Bi-Weekly Report
December 11, 2020

Tactically Tilt Toward High Beta ETF During Reopening Phase

SPHB Offers Reopening Exposure Ahead of Vaccine Distribution

Bottom Line

This Friday Strategist focuses on the vaccine rollout and investment themes we expect to play out in the reopening phase. Markets are already looking ahead to a successful vaccine distribution program and positioning for an economic rebound. From a macro perspective, we expect interest rates (e.g. economic growth plus rotation to riskier asset classes), oil prices (e.g. demand increase paired with a drop in rig count), and inflation expectations (e.g. stimulus measures with economic growth) to each face upward pressure. We also anticipate three themes to play out: (1) financial institutions to review their loan loss provisions and release excess reserves; (2) travel and leisure to rebound as individuals venture out from the home; and (3) commercial real estate values to recover as the uncertainty premium declines.

Portfolios should have exposure to the reopening narrative in 1H21. Investors know the reopening is coming, which means the valuation discount on COVID-19 impacted companies should compress as uncertainty falls. While a mix of sector and industry ETFs (e.g. JETS, XLF, XLY, XLE, etc.) can be used to gain targeted exposure to reopening themes, we favor using SPHB's high beta factor approach. SPHB rotated into COVID-19 names during 2Q20 and continues to offer broad reopening exposure. (Note: This is a shorter-term tactical tilt with an expected 3-6 month timeline.)

Main Points

► **SPHB Outperformed the S&P 500 Over the Last 12 Months, But Still Offers Upside**

- The ETF outperformed the S&P 500 Index over the last 1 year, but SPHB's current holdings significantly underperformed the S&P 500.

- SPHB's turnover spiked in 2Q20 as COVID-19 volatility names were added.

► **SPHB Offers Exposure to Reopening Themes, Including Interest Rates & Oil Prices**

- Following SPHB's 2Q20 portfolio turnover, we estimate ~70% of SPHB's holdings are exposed to the reopening phase. The top three themes are: (1) rising interest rates / loan loss reserve releases (23%); (2) oil price rebound (21%); and (3) travel / leisure rebound (15%).

► **A Delayed Vaccine Rollout & Bullish Market Sentiment Represent Key Risks**

- The risk is a misstep during vaccine rollout pushes the reopening timeline back. Multiple steps in the distribution phase present logistical challenges.

- The market wasted no time in updating projections following the positive trial results. The risk for SPHB is markets are overly optimistic. However, we expect investors to remain focused on the reopening narrative in 1H21.

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Trade Details

Trade Type
U.S. Equity / Factors

Trade ID
USEQ.2020-18

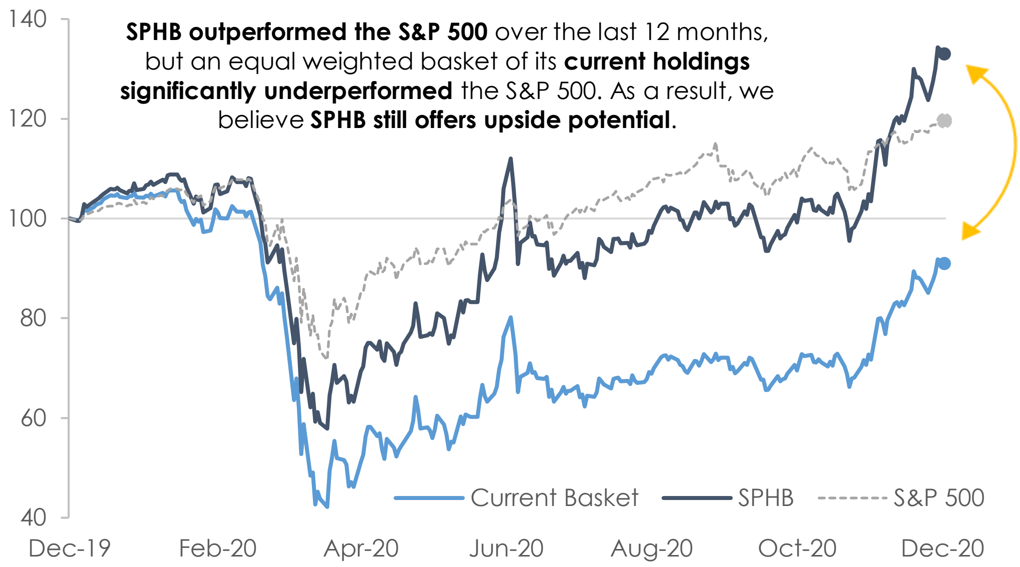
Ticker(s)
Invesco S&P 500 High Beta ETF (ticker SPHB)

