Rostov-on-Don, Russia**



**COVID, soaring: mutations, vaccines, adverse events and internet lies**

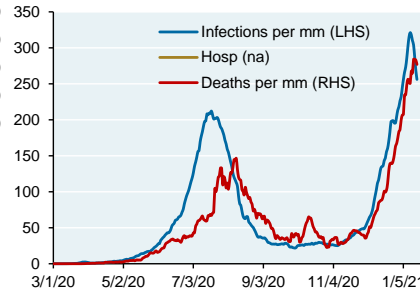
**The COVID outlook right now is all about the collision of new mutations and the offsetting pace of vaccination.** The UK, South Africa and Ireland experienced rapidly rising infections and mortality due to these new mutations. Remember: even if new mutations are not more *deadly*, they still result in more *deaths* if the infection mortality rate (deaths as a % of infected people) stays the same as infections rise.

**United Kingdom daily infections vs mortality**



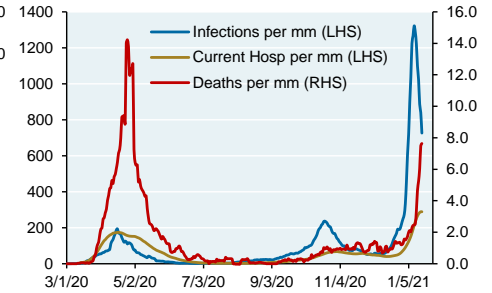
Source: JHU, JPMAM. 01/17/2021. 7 day avg.

**South Africa daily infections vs mortality**



Source: JHU, JPMAM. 01/17/2021. 7 day avg.

**Ireland daily infections vs mortality**



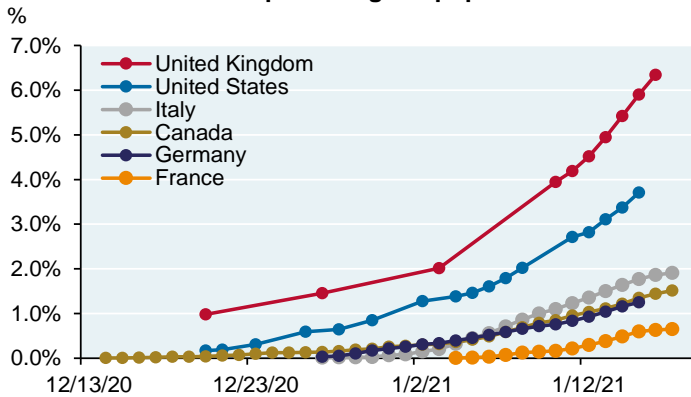
Source: JHU, ECDC, JPMAM. 01/17/2021. 7 day avg.

**Will existing vaccines “work” against new mutations? Against some, yes; against others, we don’t know yet.** New research suggests that Pfizer’s COVID-19 vaccine can protect against a mutation found in highly contagious variants that erupted in Britain and South Africa. Pfizer used blood samples from 20 people who received the vaccine, and their antibodies successfully fended off the new variant in vitro. But there are more mutations to test, one of which also originated in South Africa (E484 mutation). Testing is underway and if existing vaccines do not provide high levels of efficacy, new rounds of vaccine research, testing and production will be required.

**Vaccinations are plodding along for the procedural and personnel bottlenecks you read about, and reluctance of healthcare workers to receive them.** Indicative vaccine resistance levels, as per the NYT: Jackson Healthcare System in Miami 15%; Henry Ford Health System in Michigan 22%; nursing home staff in Ohio 60%; healthcare workers in NYC 30%. I have confidence in vector and mRNA vaccines but my preference is for recombinant protein vaccines that should be available later this year. See Section 3 on our web portal for more details.

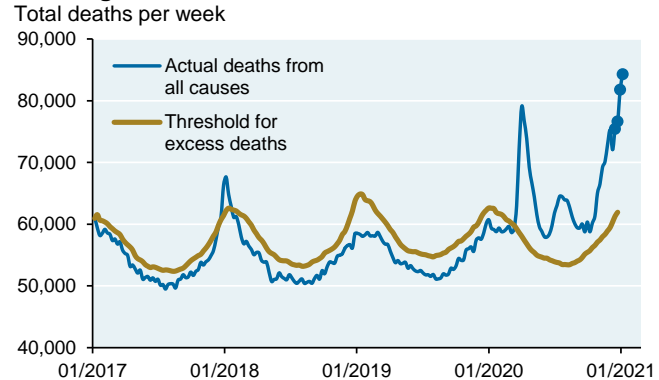
**The most aggravating internet COVID fallacy is that COVID deaths simply offset other causes of death<sup>4</sup>.** Internet social media is of course a terrible place to go for information (although I have in-laws that do exactly this, on science, politics and law). Data from the CDC is **very clear: deaths from all causes have surged relative to normal levels, and the reason for that is COVID.** End of story.

