ECONOMIC & FINANCIAL MARKET UPDATE – October,2020

"Don't Fight the Fed", The Elections & Fundamentals

A Retrospective

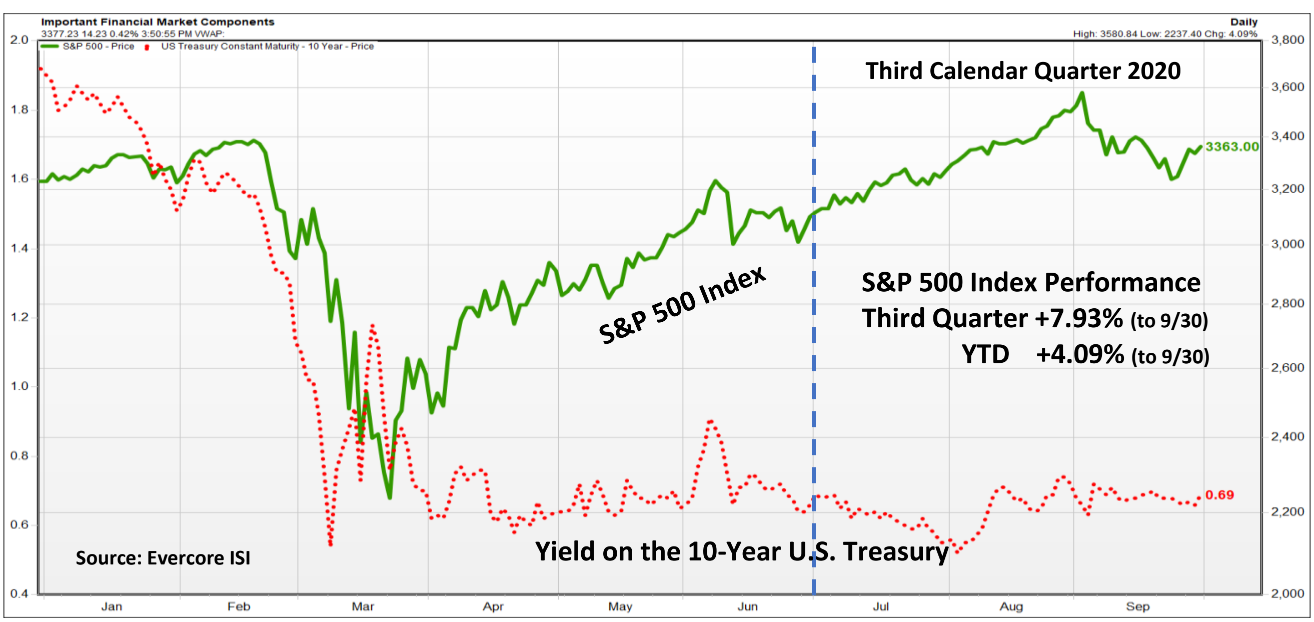
In our previous quarterly ***Economic & Financial Market Update*** (6/30/20), we discussed the unprecedented rapid decline in the U.S (and global) economy, the loss of more than twenty million U.S. jobs[i] in little more than sixty days, and the continuing acceleration of bankruptcies by not only small and moderate size business, but large ones as well. This adversity occurred during the first six months of 2020 and was brought about by the ravages of the COVID-19 coronavirus. It was "the worst of times".

At the same time, we also pointed out how rapidly the Federal Government reacted to the need for financial relief and passed the largest ($2.3 trillion) relief package in U.S. history[ii]. That legislation, the CARES Act, provided enhanced and extended unemployment benefits, loans and grants to business and municipalities, and sent one-time stimulus checks to individuals and families. While the CARES Act legislation was being written and approved, the U.S. Federal Reserve, and other global central banks, were constructing a program of massive monetary stimulus which would lead to dramatically lower interest rates and higher money supply growth. This action would create liquidity for the banking system and eventually increase consumption, borrowing, and lending – each a contributor to stabilizing and re-energizing the U.S. economy and consumer and investor sentiment.

