Security Analysis Methods

Narrative Structure Analysis for November 2020

Epsilon Theory

Dominant Narrative Structure for November 2020

Fundamentals-Focused Regime

Narrative Strength	Narrative Cohesion	Narrative Sentiment
Average (5)	*Weak (3)*	*Extremely Positive (10)*
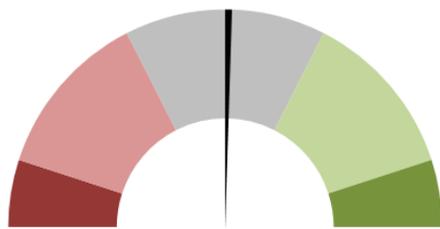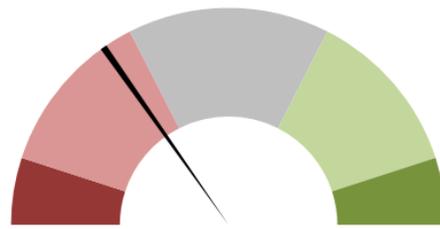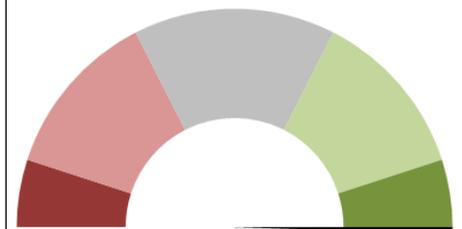
Analysis and Commentary

The preoccupation with economic and company-specific fundamentals in the language used to discuss financial markets continued in October, and consistent with our historical observation, produced a poor result for the month.

This is a simplification, however, of a fairly volatile period. The dominance of *multiple* events had significant influence over markets; our argument would not be that a fundamentals focus *dominated* those markets, but that the language indicative of that focus *dominated* how those events were discussed and framed.

Yet even that appears to have begun to wane.

In October, for the first time since 2017, we have seen the material emergence of multiples– and valuation-focused language. That doesn't mean that everyone has become value investors overnight, and it certainly doesn't mean that there's some historical tendency for value to outperform. But in some sectors where performance has been the result of conclusions that "valuations don't matter" and that "top-line growth is the goal",

we think the narrative of "what matters" is changing somewhat. What you have seen in Tech in recent weeks, for example, seems to reflect this.

Last month we wrote this:

"But if we were betting men (and we are), we would be more mindful than usual of valuation and multiples-focused language from the sell-side and our peers."

This month we reiterate and expand this point of view. We remain in what we call a Fundamentals-Focused regime, but the trend—for now—is clearly in the direction of a shift to a Multiples-Focused regime.

What does that mean?

It means that for investment theses built around profitless growth, market share and top-line-to-the-moon, we think now is a good time to reevaluate how those theses would respond to a market that cares about the long-term viability, cash flow potential and, yes, price of that growth.

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Dominant Security Analysis Methods Regimes (June 2015—October 2020)

Legend: ■ Multiples ■ Fundamentals ■ Technicals

X-axis labels: 6/30/2015, 8/31/2015, 10/31/2015, 12/31/2015, 2/29/2016, 4/30/2016, 6/30/2016, 8/31/2016, 10/31/2016, 12/31/2016, 2/28/2017, 4/30/2017, 6/30/2017, 8/31/2017, 10/31/2017, 12/31/2017, 2/28/2018, 4/30/2018, 6/30/2018, 8/31/2018, 10/31/2018, 12/31/2018, 2/28/2019, 4/30/2019, 6/30/2019, 8/31/2019, 10/31/2019, 12/31/2019, 2/29/2020, 4/30/2020, 6/30/2020, 8/31/2020, 10/31/2020

Subsequent Month S&P 500 Index Returns By Narrative Regime (June 2015 —October 2020)

