Market & Economic Review
Post Election Outlook

Election Results

The Presidential election has been won by Biden and the Senate will be either a 50/50 tie or a slight Republican majority pending the special election in Georgia for both seats. Regardless of the Senate outcome, the big shift to the left on policies and tax increases will be muted. Going into election day the consensus was for a Biden victory and a slight Democratic majority in congress. Most Wall-Street strategists saw the potential for major stimulus with a "Blue Wave" that would likely lead to higher equity prices, higher bond yields, and higher inflation. A split Government would likely see less stimulus, but also less regulation. Before the election, we communicated to clients (who wanted to make portfolio changes on concerns of the "Other Guy" winning) that presidential elections just aren't that important over the long term. There are too many variables to isolate a significant impact. For example, in 2020 the primary driver is the timing of a vaccine. Capital gain taxes have been increased at times but were overwhelmed by strong economic growth or technological advancements that still lead to strong equity bull markets. This time of year, investment groups put out some form of the below, showing equity market results based on who is in office over some time period. This chart goes back further than most, but the reality is that there are still not enough data points to give any kind of predictability.

Mixed record on assets under different political parties

Gains for Stocks, Industrial Production, Inflation, Bonds, and U.S. Dollar ($) By Party of President and Majority Party* in Congress (03/04/1901 - 10/13/2020)

	Stocks (DJIA)	Industrial Production	Inflation (CPI)	Real Stock Returns	Long-Term Gov Bond**	U.S. Dollar**
Democratic President	7.89	4.85	4.18	3.56	3.58	0.95
Republican President	3.47	1.69	1.80	1.64	8.00	-1.49
Democratic Congress	6.05	4.26	4.33	1.65	5.51	-1.44
Republican Congress	4.58	1.52	0.82	3.73	6.23	0.85
Dem. Pres., Dem. Cong.	7.23	6.38	4.67	2.44	2.00	-3.54
Dem. Pres., Rep. Cong.	9.52	1.15	2.98	6.35	7.48	4.06
Rep. Pres., Rep. Cong.	2.26	1.70	-0.23	2.50	5.21	-3.79
Rep. Pres., Dem. Cong.	4.80	1.67	3.90	0.87	9.65	-0.65
All Periods Buy/Hold	**5.44**	**3.15**	**2.91**	**2.46**	**5.75**	**-0.53**

*Majority Party = Party with average of % control in House and Senate greater than 50%

**Long-term goverment bond data starts in 1925, U.S. dollar data starts in 1971.

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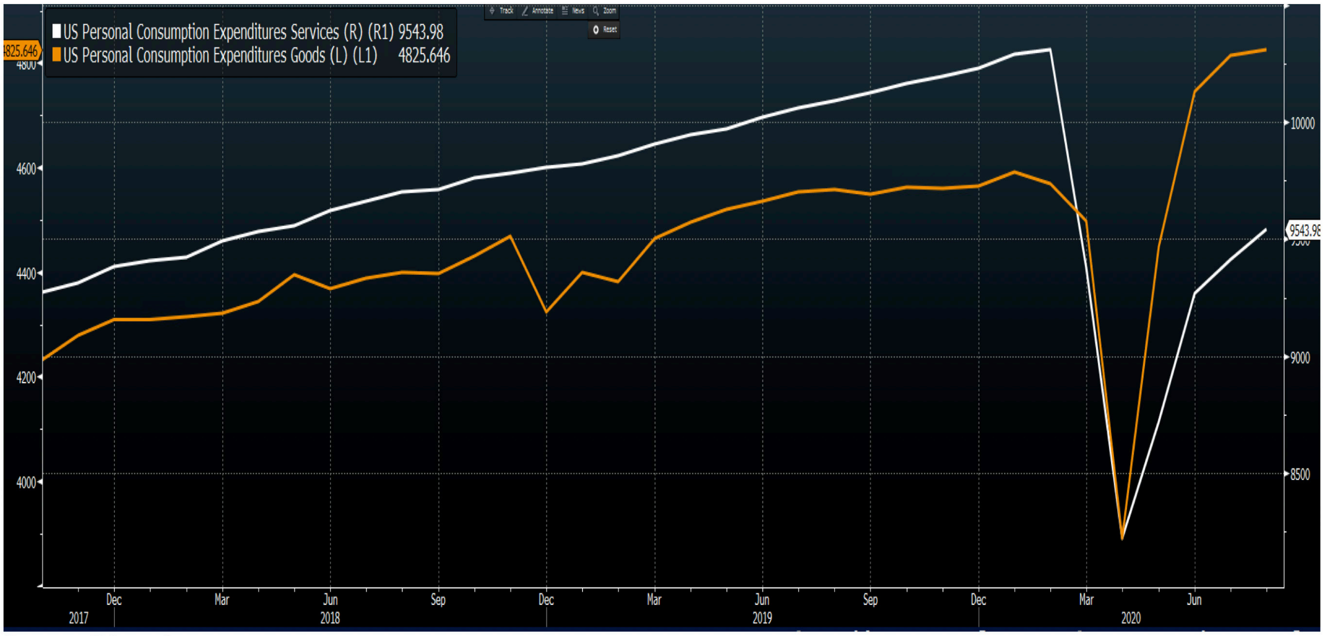