Ultimately, the most critical element to any economic/financial market recovery, would be how the U.S. and the rest of the world would act to control the spread of the virus and eventually eliminate it. As a result of policies and procedures being put into place in the spring, infection rates, hospitalizations and deaths have declined, however, the virus remains a major problem and "spikes" in cases have reoccurred.

The Results

As confidence in the impact of the CARES Act, the Fed's actions, and healthcare policy grew, it was reflected in a rapid recovery in stock prices as the S&P 500 rallied 38.5% from its March 23rd low to the end of the second quarter[iii]. As one can see from the chart below, the S&P 500 continued to rally through the third calendar quarter as well and is up an additional 7.93% from the end of June to September 30th[iv]. Interest rates (using the 10-year Treasury note as a proxy) after falling precipitously in 2020's first quarter, have remained at or near historic lows for the past six months. ***The important question then is what do we anticipate now?***



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Moving Forward

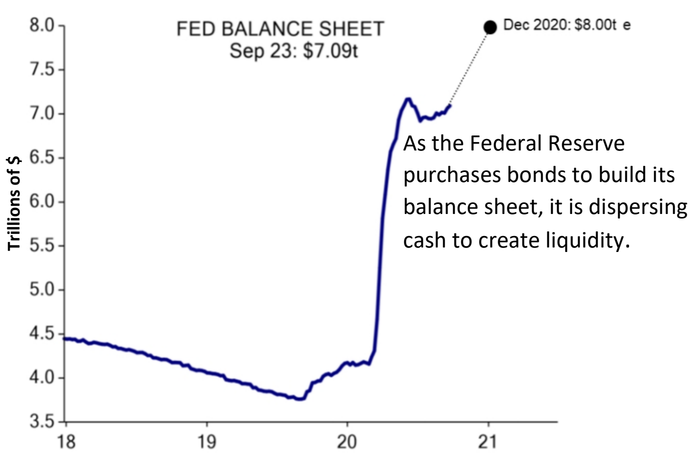
The most asked and debated question we hear today is: “What will be the impact of the election on the economy, the financial markets, and “everything else””. We wish we had a crystal ball to answer that question. We do not, but we do have some thoughts.

First, while there is a little more than a month until Election Day, and despite a lead by one candidate in the polls, many experts are suggesting that the race is still “to close to call”. Remember 2016? And, regardless of who wins, the best laid plans and ideas of a particular candidate do not always match the reality of actually governing and determining what should and can get done through legislation, executive actions, persuasion, or diplomacy. The composition of the House of Representatives and the Senate, in addition to whomever the President may be, will surely make a difference.

While a potentially changed political landscape will certainly feel different, we sight the important facts that during the past century, despite the fact that the United States has experienced several declared wars, multiple undeclared wars, recessions, depressions, inflation, deflation, Democratic led administrations and Republican administrations, the country has weathered many storms well, as the standard of living has improved consistently and the equity financial markets (S&P 500) have returned consistent compound annual rates of return that have exceeded the long-term annual rate of inflation. The actual compound rates of return for the S&P 500 ending 12/31/2019 for the period beginning 1/1/1900, the past 50 yrs., the past 20 yrs., the past 10 yrs. and the past 5 years have been +9.85%, +10.61%, +7.65%, +14.68% and +10.37%[v] respectively. Therefore, we focus most intensely on the longer-term, and on investment/economic fundamentals and less on politics.

Positive Fundamentals:

As the saying goes, “Don’t fight the Fed”. When the Federal Reserve is doing everything it can to be accommodative, keep interest rates low and strengthen the economy, it has generally been a good time to own stocks.



