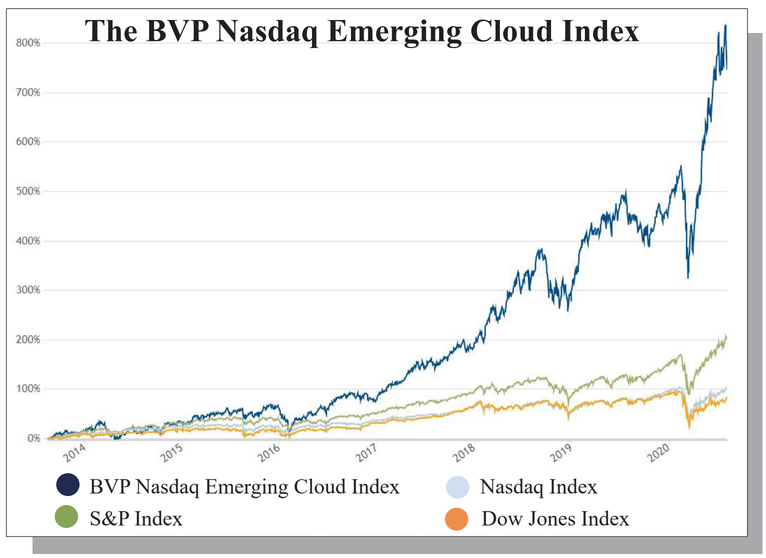
Hemenway Trust Company LLC

Summer 2020 Investment Report

After an unprecedented global economic shut down in Q1, economies around the world have been relaxing restrictions to determine what the “new-normal” will be until COVID-19 health concerns are significantly reduced. In the meantime, central banks and governments have continued to adopt extraordinary stimulus policies to bridge their economies through the worst of the pandemic. With this massive government backstop, virtually all risk assets performed well in Q2 and we saw US stocks (S&P 500) advancing over 20%, and erasing most of the losses from Q1. This should make the sharpest and deepest recession in US history likely to be the shortest.

However, the S&P 500’s +2% YTD return through July masks a wide dispersion amongst stocks. The pandemic has accelerated some of the changes we’ve been seeing over the past decade, including: online shopping and marketing, electronic payments, cloud computing, robotics, telemedicine, and online entertainment. While these changes span different industries, companies that have benefited the most are in the technology sector, which has increased 25% YTD. Even more pronounced is the more narrow Bessemer Nasdaq Emerging Cloud Index that is up 66% YTD and over 700% since 2014 (see Chart 1). On the flip side, roughly half of the 500 stocks in the S&P 500 Index are down more than 10% YTD, with over 150 stocks down over 20%.



Source: BVP.com *Chart 1*

Trimming High Valuation Stocks

Another trend that has accelerated is the biggest companies are getting bigger. Over the last 5-10 years, the five largest stocks in the S&P 500 (Apple, Microsoft, Facebook, Amazon and Google) have used their size and scale to keep ahead of competition and now make up over 26% of the entire S&P 500 Index (see Chart 2). Unlike the concentration of tech names in the late 90’s, these companies today are highly profitable and have been benefiting from multiple themes noted above. Fortunately, our portfolios have held most of these stocks and participated in their growth. Looking forward though, as the top three have a market capitalization over $1.5 trillion with historically high valuations, we must continuously question what will drive these stocks higher in the future. We also recognize that as these companies grow larger and more profitable, government regulation becomes a larger risk. Therefore, we continue to trim these names, and other high valuation stocks, and use proceeds to build up cash reserves and reallocate to the “other half” of the market still feeling the pains of the virus.

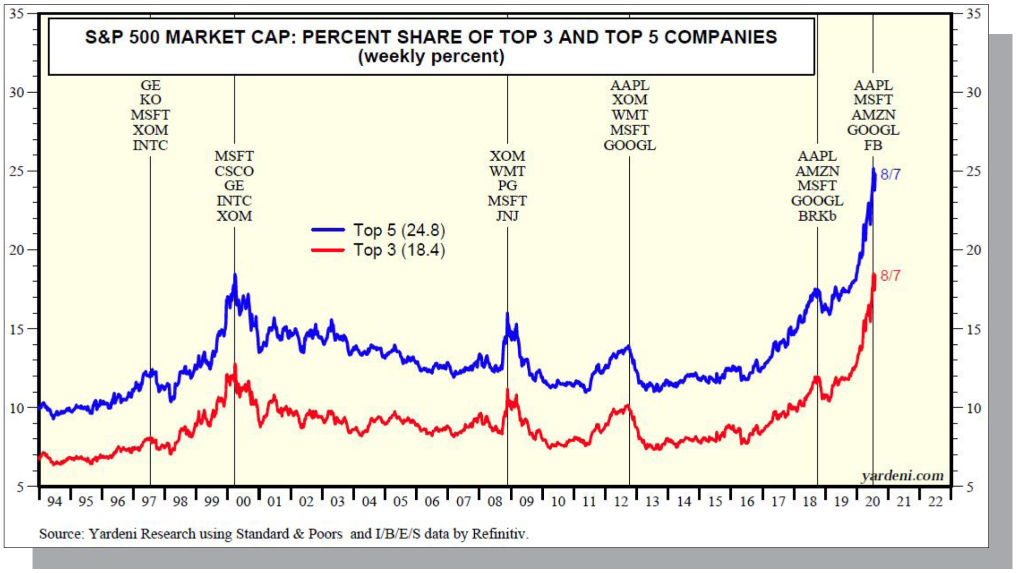


Chart 2

What about bonds?

The Federal Reserve's 0% interest rate policy and massive bond buying program has met its intended goal to increase liquidity and lower borrowing costs for individuals and corporations. US 10-year treasury bond now yields 0.55% and the 30-year treasury yields a record low 1.2%. Lower rates have also encouraged more companies to take out debt. This has helped weak companies stay afloat, but we are also seeing high quality issuers adding debt for M&A and stock buybacks. For example, in May, despite having over $200B in cash and equivalents on its balance sheet, Apple issued $8.5 billion in bonds to buyback more of its stock. While we know these yields are below the current rate of inflation, we still recommend maintaining a portfolio of short-dated, high-quality bonds as protection against the many unknowns we face.

Looking Ahead

Markets have been relatively quiet over the last two months, but we expect volatility to pick back up as we get closer to the election. During this period of uncertainty, our investment approach remains focused on balancing high-quality securities, maintaining bond and cash positions, and evaluating new opportunities. We have invested in new analytical tools to enhance our ESG (Environment, Social and Governance) investment capabilities and our investment professionals are available to discuss impact investments designed to support pressing issues such as social justice. We have always favored companies offering safe, reliable products with strong management teams and we find the additional steps we are taking are complementary to our traditional fundamental approach to investing.

Our office phone numbers and emails continue to be the best way to reach us while many of us continue to work remotely. Our contact information is on our website.