Benchmark
S&P 500 Index

Research Portal →

SPHB Turnover Spikes as ETF Rotates to COVID-19 Names

Figure 1: SPHB vs Current Holdings Performance (Last 12 Months)



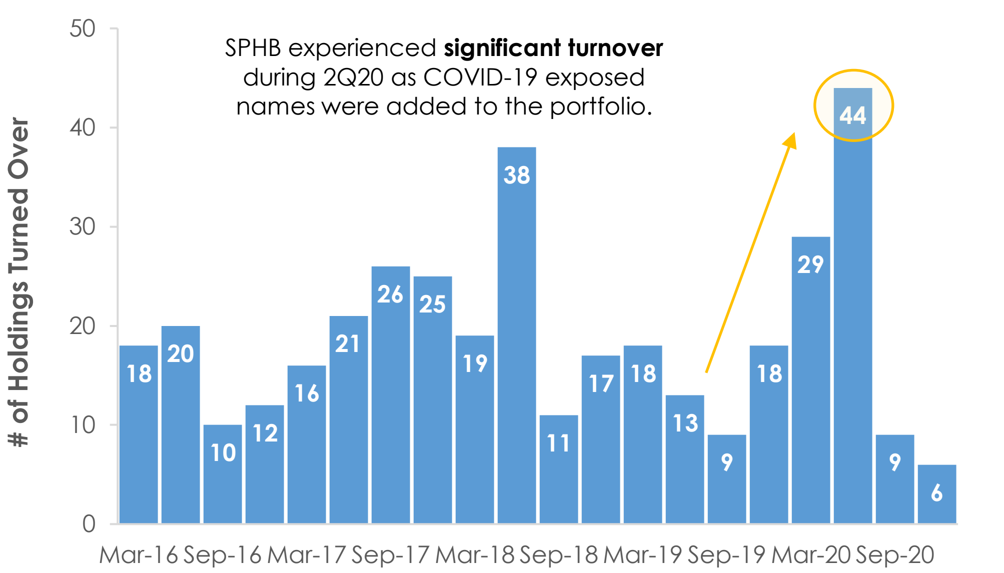
Source: MarketDesk Research. ***Note:*** *All performance indexed to 100 1-year ago.*

SPHB Outperforms S&P 500 Over Last 12 Months but Still Offers Upside …

- Figure 1 charts two SPHB performance lines against the S&P 500 Index (grey dashed line). The navy line represents SPHB's 1 year performance. The light blue performance line assumes you held SPHB's current holdings over the past 1 year. The 'SPHB ETF' outperformed the S&P 500 Index over the last 1 year, but SPHB's current holdings significantly underperformed the S&P 500.

- There is a difference between the performance of SPHB (e.g. the ETF) and its current holdings. Similar to other factor ETFs, SPHB's portfolio exposure can shift dramatically. While SPHB itself outperformed the S&P 500 over the last 1 year, its current holdings still offer upside potential.