Bar chart values: Fundamentals -1.01%, Multiples 0.37%, Technicals 2.08%

Important Disclosures: *This research is general in nature and does not reflect the analysis of any individual investor's situation and does NOT represent advice to purchase or sell any security. Investors should consult a financial advisor to discuss their individual situation before making any decision. The S&P 500 and Barclays Aggregate Bond Index are total return indices tracking US Large Cap stocks and US domestic, investment-grade fixed income securities in the United States, respectively. They are indexes, and it is not possible to invest in an index. Products tracking those indices may charge additional fees which are not included here. Any returns presented represent historical periods, and such **historical performance is no guarantee of future results.** The regimes highlighted are determined using natural language processing-based techniques which are new and which may be riskier than more traditional analysis techniques.*
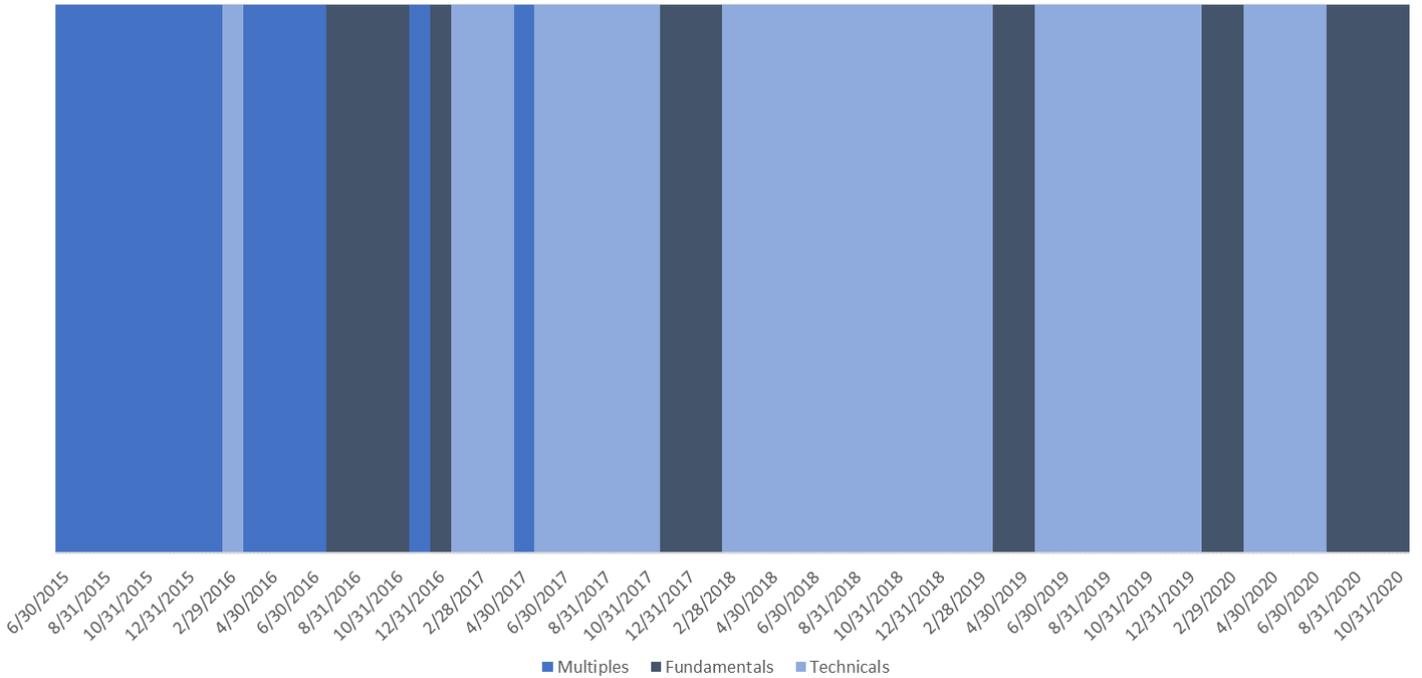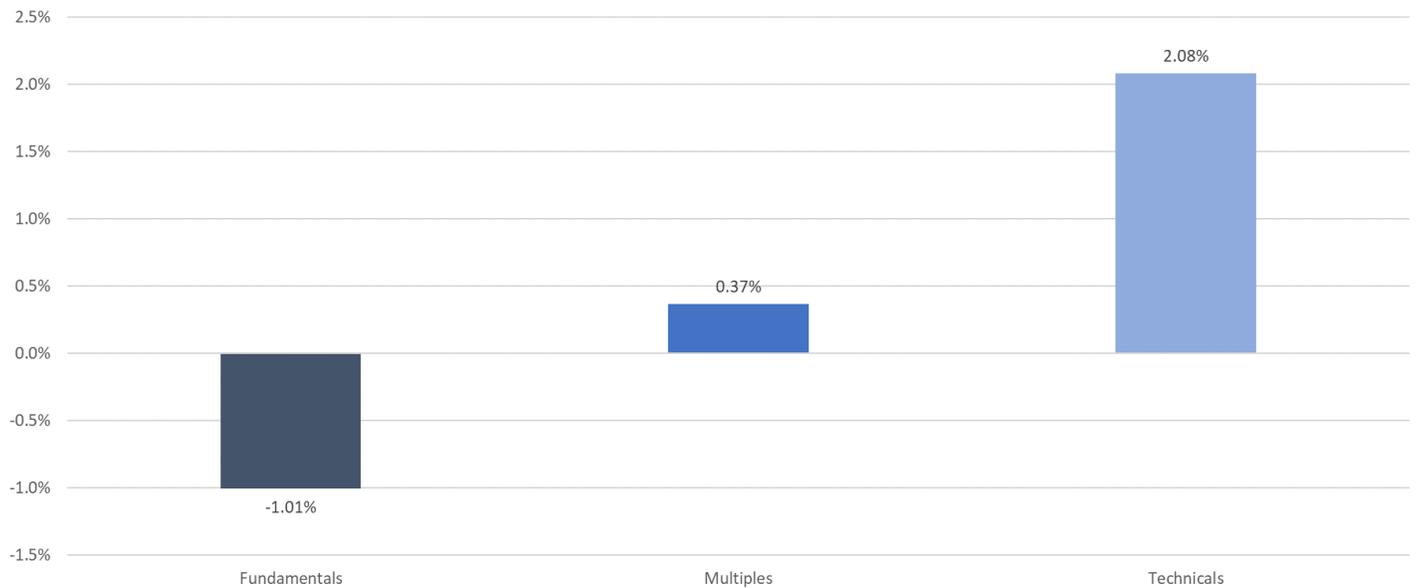
Most Indicative (On-Narrative) News

