Market Review and 4th Quarter 2020 Outlook

Market Backdrop

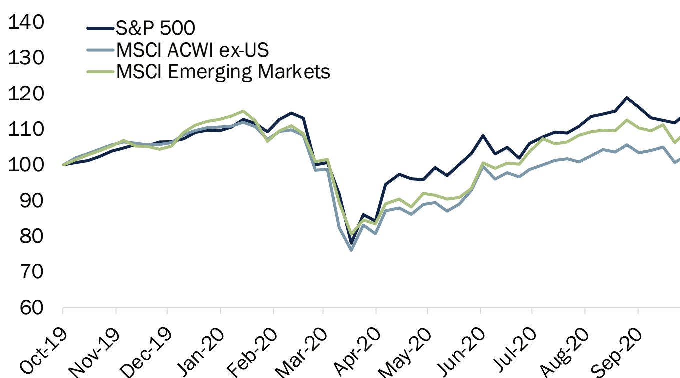
Equities markets continued their vigorous post-March rally in the third quarter as the realities of COVID-19 continued to dictate daily conduct for individuals, businesses, and governments around the world. Behaviors that seemed disorienting and disruptive in the spring became routine throughout the summer and early fall. Work-from-home remained the standard while countries and enterprises experimented tentatively with reopenings. Global infection rates reflected varying policy and social behaviors. Developing a vaccine remained an overwhelming focus, with both human and capital resources deployed to a number of promising approaches.

Equities advanced solidly in July and August, bringing major indices back to levels achieved earlier in the year. New highs were recorded in the sectors and companies that appear best positioned to benefit from the realities created by the pandemic. Many of these companies were already advantaged by secular trends in place that have now been accelerated by work-from-home for the consumer and digital transformation for the enterprise. The speedy adoption of communication mediums such as videoconferencing proved effective at replacing formerly in-person interactions, driving faster revenue recovery for many companies.

Growth companies, which led equities markets through the end of August, surrendered a portion of their advances during September, reflecting concerns about the valuation of future growth potential in the short term. At the same time, businesses most negatively affected by the pandemic, including leisure and travel, stabilized as the worst of the activity declines moderated, although overall depressed levels persisted.

The effects of fiscal stimulus – trillions of dollars disbursed through the Coronavirus Aid, Relief, and Economic Security (CARES) Act and the Payroll Protection Plan – blunted the pandemic's effect on employment and spending. Comprehensive monetary policy initiatives to bolster liquidity and stabilize asset prices contributed to record-low interest rates.

Market Index Performance



As of September 30, 2020. Source: Jennison, FactSet, MSCI.

Style Performance

- In the third quarter, growth stocks continued to lead the market and significantly outperformed value stocks across capitalizations. Large caps performed best, followed by mid and small.
- Growth stocks led for the trailing one-, three-, and ten-year time periods as well.
- Large caps dominated market performance over longer time periods.

Style Index Performance

3Q20

	Value	Core	Growth
Large	5.6	9.5	13.2
Mid	6.4	7.5	9.4
Small	2.6	4.9	7.2

Trailing 1-year

	Value	Core	Growth
Large	-5.0	16.0	37.5
Mid	-7.3	4.6	23.2
Small	-14.9	0.4	15.7

Trailing 3-Year

	Value	Core	Growth
Large	2.6	12.4	21.7
Mid	0.8	7.1	16.2
Small	-5.1	1.8	10.6

Trailing 10-Years

	Value	Core	Growth
Large	9.9	13.8	17.3
Mid	9.7	11.8	14.5
Small	7.1	9.9	12.3

As of September 30, 2020. Source: Jennison, FactSet, MSCI.

Sector Performance

- The market broadened out in the third quarter. Consumer discretionary and information technology continued to lead but were joined by cyclical sectors materials and industrials at the top.
- Information technology was the best performing sector for the one-, three-, five-, and trailing ten-years, followed by consumer discretionary.
- Energy was the weakest sector for all time periods.
- Financials and real estate also lagged in the quarter and for longer periods.