**Total vaccinations as percentage of population**



Source: OWID, JPMAM. January 18, 2021.

**Tracking excess deaths from COVID**



Source: CDC, JHU, JPMAM. January 16, 2021. Dots are estimated using most recent JHU data.

<sup>4</sup> I had an unpleasant exchange a few months ago with someone who kept insisting this; he has not contacted me since.



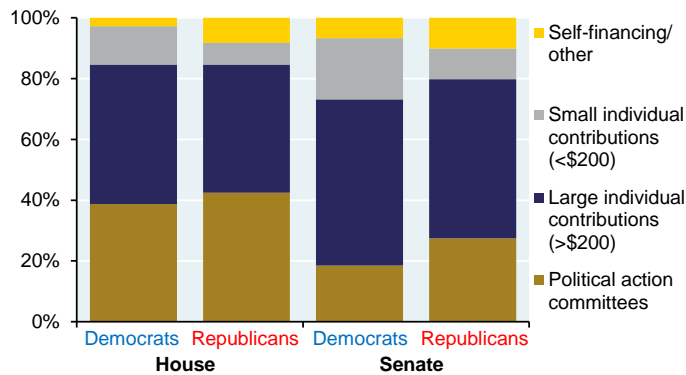
**DC insurrection: The Fly, and corporate PAC funding for Congressional objectors**

Do you remember the fly that landed on Mike Pence’s head during the VP debate? I think that fly was trying to **warn Pence** that Trump was going to betray him in the most Shakespearean manner imaginable: by ascribing to him the awesome power of effectively determining the election outcome via his role presiding over the Joint Session. One example, from Trump at 1 am on Jan 6: “If Mike Pence comes through for us, we will win the Presidency”. Pence of course had *none* of these powers, even under the most distorted and charitable readings of the Electoral Count Act and the 12<sup>th</sup> Amendment; we explained all of that in our Jan 1<sup>st</sup> note on Joint Session rules. But enough people believed it, particularly after Trump expressed his anger at Pence for betraying him<sup>5</sup>.

So, here we are the day before the inauguration and a number of US companies announced that they will **cease making political donations to members of Congress** who objected on Jan 6<sup>th</sup> to the Electoral College results, and who requested a 10-day election audit that was almost certainly procedurally impossible<sup>6</sup>. For context, here’s a look at political funding sources in the House and Senate. Political Action Committees (PACs) represent 20%-40% of Congressional funding, and 2/3 of that amount is **corporate PACs**<sup>7</sup>.

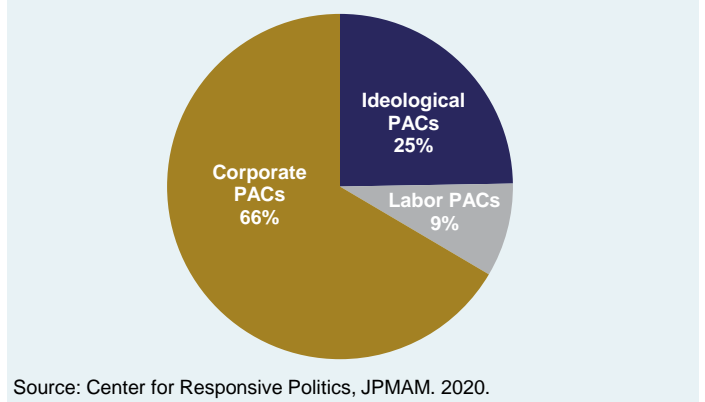
**Political funding sources**

Average of 2014, 2016 & 2018 election cycles by chamber and party



Source: Center for Responsive Politics, JPMAM. 2020.

**Congressional candidate funding by type of PAC, % of total PAC funding received by top 50 recipients in 2020 election**



Source: Center for Responsive Politics, JPMAM. 2020.