Headline	Outlet	Link
Why this frustrated value stock pro sees shades of 1999 in the market now—and bargains in the future	Marketwatch	Article Here
China's Ant Group has teed up the biggest-ever initial public offering.	NY Times	Article Here
One of the cheapest tech stocks is going through a transformative period, market analyst says	CNBC	Article Here
The Finance 202: Trump failed to deliver a Rust Belt revival, imperiling his reelection chances	Washington Post	Article Here
Robinhood's Addictive App Made Trading a Pandemic Pastime	Bloomberg	Article Here
Look Who's Really Chasing Hot Stocks Like Zoom	Dow Jones	Article Here
Global stocks: Stimulus hopes alive but sentiment sapped by COVID surge	Reuters	Article Here
A Stock-Market Bubble Is Forming	Morningstar	Article Here
Older Americans are selling the stock market, slowly but ceaselessly, to junior generations	CNBC	Article Here
KKR warns the Fed could strike against financial market 'froth' even with low interest rates	Marketwatch	Article Here
Wall Street steadies itself following encouraging reports	Houston Chronicle	Article Here

Narrative Structure Measures by Archetype

	Strength	Cohesion	Sentiment
Fundamentals-Focused	Average (5)	Weak (3)	Extreme Positive (10)
Multiples-Focused	Average (5)	Average (5)	Extreme Positive (10)
Technicals-Focused	Very Weak (2)	Above Average (7)	Very Positive (9)