2018-2020

1992 - 2020

Source both charts: Evercore ISI

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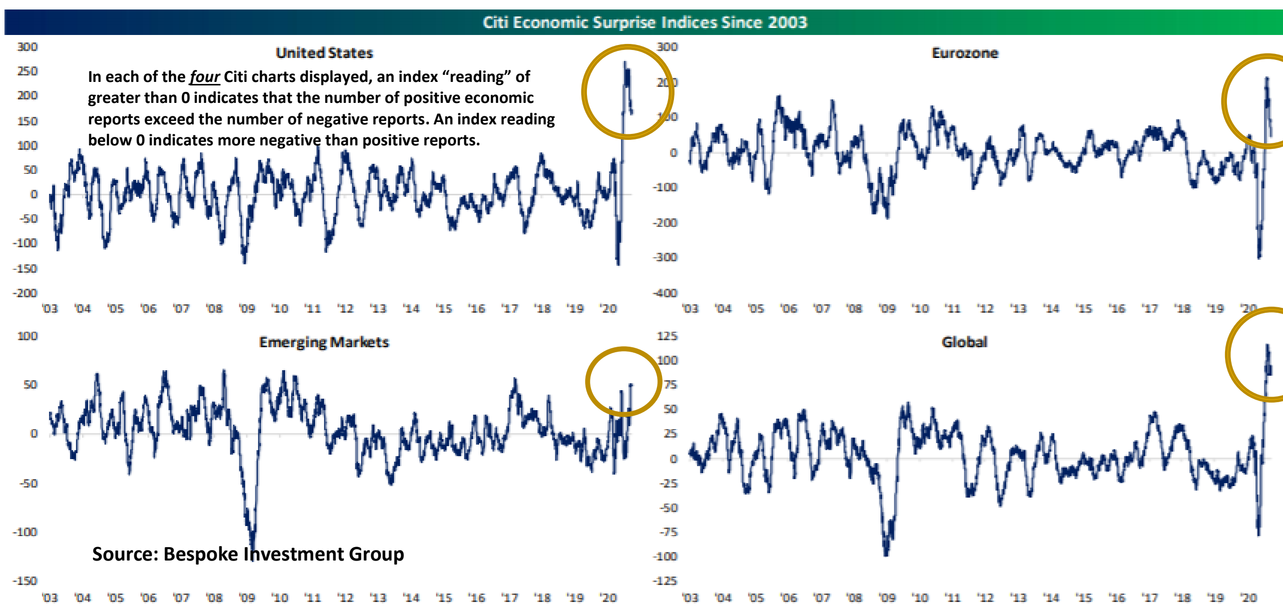
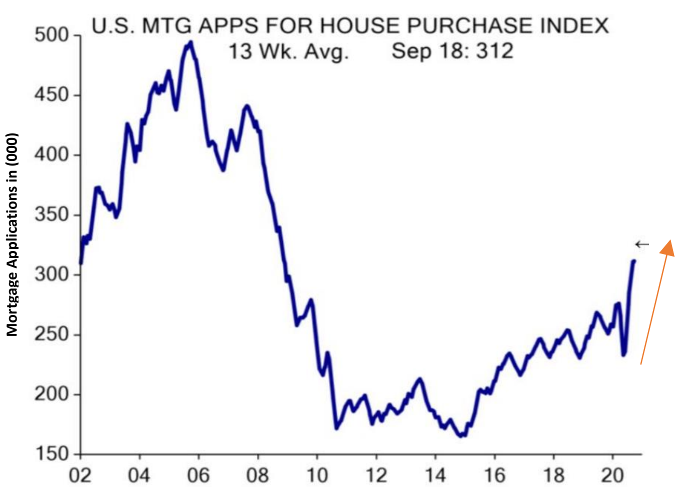
With the 10-year U.S. Treasury yield at just 0.69%[vi] and the dividend yield on the S&P 500 at 1.83%[vii] there is not a lot of rationale to own intermediate or longer-maturity bonds.

Additional evidence that the Fed’s and global central bank’s actions to stimulate the U.S. and global economies have been effective, may be seen in a series of charts that display the Citi Economic Surprise Indexes. These *__indexes__* measure how economic data is coming in ***__relative__*** to expectations. From the March/April lows, the indexes have rallied strongly, though they are modestly off their highs, but still above pre-COVID levels. The movement of these indexes further strengthen our belief in an improving economy.