**Which politicians generally receive corporate PAC donations?**

A colleague of mine suggested that corporate PAC donations are usually skewed towards the moderates. **We took a look at some actual data, and this is only partially true.** The first chart on page 6 superimposes corporate PAC donations on Senators as a function of their conservatism/ liberalism. Corporate PAC donations to GOP Senators more or less match up against where these Senators are ideologically, so there’s no preference for moderates that we can see. However, **corporate PAC donations to Democrats are skewed to slightly more centrist Senators**, and there’s also almost no funding for the most progressive Democratic Senators.

<sup>5</sup> See <https://reason.com/2021/01/06/trump-tweets-about-mike-pences-betrayal-while-his-supporters-force-the-v-p-to-evacuate-the-capitol/>

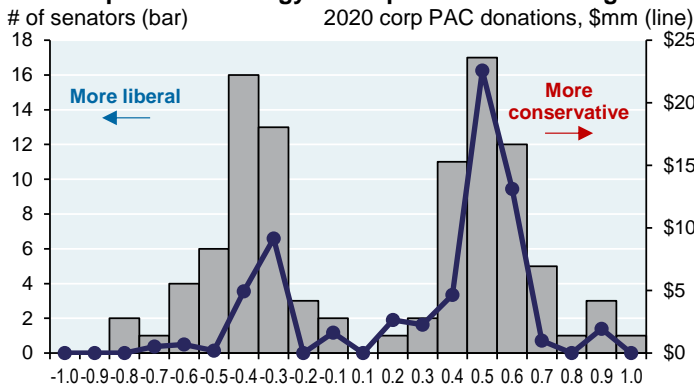
<sup>6</sup> Our constitutional law advisor Michael Morley: **once Congress begins counting electoral votes, there are procedural barriers that make it difficult/impossible for Congress to stop to create an electoral commission along the lines Cruz suggested.** Congress is barred from adjourning the joint session to pass a resolution or law creating a new electoral commission, unless it were willing to declare the Electoral Count Act unconstitutional and act directly contrary to its provisions. Other sections of the ECA confirm that the joint session is unable to vote on anything other than a motion to withdraw to separate chambers to vote on electoral slate objections.

<sup>7</sup> This dataset excludes **SuperPACs** which are prohibited from contributing directly to candidates. SuperPACs exploded in size since 2010; donations by Democrats and Republicans have been split ~50/50 since 2014. In 2020, \$2 billion in SuperPAC spending was 55% Conservative and 45% Liberal. Twenty five mega-donors account for half of all individual donations to SuperPACs. Sources: Public Citizen, Center for Responsible Politics.



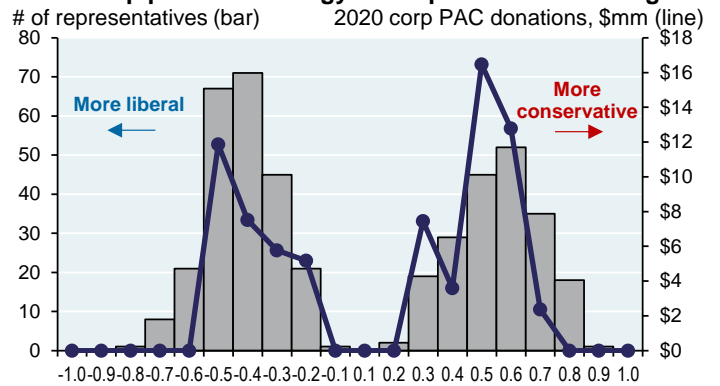
**In the House, corporate PAC donations to both parties mostly match up against where the Representatives are politically.** However, there’s some evidence (as in the Senate) that the most liberal and most conservative Representatives do not receive much corporate PAC funding.

**Senator political ideology vs corporate PAC funding**



Source: VoteView Roll Call Votes database derived from Congr. voting histories, Center for Responsive Politics, JPMAM. 2020.

**House Rep political ideology vs corporate PAC funding**



Source: VoteView Roll Call Votes database derived from Congr. voting histories, Center for Responsive Politics, JPMAM. 2020.

**What would I do regarding PAC funding for Congressional objectors?** To be clear, my opinion is my own and plays no role in anything except writing this piece. Here’s how I see it.