GICS Sector Performance - S&P® 500 Index

	3Q	One Year	Three Years	Five Years	Ten Years
Consumer Discretionary	15	29	21	18	18
Materials	13	12	6	12	9
Industrials	12	1	5	11	11
Information Technology	12	47	30	28	20
Consumer Staples	10	8	9	10	12
Communication Services	9	18	12	15	16
Utilities	6	-5	8	10	10
Health Care	6	20	11	12	15
Financials	4	-12	-0	8	10
Real Estate	2	-7	7	8	11
Energy	-20	-45	-23	-16	-13
Total	9	12	13	11	11

As of September 30, 2020. Source: Jennison, FactSet, MSCI.

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Earnings Results

Earnings results for the broad market S&P 500 improved over the first quarter with 89% beating or meeting expectations versus 70% in the first quarter. It is important to note that because of COVID-19, earnings expectations came down significantly for Q1 2020 and have remained so for the rest of the year.

- Industrials and health care posted the strongest results with over 90% of companies exceeding or matching consensus expectations.
- Five sectors enjoyed 80–90% of companies meeting and exceeding and this included growth, defensive, and cyclical sectors.
- Results for financials, consumer discretionary, and energy were more modest.
- Real estate disappointed overall with 45% of companies missing expectations. The sector overall has struggled more than most amid COVID-19.

Sector Name	% of Companies Beating/Meeting	% of Companies Missing
S&P 500	89%	11%
Industrials	92%	8%
Health Care	90%	10%
Utilities	89%	11%
Communication Services	88%	12%
Consumer Staples	88%	12%
Materials	86%	14%
Information Technology	86%	14%
Financials	78%	22%
Consumer Discretionary	75%	25%
Energy	73%	27%
Real Estate	55%	45%

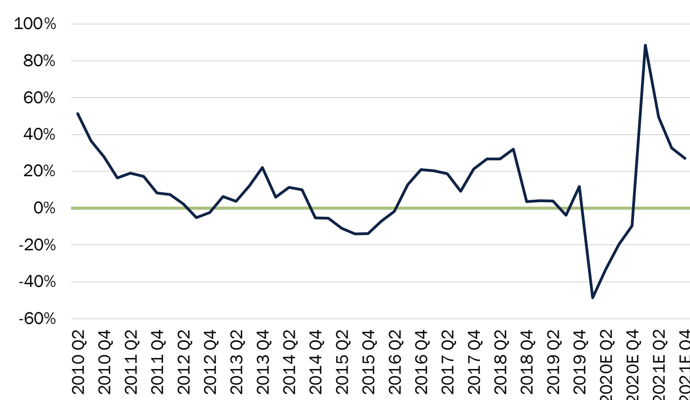
As of September 24, 2020. (most recent available) reflecting the end of the second quarter reporting season. Source: Standard & Poor's. A consensus estimate is a figure based on the combined estimates of analysts covering a public company. Percentages refer to companies meeting, beating or missing consensus estimates. Chart was created by Jennison using Standard & Poor's estimates.

Sector Weights as of September 30, 2020

	S&P 500	MSCI ACWI ex US	Russell 1000 Growth	Russell 10000 Value
Communication Services	11	7	11	10
Consumer Discretionary	12	14	16	8
Consumer Staples	7	10	5	8
Energy	2	4	0	4
Financials	10	17	2	18
Health Care	14	10	14	14
Industrials	8	12	5	13
Information Technology	28	12	45	10
Materials	3	8	1	5
Real Estate	3	3	2	5
Utilities	3	3	0	6

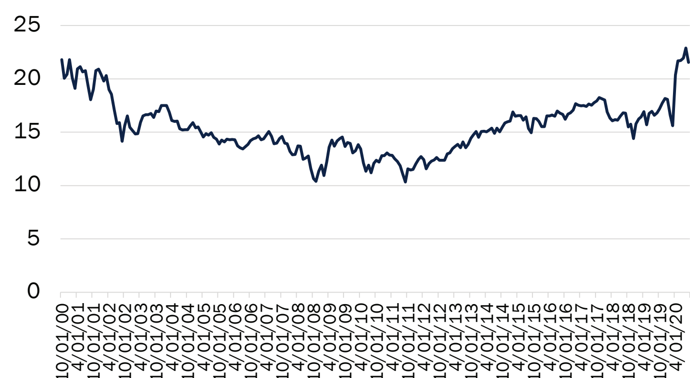
As of September 30, 2020. Source: Jennison, FactSet, MSCI.