Figure 2: SPHB Portfolio Turnover by Quarter (# of Holdings)



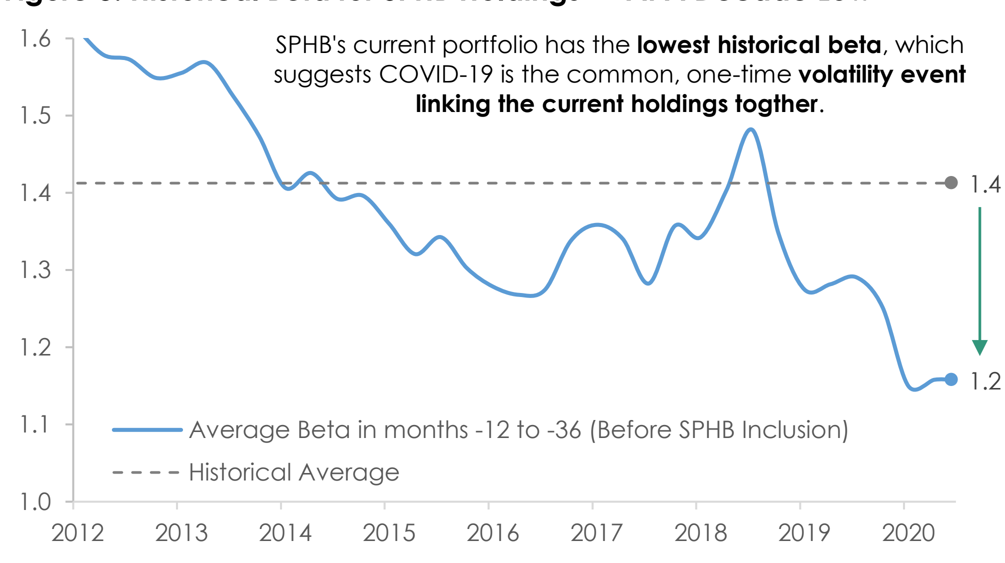
Source: MarketDesk Research

SPHB Portfolio Turnover Spiked in 2Q20 As COVID-19 Volatility Names Were Added …

- Figure 2 graphs SPHB's quarterly portfolio turnover for the last 5 years. In an average quarter, SPHB turns over 19 of its ~100 holdings. However, SPHB's turnover spiked to 44 securities in 2Q20 as market volatility spiked amid COVID-19.

- SPHB's emphasis on high beta stocks means volatility events can materially alter the ETF's portfolio exposure. For example, AMZN, MSFT, and NFLX were each SPHB holdings as of 12/31/2019 as the ETF captured Tech's upside beta in 2019. That all changed in 2020 as high beta now signals negative exposure to COVID-19. As a result, today's SPHB is tied to COVID-19's Spring 2020 downside beta and the reopening phase.

Figure 3: Historical Beta for SPHB Holdings — At A Decade Low



Source: MarketDesk Research. ***Note:*** *SPHB weights holdings based on their last 12 month's beta. The blue line shows the portfolio's average beta for the months -12 to -36 prior to inclusion to SPHB.*

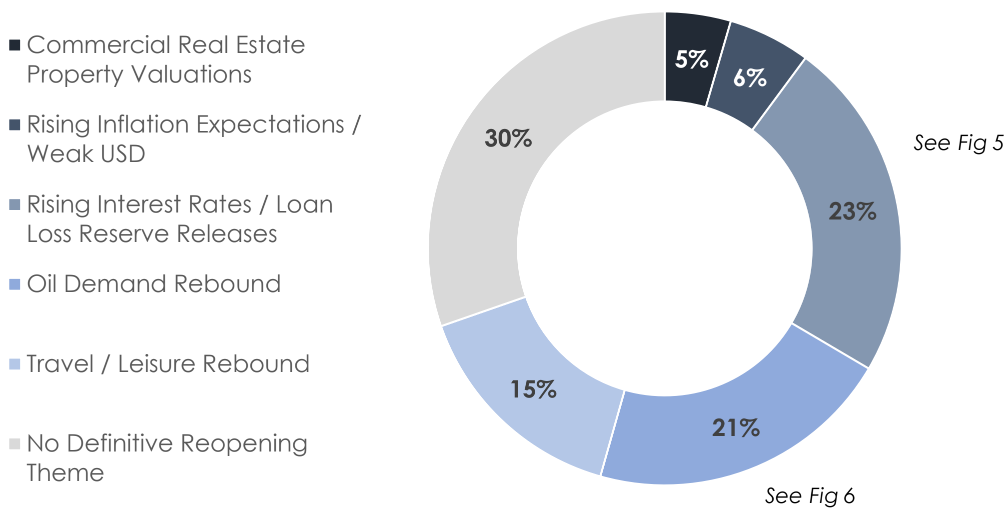
Historical Volatility of Current SPHB Holdings is Lower than Average …