*Arguments to cease donations.* It’s hard to find reasonable, good-faith reasons for the objections. There were no competing slates on the floor (some competing slates were reportedly submitted to the National Archives but Pence chose *not* to submit them to Congress). In other words, even though 5 of 6 “disputed” states are controlled by GOP legislatures, NONE of them officially submitted a competing slate. Furthermore, after dozens of Court cases, no judge or group of judges at any level ruled that officially certified Biden slates should be in any way discounted or decertified. As a result, the Jan 6<sup>th</sup> objections were attempts to disenfranchise voters without good reason and were not in accordance with the objectives and principles of the company’s PAC; as such, the PAC should be retargeted to politicians who share the values of the firm.

*Arguments NOT to cease donations.* Irrespective of their reasoning, Congressional objectors were adhering to rights ascribed to them in the Electoral Count Act, a bill passed in 1887 for the express purpose of avoiding more violent and disruptive means of resolving Electoral College disputes. If companies punish objectors who use legal means, that creates incentives for objectors to use extralegal means next time. Democratic House Reps raised objections at the Joint Session in 2004 on Ohio, and tried to raise objections in both 2000 and 2016 but House Reps could not find a Democratic Senator to support them. Whatever their motives, those objectors should not have been sanctioned either. Here’s how the process should work: objectors should state their reasons for doing so, and supporters of officially certified slates should denounce such objections (such as those raised by Hawley and Cruz) for being cynical, unsupported and baseless reversals of the will of the voters, using data, court opinions and legal precedent in doing so. That’s how politics is supposed to work.

**All things considered, I would not cut off funding to Congressional objectors solely based on their Jan 6<sup>th</sup> decision.** I would align corporate PACs with politicians who share the firm’s values over a wide range of issues, including bills that support protection of voting rights<sup>8</sup>. However, while I would not cut off PAC funding based on that decision alone, I understand the rationale of companies who did.

<sup>8</sup> Democrats in Congress tried last year to amend parts of the **Voting Rights Act** that were deemed unconstitutional by the Supreme Court in 2013 due to use of substantially outdated formulas for determining which jurisdictions need advance DOJ or Federal Court approval to change election-related rules. Voting rights legislation that is updated to reflect changing minority voter registration and participation *and* which is likely to survive Supreme Court challenges would be the most practical and effective way to prevent voter suppression.

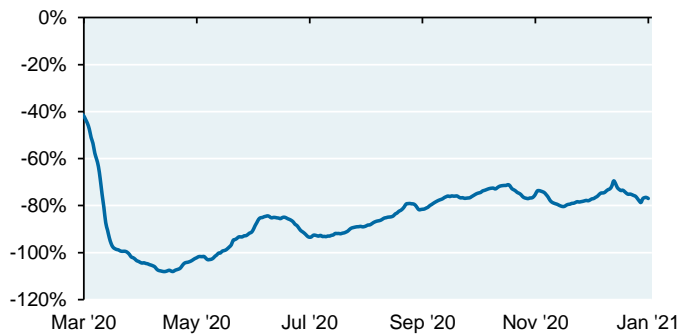




**There’s still a fear of flying, but oil demand and oil stocks have rebounded**

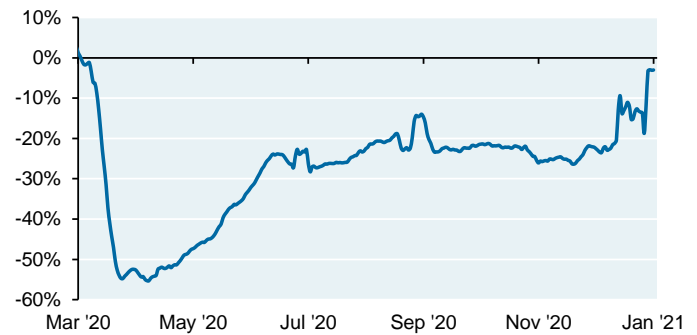
Airline spending is still moribund but oil demand is rising sharply both in the US and elsewhere. In our 2020 Annual Energy piece last June, we outlined the reasons why we expected a rebound in oil and gas stocks and related service sector businesses. **We believe that the loss of capital discipline by investors and oil & gas companies, rather than stranded asset risks and renewable energy penetration, were the primary drivers of poor energy sector performance from 2017-2020.** The pace of renewable energy adoption, particularly for primary energy consumption unrelated to electricity, is simply too slow to explain that poor performance. Capital discipline has unsurprisingly returned to the energy sector, as it usually does after people lose a lot of money. One last point: we consider it unlikely that Biden will try in 2021 or 2022 to resuscitate the Iran deal, which if reinstated could release another 1mm bpd onto the global oil market.