S&P 500® Index - YoY EPS Growth



As of September 30, 2020. YoY = Year over Year. Source: FactSet.

S&P 500® Index - YoY EPS Growth



As of September 30, 2020. YoY = Year over Year. Source: FactSet.

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Looking forward

- At this point, it is still early to make precise estimates of companies' earnings through the rest of 2020. This level of uncertainty is historic as is the extreme market volatility that comes with it. Recent unexpected spikes in new infections and hospitalizations is a good reminder of the degree of uncertainty around COVID19 and the path for reopening.
- Almost all companies (across sectors and industries) have withdrawn forward estimates and guidance for the remainder of 2020. For most companies, there are too many unknowns around economic activity, confidence, unemployment, rates, defaults and credit losses, drastically lower consumption and business spend, destroyed consumer and business confidence, and the financial hit to both businesses and consumer balance sheets.
- Recent economic data (both hard, soft, and leading) indicate a V shape recovery is occurring in the US and around the world, driving strong earnings vs expectations going into the quarter

Outlook from Jennison's Growth Teams

The US economy continues to recover from the worst effects of the pandemic, but the pace of the rebound appears to be moderating. Congress has so far failed to agree on additional stimulus to take up the slack from the massive, but now-largely-exhausted, programs approved in March. Further job reductions at large companies, particularly where the effects of COVID-19 have created the most disruption, are an additional headwind. The uneven pace of reopening heightens the need for further government action into year-end and beyond.

Corporate-profit recovery is set to continue, aided by reduced labor and travel costs that further expand profit-margin opportunities. However, the outlook overall remains uncertain, not least because of next month's US presidential election and the pandemic's ongoing impact.

COVID-19 continues to disrupt activity around the globe. We are optimistic that promising results from a number of clinical trials will result in an effective vaccine in the coming months. But it may be another 12-18 months before a finished product-- the likely prerequisite for a broad-based recovery in confidence and activity -- is globally available. Sectors whose share prices and operating fundamentals have been disproportionately hit by the disease will likely experience a relief rally once distribution of a vaccine begins, but a return to pre-COVID-19 operating rates will probably not transpire for some time thereafter.

Investors have demonstrated their preference for businesses that were thriving before COVID-19 and that have benefitted from pandemic-related tailwinds and enhanced competitive positions. Jennison's Growth portfolios hold many companies across the technology, consumer, and communications services industries in this category. Prospects for their continued growth at above-average rates remain strong.

Sector Views

Information Technology

The S&P 500 Index's information technology sector rose 12.0% in the third quarter of 2020, outperforming the overall index, which advanced 8.9%. Large cap tech stocks and a group of smaller, faster growers that enjoy some of the tech-enabled benefits of their larger peers sold off in early September. As these stocks have made major positive moves over the last several months, we believe the sell-off was most likely the result of normal profit-taking and price consolidation.

Recent technology sector earnings reports continue to be strong, confirming the underlying strength of technology company business models. We believe the market should continue to favor companies with asset-light business models and faster organic growth in the current COVID-19-induced environment.

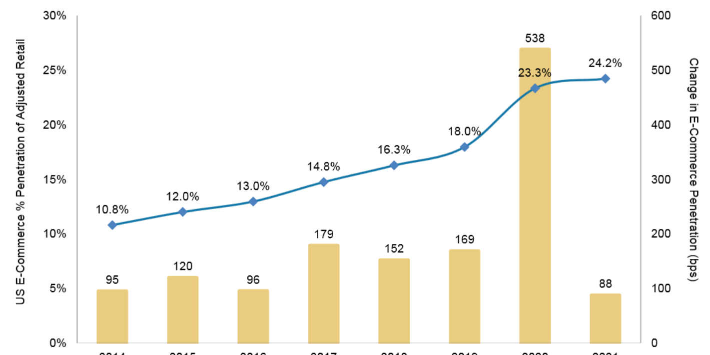
We are in a slower-growth environment with low interest rates — "lower for longer." COVID-19 and the monetary policy response to the pandemic have extended the outlook for this interest rate regime. In periods like this, when growth is scarce, we expect companies that can exhibit consistently faster growth than the overall investable universe will be rewarded.

