2020: A Year of Haves and Have Nots

The year 2020 was one of anything but 20/20 vision. Last year was marked by many unprecedented events. Global equity markets sustained strong performance in the first few weeks of the year, until the coronavirus spread around the world. As a result of lockdowns intended to contain the virus, economic activity came to a screeching halt in many countries. This resulted in the outperformance of defensive companies such as food, gaming, cloud computing, technology and health care companies while travel, restaurant and entertainment related stocks lagged. About one-third of the world population was in lockdown and over 40 airlines around the world temporarily grounded their fleet while many major carriers cancelled 90% of scheduled flights. This in turn ushered in the end of the longest bull market in history. However, the magnitude of fiscal and monetary stimulus undertaken by many countries led to an unprecedented reversal in equity markets (Exhibit 1).

Exhibit 1. Global Equity Market Performance in 2020

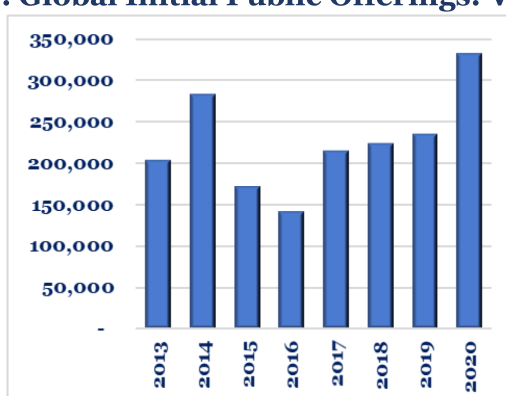
	Until Mar 23, 2020	After Mar 23, 2020
S&P 500	-30.43%	70.17%
MSCI ACWI ex USA	-33.29%	66.60%

Sources: Bloomberg, MSCI

Almost a year after the initial outbreak of the coronavirus, although infections have yet to be contained, there is optimism due to vaccine rollouts, continued monetary stimulus and the likelihood of further fiscal stimulus driving sustained returns in equity markets. In particular value stocks have made a significant comeback. The MSCI ACWI ex USA Growth index outperformed value by almost 25 percentage points (pp) in the first nine months of 2020. Since then, a change in leadership has driven value stocks to outperform by 6pp through year-end. In general, value stocks tend to be cyclical stocks in the Energy, Materials, Industrials and Financials sectors, and thus more sensitive to the economic cycle.

Although the fortune of many companies ebbed and flowed with the changing dynamics in the equity markets as explained above, newly issued IPOs had a bumper year. According to Baker McKenzie, globally 1,591 companies raised $331bn in 2020 – a record year for capital raisings (Exhibit 2). IPO issues picked up rapidly in the third quarter as the market was flush with liquidity. In the US alone, there were 480 IPOs, which was a historical record and more than double the level in 2019. The previous record IPO years were in 1999 and 2000, when there were 486 and 406 new listings, respectively.

Exhibit 2. Global Initial Public Offerings: Value ($m)

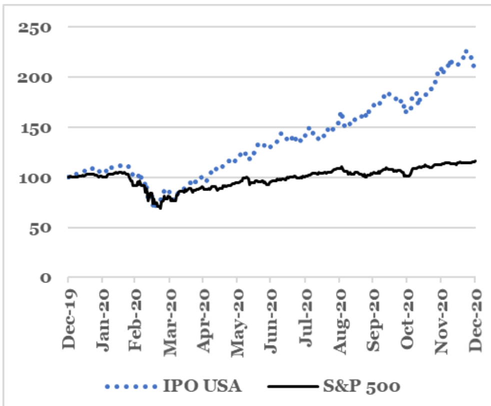


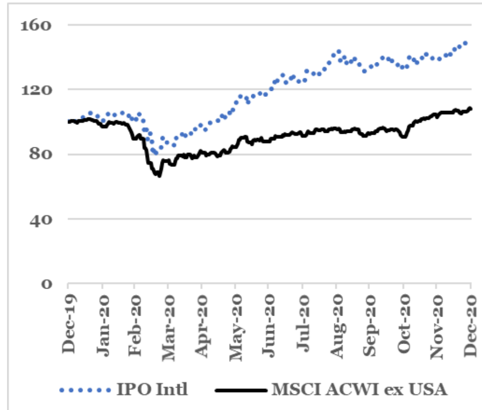
Source: Baker McKenzie

The Financials sector was by far the dominant sector accounting for 360 listings and raising $108bn globally. Popularity of SPACs (Special Purpose Acquisition Companies) accounted for the high level of activity in Financials. The next largest sector was Technology at $55bn, driven by a surge in Asia. Similarly, Industrials ($24bn), Health Care ($33) and Consumer Products as well as Services ($27bn) all saw robust levels of IPO listings.

The year 2020 was not only conducive to capital raising, but the performance of the newly issued stocks was also spectacular. In Exhibit 3, we present the performance of the broader market indices relative to a basket of newly listed companies. In just one year, newly issued stocks in the US outperformed the S&P 500 index by 103 percentage points while internationally, IPOs outperformed the MSCI All Country World ex USA index by 50pp!

Exhibit3. Performance of IPOs versus the Broader Equity Indices: 2020

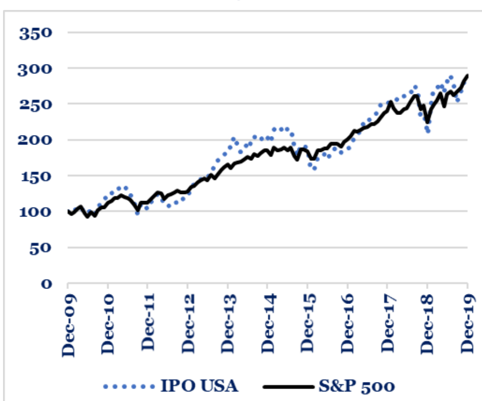




Sources: Bloomberg, Renaissance Capital

Although there is academic literature supporting the idea that IPOs tend to be underpriced, the prevalence of triple digit returns on debut was a phenomenon particular to the year 2020. For example, DoorDash, Airbnb, BigCommerce Holdings, c3.ai, Lemonade, etc. more than doubled on their debut. However, over the 10-year period through 2019, IPOs performed in line with the broader markets (Exhibit 4). Thus, investing in IPOs does not always lead to significant outperformance. In fact, history shows that new listings tend to stumble before they gain stronger footing.

Exhibit4. Performance of IPOs versus the Broader Equity Indices: A Longer-Term Perspective



Sources: Bloomberg, Renaissance Capital

Most often, companies that do IPOs tend to be start-ups in high growth industries that are not necessarily profit-making. According to data from Jay Ritter, an IPO specialist and finance professor at the University of Florida, almost 80% of the US IPOs in 2020 were unprofitable leading up to their debut. Hence, although market liquidity may justify a bumper year for IPOs, it does not justify the surge in performance of companies that are not profitable. Accordingly, it is highly likely that these 'haves' of 2020 may become the 'have nots' of the future as buoyant share prices of the recent IPOs revert to a price level that is justified by their fundamentals.