National credit and debit card spending trends  
AIRLINE spending, all transactions  
Spending change vs 2019, 7 day smoothing



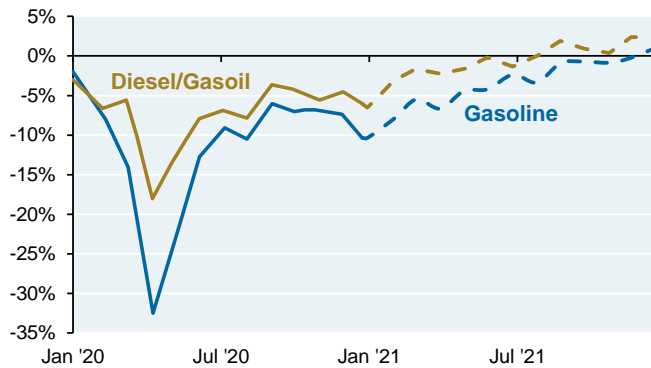
Source: Internal Chase data, JPMAM. January 11, 2021.

National credit and debit card spending trends  
OIL spending, all transactions  
Spending change vs 2019, 7 day smoothing



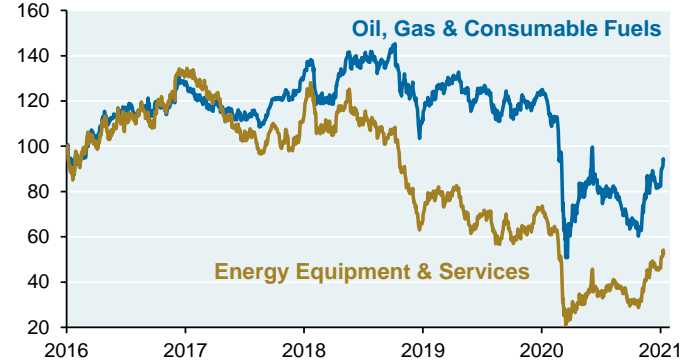
Source: Internal Chase data, JPMAM. January 11, 2021.

**Global gasoline and diesel demand**  
Percent change vs 2019



Source: J.P. Morgan Global Commodities Research. January 13, 2021.

**S&P 500 energy industry total returns**  
Index, Jan 2016 = 100



Source: Bloomberg. January 13, 2021.



**The flightless moa: European equities**

What can explain the flightless moa that is European equities? Since 2010, European equities generated cumulative returns of 88% while US equities cumulative returns were 335%. The next chart dissects European equity underperformance into its component pieces by using a “build” approach:

- outperformance of the dollar vs the Euro
- the higher weighting in the US to tech vs financials/industrial/staples (sector outperformance)
- US outperformance vs Europe WITHIN sectors such as tech, consumer discretionary and financials (stock-specific outperformance)

Bottom line: US outperformance vs Europe is a function of all of these things, with the **largest attribution due to stock-specific outperformance within sectors**. While I can imagine that the currency tailwind for the dollar won't last forever, other factors may be more durable over the long term as we discussed in the Outlook (i.e., higher ROE/ROA for US firms vs European counterparts). We expect 2021 to be a better year in *absolute* terms for Europe once its economy, which is highly geared to global trade, reopens.

**US vs Europe performance**

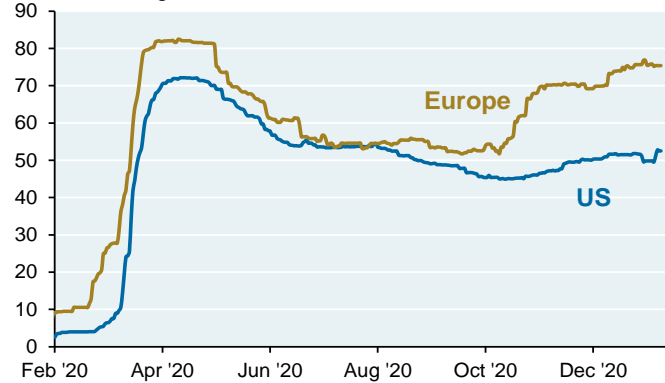
Total return, Jan 2010 = 100



Source: Bloomberg. January 15, 2021.

**Lockdown stringency index: US vs Europe**

Index, 100 = highest level of lockdown strictness



Source: University of Oxford, JPMAM. January 14, 2021.



The flightless extinct moa



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