- Figure 3 charts SPHB holdings' volatility before they were added to the ETF. From a methodology perspective, SPHB holdings are selected based on their last 12 months beta. The light blue line represents the average beta for SPHB's holdings in months -12 to -36 (e.g. the two years before the 1 year beta reading that led to SPHB inclusion).

- Beta measures a security's volatility against the broad market. Investors use it to judge downside risk. The historical beta of today's SPHB holdings is at a decade low. Our view is a large percentage of SPHB's current holdings are only in the ETF due to COVID-19 volatility. As the vaccine is distributed, we believe SPHB's current exposure is leveraged to the reopening.

Tactical Exposure to Rising Interest Rates & Oil Prices

Figure 4: SPHB's % Exposure to COVID-19 Reopening Themes

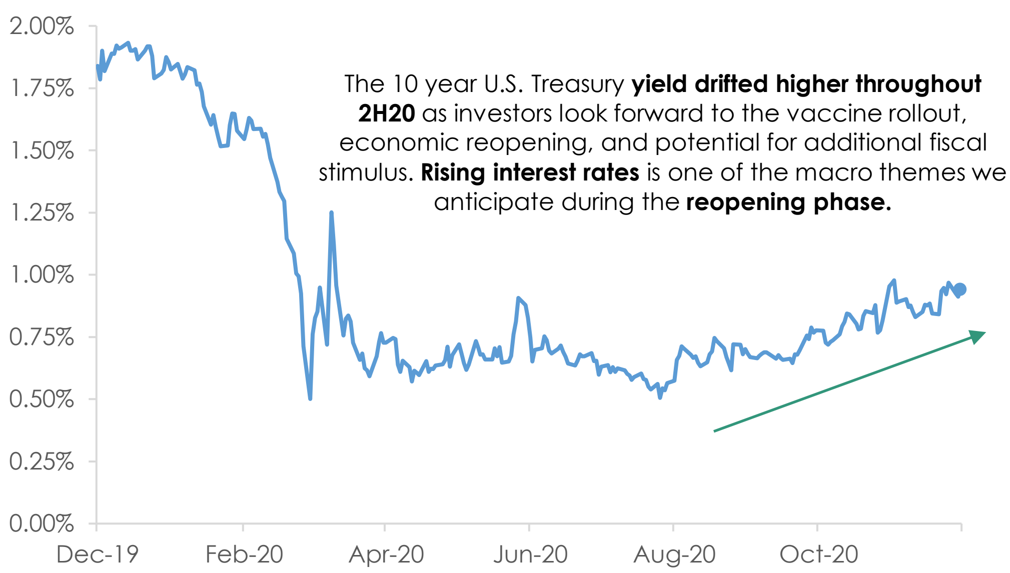


Source: MarketDesk Research

SPHB Offers Exposure to Major Reopening Themes …

● Our team sorted through SPHB's current holdings and grouped them into various reopening themes. The table in Figure 4 shows the current breakdown. The top three exposures are: (1) rising interest rates / loan loss reserve releases in the Financials sector; (2) oil demand rebound in the Energy Sector; and (3) travel and leisure rebound in the Consumer Discretionary and Industrials sectors. SPHB also offers marginal exposure to rising inflation expectations / USD weakening in the Materials sector, as well as commercial real estate property valuations in the Real Estate sector. We estimate SPHB's total reopening exposure at ~70%.