We believe that during times of crisis, uncertainty, and doubt, businesses and consumers are more willing to adapt their behaviors and to seek innovative, creative products and services that improve productivity and reduce costs. In tumultuous environments such as the current pandemic, innovative technologies take root and typically gain significant market share. Given this dynamic, we believe technology-related stocks will extend their decade-long market leadership, supported by reasonable relative valuations that continue to be driven by the sector's overall stronger ROEs and free cash flow generation, often as a result of innovative and disruptive product offerings. Specifically, many tech companies have wide competitive moats and other competitive advantages, as well as secular tailwinds, that we believe support durable, high-quality fundamentals, including faster-than-average revenue growth and better-than-average margins.

The impressive performance of many tech stocks since March also reflects indications that the digital transformation of the global economy is accelerating meaningfully in the COVID-19 environment, as social-distancing and shelter-in-place directives necessitated by the pandemic have underscored the value, utility, and resilience of ecommerce, digitally enabled payments, cloud computing, and streaming business models. To cite one example, we believe the rapid adoption of ecommerce will continue to accelerate meaningfully.

US Ecommerce Adoption Projected to Accelerate in 2020

Ecommerce Penetration Rates and Year-Over-Year Penetration Growth



Source: Company data, Morgan Stanley. 2020 and 2021 data are estimates.

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Strong earnings growth isn't limited to "tech" companies grouped in the index's information technology sector. It extends to other businesses with technologically driven advantages in other sectors, as well, such as social media companies, classified as "communication services," internet retailers and streaming entertainment providers, grouped in "consumer discretionary," and robotic surgery, diagnostic, and biopharmaceutical companies classified as "health care."

Investment Themes & Areas of Focus

- The use of digital technologies to create new (or alter existing) business processes, cultures, and customer experiences has become a strategic imperative as enterprises seek to meet changing business and market needs. This digital transformation has been driven by digital technologies such as social media, mobile devices, artificial intelligence, and cloud computing.
- Software as a service (SaaS), another of these transformative digital technologies, delivers mission-critical cloud applications and services that are disrupting the software industry. Initially adopted by internet- and cloud-native businesses, and still in the nascent stages of utility, SaaS has begun to penetrate the mother lode of large mainstream enterprise markets. As the strategic necessity of implementing software enhancements as they become available becomes increasingly apparent, businesses are being driven to adopt the SaaS model. With penetration rates remaining relatively low, SaaS expansion opportunities over the coming decade look substantial.
- The COVID-19 pandemic has highlighted the prudence – and in many cases, the government-mandated necessity –of working from home or at other offsite locations. Investors are viewing tech companies with products and services that facilitate seamless offsite work and communication capabilities with renewed appreciation.
- We look for companies positioned to benefit from increased business spending on technology. This includes investing in industries such as 5G, SaaS, business intelligence (AI), semiconductors, cloud storage and software, and life sciences tools.
- We think the continued ramping-up of data/information/ entertainment usage across a broad range of devices and applications, along with digital payments, are among the areas that offer long-duration opportunities and huge addressable markets for companies with the right technologies. Business and consumer behaviors have clearly changed, with adoption and uptake rates inflecting higher.
- Additionally, we are assessing companies that we believe can continue to grow in the current pandemic-induced global recessionary environment regardless of how the economic recovery unfolds.

Health Care

In third-quarter 2020, the Health Care sector of the S&P 500® Index rose 5.9%, underperforming the overall index, which advanced 8.9%.

Efforts to develop a vaccine for COVID-19 are advancing on many fronts, with new data becoming available virtually every day. Data from vaccine trials have been encouraging but patient numbers are small, and comparing results of studies with varying endpoints is difficult. We are also monitoring antibody and antiviral treatments.

