Manager Perspective

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A few clients have expressed concerns over how the market may react to the results of the upcoming presidential election, and I thought I would share a few of my thoughts on the subject. One of the first lessons my mentor taught me as a young trader back in the late '90s is that we never trade based on potential election outcomes. We may under-weight or over-weight a certain stock, sector or asset class for emphasis, *yet we always maintain a balanced portfolio*.

As for this year's elections, only a party sweep could result in any real legislation passed in the near term, as our elected officials do not appear to be in the mood to compromise. The tax cuts passed at the end of 2017 were supposed to lead to a surge in capital investment (CAPEX) by US corporations that would "trickle down" through the economy. It did not. It gave us about 0.20% extra GDP in 2018 relative to 2017 before the trade war with China started. It is much easier for a Chief Investment Officer to conduct stock buybacks rather than invest in new CAPEX projects that may or may not provide a return above the cost of capital. So, that's where most of the tax cut went - to repurchasing shares. Repurchases may enhance stock returns, but CAPEX spending is better. It has a HUGE positive "multiplier effect" on the economy in terms of jobs and consumption, and eventually stock returns. In sum, the tax cuts were disappointing from an investor perspective.

The driving force behind the market this year and next is the Fed (and other central banks around the world). There is an enormous amount of stimulus in the system, much more than in 2008, and this provides market support. As the saying goes, don't fight the Fed! The lesson the Fed learned in the 2008 financial crisis was that they didn't act soon enough and left too early. Fed Chairman Powell has repeatedly noted that this Fed will stick around until the "danger sign" stops flashing. That means interest rates may stay low into next year, and business loan programs may stay in place for an extended period as well.

Market timing (moving in and out of cash) is almost never advisable for long-term investors because it is very, very difficult to execute. There will always be some exogenous force working against us. In our industry we call this the "wall of worry." It is our job to find suitable investments for clients' portfolios no matter the investing environment. We do expect to hear quite a bit of noise around increased taxes and regulation from the Democrats. For sure, increases would dent earnings. But we are a long, long way from meaningful changes in legislation. And, overall, we expect earnings to be greater in 2021 than in 2020.

We believe the market needs to cool a bit as stock fundamentals catch up with valuations and Congress continues to deliberate further stimulus. We may even get a pullback/consolidation in stocks prior to the election, and that's ok. Pullbacks always provide opportunity for long-term investors. Additionally, there is technical support for stocks with about $5 trillion in cash still on the sidelines. Finally, with interest rates at this low level, stocks are simply more attractive than bonds and provide the best long-term potential to meet our investment objectives.

Yet we need to remain invested to reap the reward. We expect to stay the course for now.

As always, please reach out if you have any questions or concerns.

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