Figure 5: 10 Year U.S. Treasury Rate (Last 12 Months)



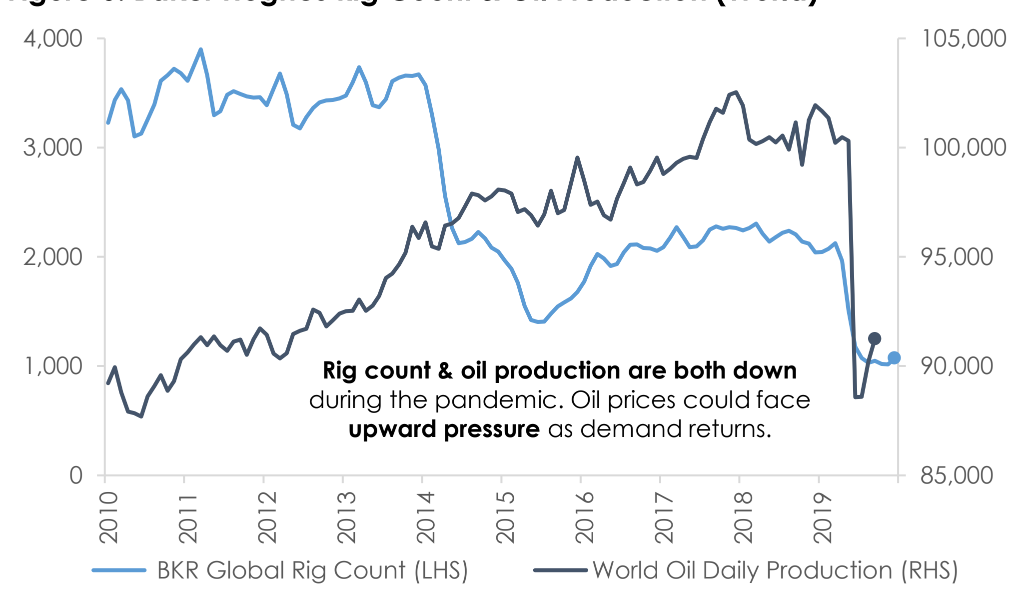
Source: MarketDesk Research, U.S. Department of the Treasury

10 Year U.S. Treasury Rate Drifts Higher During 2H20 …

● Figure 5 charts the 10 year U.S. Treasury (UST) yield over the last 12 months. The Federal Reserve cut the federal funds rate to 0-0.25% in March 2020 to support credit markets. The 10 year UST yield touched a low of 0.51% on 8/4/2020. It now sits at 0.93% after drifting higher in recent months.

● Rising interest rates is one of two macro themes we would invest in during reopening. Interest rates should face continued upward pressure as the economy reopens and investors rotate into riskier assets. Financials benefit from a steeper yield curve. In addition, banks and other lenders will review their loan loss provisions and could release excess reserves in the months ahead.

Figure 6: Baker Hughes Rig Count & Oil Production (World)



Source: MarketDesk Research, Baker Hughes, U.S. Department of Energy

Oil Production Down Sharply as Drilling Rig Count Plunges …

● Figure 6 charts the Baker Hughes Rig Count against world oil production. Rig count and oil production both plunged during COVID-19 as oil demand collapsed. However, both rig count and oil production crept higher in recent months as restrictions were gradually lifted.

● Rising oil prices is the second macro theme we would invest in during reopening. Oil demand should rise as individuals venture out of their homes and the economy reopens. While we are bearish on the oil industry longer-term, we believe the reopening will put upward pressure on oil prices. As a result, we favor tactically increasing Energy exposure for 1Q21 and into early 2Q21.

Vaccine Distribution & Market Sentiment

Key Risks — Vaccine Distribution & Bullish Market Sentiment …

There are two risks to tactically using the high beta ETF as a reopening proxy. While recent vaccine trials represent a tangible step toward reopening the economy, vaccine distribution will be a formidable task. High beta companies will be negatively impacted if distribution is delayed, case counts surge, and/or restrictions remain in place. From a sentiment perspective, investors appear overly bullish right now as they look forward to a successful vaccine rollout.