Source: Bloomberg

Equity Markets

Equity markets continued to rally during the quarter before the election, as stimulus injected into the economy offset the negative economic effects of Covid. While cases spiked in the Southern United States, political leaders at the state and local level implemented a more direct plan of mask requirements and brief periods of bars being shut down rather than the punitive full shut down we saw in March and April. Except for hospitality, travel, and entertainment, most businesses were able to get back to a more normal level of business activity. In fact, we have seen some sectors such as home improvement, furniture, and online electronics reach levels above their February peak.

While Covid cases spiked early in the 3rd quarter, the economy did not experience much of a decline in the reopening. In some parts of the country, openings continued to be delayed, but overall growth continued to accelerate. We have seen a dramatic divergence between the goods/manufacturing part of the economy relative to the service component (chart below). Historically, service has led the way out of recession. This time the service industry has lagged due to the high exposure to social interaction and Covid cases not being driven down to low enough levels for consumers to return to travelling and dining out as much as they did pre-Covid. With the availability of a vaccine we will likely see a shift back towards services as purchases of goods were likely pulled forward by those with money to spend.

The outcome of the election, with a Democratic President, and a split Congress or narrow Democratic control, has been seen by the market as a stable outcome. While no big progressive spending bills will likely be passed, it is likely we will see another stimulus plan with the Federal Reserve maintaining an environment of low rates and high liquidity. While the outcome of the election was becoming more certain, markets seized on the news of a vaccine by Pfizer that had 95% efficacy. With the news hitting less than a week after the election, markets began pricing in the successful availability of the vaccine by spring. The results of the election and an increase in cases became less important to equity markets. In fact, as the growth in cases reached new highs, the so called "Work from home" or "Stay at home" stocks underperformed. Value stocks that include energy and financials experienced a catch up trade as a viable vaccine benefits them the most.

Looking Ahead

Large cap U.S. growth stocks have been the strongest performing major asset class since the end of the Great Financial Crisis (2008/2009). It has primarily been due to the great innovation in e-commerce, technology, and healthcare that has taken place primarily in the United States. Small cap value and international stocks have been laggards, due to less growth and exposure to financial and industrial sectors. While we expect to see the wave of innovation in the U.S. continue, we will likely see more broader participation in more cyclical stocks over the next 6-9 months. With Covid, we have not seen the typical strong returns coming out of a recession that we normally see in the cyclicals. With a vaccine and a return to normal, we are likely to see sectors such as travel/hospitality, in store retail, and energy/materials gain some traction. We are looking to rebalance toward small, international and value relative to our current overweight to large, U.S. and growth position. We continue to see a better environment for active management relative to passive.

The Federal Reserve has indicated they are likely to keep rates low for the foreseeable future and we could see another round of fiscal stimulus in the $900bn range. Under these conditions and with a vaccine widely available mid-2021, we could start to see some signs of inflation. We see a continued steepening of the yield curve which will benefit financial stocks and provide opportunity to pick up more yield in our bond portfolio. Our bond positioning has been on the shorter end, so we will not experience a significant hit with rates picking up on longer maturities. The historically high valuation of equity markets and low bond yields make a traditional portfolio's future returns lower than average. We see opportunities in absolute hedge fund strategies including long volatility and long convexity. These strategies benefit when equity markets decline and/or interest rates move higher. Historically, bonds have been a good hedge against major equity sell-offs. With rates at such low levels the benefit of bonds has decreased. We still prefer to hold high quality bonds with short to intermediate duration, but at lower amounts than historically. This allows us the benefit of portfolio construction which helps to lessen the volatility of an investment portfolio. As we have written in the past, our lower duration portfolio allows us to invest in higher yielding bonds as rates move higher.

GDP for the final quarter is likely to come in around 3.5%-5% as the pick-up in Covid cases has slowed the pace of openings in certain parts of the country. Growth for 2020 should be around -3% to -4% with a high likelihood of getting back to the high-water mark sometime in the 2nd half of 2021. We will have a much more in-depth analysis of 2021 in our next newsletter scheduled for mid-to-late January.

Current Positioning

- **Equity:** Favor Large Cap and U.S.
  - Favor Quality and GARP (Growth At a Reasonable Price) managers
  - Adding to active management within our small/mid and international exposure

- **Fixed Income:** Quality bonds with average duration around 5 years
  - Core municipal and investment grade corporate bond allocation

- **Alternatives:** Environment for Hedge Funds is improving we are slowly adding exposure
  - Private Equity exposure is increasing with focus on small-mid buyout funds and co-investments with small to mid-size funds. Looking at secondaries and distressed
  - Adding to long/short exposure rebalancing from equities
  - Looking to add to absolute return rebalancing from equities and fixed income

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