—New Albany—
Investment Management

**October 26, 2020**

## Market Insight

- **Does the Election Matter?**
- **Reasons to be Optimistic**

The markets continue to confound logic. You are not alone if you are wondering why the S&P is sitting near all-time highs just days before a very emotionally charged election. Are not the political views of the Democrats and Republicans sharply different on health, labor, trade, and taxes- all of which will impact employment, consumption, productivity, and capital spending? Voters are hopeful 'their voice' will be heard and ultimately influence the direction of this country for at least the next four years. Yet despite the potential dramatic changes ahead, the market has not only been resilient, but perhaps it is signaling better days lie ahead. Could it be the Election does not really matter? Yes of course the election matters, but perhaps not so much when it comes to the markets and the economy.

Though the office of the President does hold great power and does have influence, it does not control the markets. The markets are too complex. In fact, one could argue that sometimes the market has greater influence on who gets elected and government policy than the voters. But I shall leave that thought for another time.

**Cautiously Optimistic:** When it comes to navigating the markets, I always try to identify the risk/reward opportunities. I know firsthand, it takes a long time to accumulate wealth, and yet it can all be wipe away very quickly. Today, despite the present 'uncomfortable' news, there are several reasons to be positive about the future of the economy, the markets, AND our country.

Rebounding Economy: Although GDP fell -31.4% in the second quarter, it is expected to **rebound over +35% in the 3rd quarter**. This brisk snap back is due in part to the huge stimulus from both the Fed (+$3 trillion) and the Treasury (+$2.2 trillion), and because the consumer and businesses are adjusting and adapting to a new environment. Going forward, the Fed has pledged to allow inflation to run hot and to keep rates exceptionally low for several years. And Congress is expected to pass another fiscal aid package. These policies are highly significant in that they will act as a turbo charge to an economy that already has plenty of liquidity and cheap credit. Yes, there are still big pockets of weakness (hospitality, travel, entertainment); however, there are many other areas that are booming (online shopping, auto sales, residential real estate, construction.) Though uneven, economic growth is strengthening and in fact transforming.

Reallocation of Resources: As businesses and consumers adjust to the new environment there are dislocations of resources - employment, supply chains, spending patterns etc.- and it causes an uneven recovery. This is what we are experiencing now, a reallocation of resources and redistribution of demand. One obvious example is the shift in how consumers shop. The huge increase in online shopping has caused supply disruptions but has also accelerated the demand for warehouse space, delivery trucks, and employees to fill and deliver those orders. This dislocation and reallocation of resources takes time to resolve, but as it happens, it will provide an even faster, more efficient service based economy and new momentum for the future. **The economy will come out of this slump leaner and stronger, and that is good news!**

Rebounding Earnings/Markets: 3rd quarter earnings are expected to fall *only* 21% year-over-year, the second largest decline since Q2 2009. And this is good news? Well no. But the markets are always looking forward, at least six months, and the assessment is quite positive. The Street forecast is expecting a significant rebound in the economy in 2021 for two reasons: a COVID-19 vaccine is expected to be widely distributed by mid- 2021; the Federal Reserve's is maintaining an exceptionally accommodating policy. Below is a chart of GDP outlook and its components from the Conference Board. Notice the annual change in GDP growth from -3.5% in 2020 to +3.5% in 2021. This **remarkable swing in GDP from negative to positive has NOTHING to do with the election results, but simply reflects the policies and initiatives ALREADY in motion.**

THE CONFERENCE BOARD BASE CASE ECONOMIC OUTLOOK, 2019-2020-2021

Percentage Change, Seasonally Adjusted Annual Rates

| | 2020 | | | | 2021 | | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| | I Q* | II Q* | III Q | IV Q | first half | second half | ANNUAL | ANNUAL | ANNUAL |
| Real GDP | -5.0 | -31.4 | 34.6 | 1.5 | 1.9 | 6.4 | 2.2 | -3.5 | 3.5 |
| Real Consumer Spending | -6.9 | -33.2 | 34.9 | 2.7 | 2.6 | 6.8 | 2.4 | -4.4 | 4.0 |
| Residential Investment | 19.0 | -35.5 | 40.0 | 10.0 | 5.0 | 4.0 | -1.7 | 2.5 | 6.3 |
| Real Capital Spending | -6.7 | -27.2 | 8.9 | 5.7 | 3.2 | 5.6 | 2.9 | -5.9 | 2.5 |
| Exports | -9.5 | -64.4 | 19.0 | 5.0 | 5.0 | 5.0 | -0.1 | -16.8 | -0.8 |

Strong earnings will be a big tailwind for stocks. As the economy rebounds, so will Corporate earnings which in turn will bolster the markets. The chart below shows the actual (solid blue) and estimated (dotted blue) earnings growth for the S&P. **For 2021, annual earnings are expected to grow between 15-25%.** Now that is something to get excited about!


Source: Charles Schwab

Rebounding Country: “It is always darkest just before the Day dawneth,” Thomas Fuller, 1650. Even in the worst of circumstances there is Hope. In the history of the world, and more recently, in the history of our Country, this truth has played out again and again. It is helpful to remember how messy, and at times very ugly, the democratic process was during the founding of our Country. Many of the Founding Fathers were arch enemies when it came to their views of government structure and policy. But their commitment and perseverance carved out a governmental process that continues even today to provide freedom like none other in the world. It is certainly not perfect, but our democratic structure continues to cultivate ingenuity, creativity, and opportunity. And because of that, I am optimistic our Country will continue to grow and prosper!

**Investment Strategy:** Planning for Growth. Risk exposure remains targeted to the middle of established risk tolerance bands; however recent reallocations in stocks have increased the Beta or sensitivity of the portfolio to those areas of the market that can provide better upside potential in a pro-growth economic environment. In addition, Bond allocation was recently shifted to shorter duration assets to avoid potentially rising long term rates (falling prices) in a strengthening economy.

As always, please contact me with any questions or concerns. Your feedback is always encouraged and appreciated.

Best Regards,
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