#1 Delayed Vaccine Rollout / Distribution Challenges: The companies most exposed to COVID-19 experienced volatility surges as businesses closed and restrictions were implemented during 1H20. The high beta factor zeroed in on the volatility surges, and Figure 2 shows SPHB's 2Q20 turnover spiked as a result. Publicly traded airlines and cruise lines, industries that were both hobbled by travel restrictions, were added to SPHB. Banks exposed to the Fed's interest rate cut and rising loan loss provisions, as well as oil drillers exposed to collapsing oil demand and weak oil prices, were also added to SPHB. As a result, today's high beta factor is overweight the companies most negatively impacted by COVID-19.

With a large percentage of SPHB's holdings selected based on COVID-19 volatility, SPHB is highly correlated to a successful vaccine rollout. This makes SPHB an attractive reopening proxy. However, SPHB's reopening exposure is a potential double-edged sword due to current holdings' dependence on a successful reopening.

The risk is a misstep during vaccine rollout pushes the reopening timeline back. Numerous steps during the distribution phase present logistical challenges. Mass production, transportation requiring dry ice, and encouraging citizens to receive the vaccine must all be accomplished. It will require a coordinated global response the likes of which has not been attempted in recent history. If the vaccine rollout breaks down at any point along the distribution chain, reopening will be delayed and SPHB's holdings will be adversely impacted.

#2 Bullish Market Sentiment: Three separate trials announced positive vaccine results in November. Pharmaceutical researchers' ability to compress what is normally a multi-year drug discovery timeline into 6 months is an amazing feat. The market wasted no time in updating projections following the positive vaccine trial results. Economic growth is forecasted to pick up. Inflation expectations are rising. Interest rates continue to drift higher. The message is clear -- investors are already factoring in a successful distribution effort with limited roadblocks. SPHB surged almost 15% over the 1 month period starting 11/9/2020.

The risk for SPHB is markets are overly optimistic. It could be months before the economy starts to feel the impact of the vaccine rollout. Any number of negative catalysts could occur between now and then, including the ongoing COVID-19 surge, restrictions remaining in place, and the previously mentioned delayed vaccine rollout. SPHB could succumb to weakened market sentiment. While this represents an unquantifiable risk, it is a risk we are willing to take on during the reopening phase. Investors can see the light at the end of the tunnel, and we expect them to remain focused on the vaccine rollout during 1H21. We believe portfolios need exposure to the reopening narrative.

Trade Implementation — High Beta ETF to Gain Cross Sector Exposure to COVID-19 Volatility Companies

This tactical position is about gaining exposure to the vaccine rollout and macroeconomic themes associated with the reopening (e.g. interest rates, oil prices, etc.). Our preference is to gain exposure via one ETF rather than actively trying to pick a handful of airlines, cruise lines, banks, and oil drillers.

The high beta factor is an attractive reopening proxy despite the negative connotations around high beta stocks. After the 2Q20 rebalance, the high beta factor is highly correlated to COVID-19, which suggests it will be positively benefitted by the reopening phase and vaccine rollout.

The timeframe for this tactical position is in the 3-6 month range. We expect most of the positive reopening bump (e.g. additional stimulus, vaccine rollout, business reopenings) to occur in 1Q21 and early 2Q21. While we believe the rally could continue into 2H21, there is a chance the risk / reward setup will be less favorable at that point. We envision rotating to a lower beta, less risky reopening proxy as the trade evolves.

Refer to page 5 for our preferred high beta ETF.

Impacted ETFs

Figure 7: Selected High Beta ETF

Ticker	Company	YTD Return	Notes / Rationale
SPHB	Invesco S&P 500 High Beta ETF	22.8%	Highly correlated to COVID-19 reopening phase & vaccine rollout; Reopening themes include rising interest rates, rebounding oil prices, & travel & leisure rebound (Refer to Figure 4)

Source: MarketDesk Research. ***Note:*** *The benchmark for this tactical opportunity is the S&P 500 Index (SPY).*

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