US presidential candidates' health care views are coming into focus. Democratic nominee, former Vice President Biden, is focusing on rebuilding the supply chain and implementing tax incentives to move drug manufacturing back to the US. He is also looking at direct government negotiations for some drug prices. He favors expanding health care coverage and combatting inequality with a public insurance option that would be offered to all Americans on a sliding scale according to income and lowering the eligibility age for Medicare coverage from 65 to 60. Details have yet to be presented, but we think expanded coverage is generally a positive for most health care sectors; hospitals could be negatively affected if the mix of reimbursement shifts away from commercial to Medicare rates. Trump's purported focus is on making drug pricing in the US more in line with pricing elsewhere in the world, lowering prescription drug costs for older Americans, and opening the door for drug reimportation, an idea not historically embraced by the FDA.

The relative prospects of health care companies in the midst of the COVID-19 pandemic vary by industry and individual company fundamentals.

Biotechnology. The biotechnology/biopharmaceutical industry trailed the S&P Composite 1500 Health Care Index and the S&P 500 Index in the third quarter; however, it continues to significantly outperform year-to-date. There is some speculation that the Food and Drug Administration's (FDA) regulatory timelines for select therapies may be at risk because the fast-tracking of COVID-19 vaccine filings may strain FDA resources. Although it is unclear which FDA offices will review these filings, it's reasonable to assume that some, particularly mRNA vaccines, would be taken on by the same group that oversees gene therapeutics, for example. This dynamic could cause delays but would not alter outcomes. The FDA continues to make accommodations in cases of true unmet needs. The pandemic has highlighted the speed of discovery and the range of modalities available, and the FDA continues to make accommodations, to address these needs.

Pharmaceuticals. Pharmaceutical companies look to have low exposure to COVID-19. New patient starts could be delayed, and drugs used for acute illnesses (antibiotics, analgesics, anesthetics) or administered by physicians (vaccines, macular degeneration injections) could be disrupted, but most drug sales should be unaffected, including those of self-administered diabetes and respiratory disease treatments.

Medical devices. Cardiology and orthopedic device procedures have been largely suspended in the US and Europe. We expect overall sales declines in the near term, but health systems will be motivated to restart procedures as soon as capacity allows. We are focused on high-quality companies that make cardiology, orthopedics, and ophthalmology devices, as well as companies that make diabetes devices, where demand is relatively inelastic.

Managed care. The collapse in health care utilization will be a significant tailwind to insurers. These cost savings will likely far outweigh COVID-19 patient care costs. We prefer companies with low recession exposure (i.e., insurers not hurt by unemployment) such as companies with exposure to government health insurance programs.

Hospitals. We expect hospital companies will be hurt significantly by delayed or deferred procedures and potentially higher costs for COVID-19-related protective equipment. However, hospitals are receiving US government financials assistance and are generally protected by policy makers. The valuations of hospital stocks have dropped, providing some potentially attractive short-term investment opportunities.

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Life science tools. The life science tools/research group has been resilient, although scientists in work-from-home protocols could reduce demand for instruments and consumables. There could be positive demand tailwinds for the group related to lab testing and research related to food safety and viruses. We are focused on quality names that should be well-positioned after the pandemic subsides, especially companies with bioproduction assets.

Telemedicine. The COVID-19 outbreak has given rise to what we believe is a sea change that could permanently modify health care benefits, treatment, and consumer behavior. In the current environment, employees are now seeking out telemedicine services, and insurance plans are waiving co-pays and co-insurance for those that utilize it. Preliminary data suggest that since the pandemic's outbreak, telemedical visits have increased substantially, with most visits coming from new users.

Investment Themes & Areas of Focus

- We expect that productive research and development activity will yield effective disease treatments that improve the quality of patients' lives. These characteristics historically have been the source of longer-term outperformance in the sector.
- We believe many biotherapeutic companies have compelling fundamentals and innovative products and pipeline drugs.
- The number of drug candidates in biopharma pipelines is at all-time highs. Increased research and development investment by large global pharma companies, as well as advancements in drug screening and discovery, are driving the increase in drug candidates.
- Larger multinational pharmaceutical companies, especially those with patent-expiration pressures, will continue to make acquisitions of smaller cap companies with single products or promising pipeline assets.

Financials

In response to the COVID-19 pandemic and the resulting collapse of the global economy, the S&P 500® Index's financial sector (index) continues to lag the overall market and is one of the worse performing sectors. The drastic fall in interest rates and uncertainty around credit quality has affected both fundamentals and market expectations. The volatility in index performance has been extreme, both during the market sell-off and subsequent rally off the bottom. The index fell 42% year to date through the market low on 3/23, but has rallied over 38% since. Year-to-date the index is down -20% versus the S&P500 at +5.6%.

While government action early on in the COVID crisis and the subsequent re-opening of certain parts of the economy have served to mitigate the declines in the sector's performance, there are still too many macro-uncertainties to provide a meaningful outlook for financials over the near- to medium-term. The Fed has signaled that interest rates will remain at depressed levels for the foreseeable future and there is still no visibility on sustainable economic growth. While there has been significant progress toward a COVID vaccine, questions remain about timing, accessibility and the potential for a second wave globally before immunization is available. Lingering effects on consumer and business confidence, credit losses and balance sheets serve to cloud the outlook on the timeframe of exiting the recessionary environment.

Investment Themes & Areas of Focus

- Overall, banks are significantly better-positioned today than they were in 2008-2009 financial crisis across a broad range of balance sheet, capital, and risk management metrics.
- Valuations remain very attractive, and are approaching their lower historical bounds on a relative and absolute basis. They compare favorably to levels seen post the Global Financial Crisis, despite much stronger company fundamentals; while the argument can be made that the sector is oversold, there is also a lack of near-term catalysts to drive share appreciation.
- Looking forward for the next few years, consensus is expecting rates to stay historically low, the curve to remain flat and potential credit risks to remain across a broad range of bank and insurance company assets. The result is that we can expect continued headwinds working against traditional fundamentals and market sentiment, which will continue to put downward pressure on their P/E's.
- Secular growth companies with defensive attributes (low leverage rates, asset light models, sustainable, high margin, and high free cash flow businesses) should continue to fare better in this type of environment. Several digital payment and financial technology companies meet these criteria and have demonstrated superior fundamentals and stock price performance through the COVID-19 crisis especially.
- Property & casualty (P&C) insurers fare better in this environment given strong pricing power, while asset-heavy banks and life insurance companies with more interest rate sensitivity could raise the risk profile of a diversified portfolio.

Midstream Infrastructure

After rallying off the bottom from March lows in the second quarter, midstream infrastructure flat lined over the third quarter. The group struggled on worries of sluggish global economic activity, the potential for further COVID-19 lockdowns and the impact to overall demand.

In addition, tax-loss selling, the upcoming US elections and corresponding regulatory uncertainty, as well as the return of levered investors' forced selling, all contributed to the group's performance. While the Alerian Midstream Energy Index (which includes not just MLPs, but a broader group of midstream infrastructure companies) retreated just over 9% in the third quarter, it significantly outperformed the 16% decline in the Alerian MLP Index.

The larger, more financially sound midstream companies have already taken decisive measures in order to conserve cash and "right-the-ship" during this global pandemic – and in our view, will likely continue. Cash-flow metrics have improved across the board after companies have reduced capex and growth spending over the last 15+ months. In fact, we expect free cash-flows to become more pronounced this year and throughout 2021, as further cost reductions and increased asset optimizations are likely to continue going forward. Given today's macro uncertainty stemming from multiple fronts, the current muted growth outlook is unsurprising. However, the attractive cash-flow story along with the sector's compelling valuations and attractive yields are quite compelling, and we believe the sector's recent underperformance is overdone.

As the US economy begins to open and economic activity begins to slowly ramp, we remain optimistic given the significant

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transformational corporate reform that has been occurring in the midstream sector over the past few years, which was already having long-term positive benefits. Although it's difficult to predict short-term outcomes, over the longer-term we believe the large integrated, reformed companies will survive. While the demand for energy hydrocarbons will continue, it will not end. These midstream infrastructure companies have physical steel "in the ground," many with asset networks that have high barriers-to-entry and are difficult to replicate, in our view.

Investment Themes & Areas of Focus

- "Reformed" companies (i.e., companies exhibiting higher capital discipline, and healthier, more conservative balance sheets that can withstand a downturn, along with improving ESG metrics such as solid corporate governance).
- Integrated business models – (the "Haves") the larger, more integrated companies with multiple touch-points along the energy value chain, that have higher barriers-to-entry, along with steady cash-flows.
- Firms with exposure to the natural gas liquid (NGL), liquefied natural gas (LNG), and natural gas demand export themes.
- Renewable energy companies to diversify our overall energy holdings, and provide exposure to the renewables investment theme.
- Utility companies with significant midstream businesses

Utilities

Despite and economic environment that should favor dividend-paying stocks with stable fundamentals and predictable growth, utilities underperformed the broader market—which was driven by the strong performance of growth stocks.

Given the macro uncertainties in place, anemic growth expectations and low yields, along with broad government support towards renewables, the relative underperformance of utilities to the broader market was a bit surprising in our view. Despite the S&P 500 Utility sector's moderate performance –a 6.14% advance – fundamentals have held up better, relative to other value oriented sectors, such as energy and financials.

Just a few months ago, market participants were initially focusing their attention on the COVID-19 pandemic's impact to electricity demand, which we did not believe was a "needle mover" to company profitability. Today, market participants have shifted their attention to the potential policy impacts of the upcoming US presidential election, along with broader macro uncertainty. Furthermore, we have seen the current trend among sell-side generalists to view information technology as a more defensive sector than utilities, given the rapidly changing energy and utility landscape. While the group's underperformance is at odds with the underlying stability of the group, we continue to find the sector attractive given the ultra-low bond rate environment, and the sector's predictable fundamentals. Additionally, the continuation of utility companies' ability to execute operationally – delivering on earnings guidance, and de-risking their portfolio's, along with the potential growth opportunities from renewable energy investments could drive the sector going forward, in our view.

During the third quarter, with the exception of gas utilities, all segments within the S&P 500 Utilities Index advanced over the period. Independent power & renewable electricity producers drove the group, while water utilities also posted solid returns. Electric utilities and multi-utilities, posted more muted returns.

We believe the Utilities sector represents a compelling "defensive growth" proposition for investors for a few main reasons:

- Despite a low growth environment, improving economics in renewables such as wind and solar power, continue to remain a growth driver for the overall sector – companies now have renewables incorporated into their capex strategy plans (versus five years ago when renewables weren't included) – allowing those utilities to earn a regulated rate of return on their renewable investments.
- Their "defensive" nature – those with regulated activities and quasi-regulated renewable portfolios, combined with their long-duration cash-flows and predictable rate base earnings – remain not only attractive given their ability to provide stable dividends for investors amidst any macro uncertainty, but also should provide earnings growth above the sector's historical 3%-5% EPS growth, in our view;
- With a lower for longer interest rate environment, utilities should continue to benefit from access to lower cost of capital – savings that eventually flows directly to their bottom-line. While the P/E ratios for the overall broader market (S&P 500 Index) including utilities have declined, we believe utility company earnings over the long-term have historically been more predictable, and typically less volatile than the broader market.
- The renewables segment within the utility group should continue to benefit from government stimulus packages tailored to a green recovery, along with renewables development tailwinds that should sustain dividend growth, in our view.

Investment Themes & Areas of Focus

- Regulated Utilities - companies operating in favorable regulatory environments and geographies, with above- average projected earnings and/or dividend growth driven by regulatory rate-base investment.
- Renewable Electricity - we see continued momentum across multiple fronts that support on-going investment and usage in renewables, stemming from the "energy transition" – a secular trend toward renewables – that will provide unique investment opportunities over the long-term.
- Water Utilities - state utility commissioners encouraging spending on improving water quality as well as pipeline replacement and maintenance, enables companies to provide transparent 10-year outlooks on their spending and income plans, a positive dynamic for this sub-industry.
- Communications Infrastructure - wired broadband network and data center operators are well positioned to capitalize on exponential global data demand growth; and tower operators given their critical infrastructure, multi-year contracts, and strong free cash-flow generation.

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