Another important segment of the U.S economy that is helped by the decline in interest rates is housing and it is clearly an industry in demand. As one can see from the charts, both Mortgage Applications and Existing Home Sales have rebounded sharply from the mid-spring lows and are now actually at multi-year high annual rates.



Source: Evercore ISI

Years displayed on X-axis on both charts 2002 - 2020

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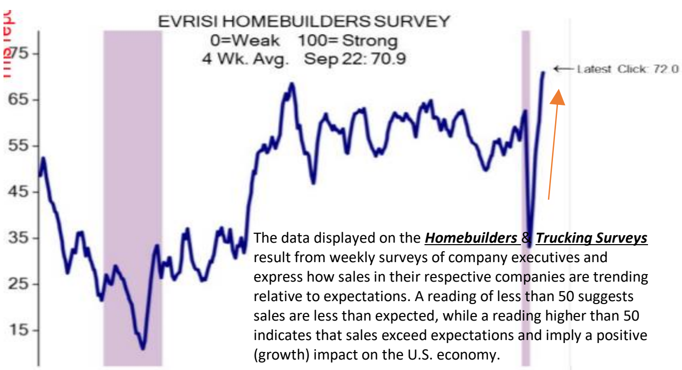
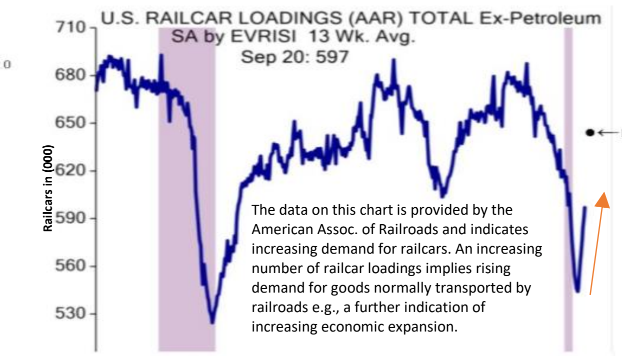
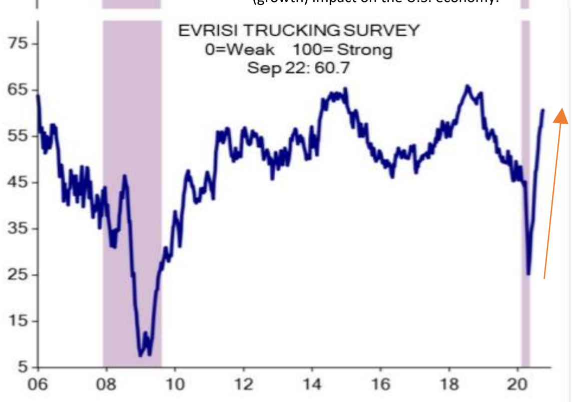
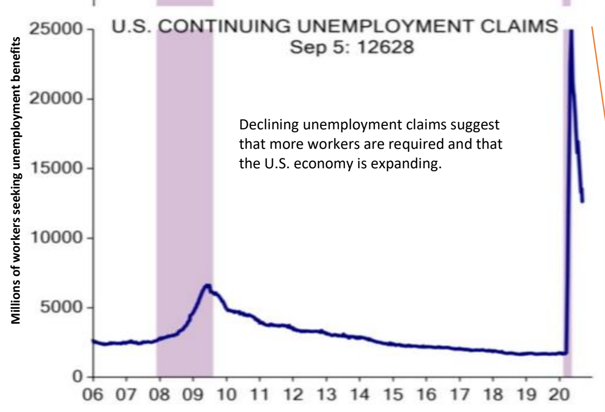
There are quite a few more positive indicators (see the charts below) that give us confidence that the economy is recovering, that employment will continue to gradually improve and that a greater degree of normality will return.

Source all 4 charts: Evercore ISI; Years displayed on X-axis 2006 - 2020

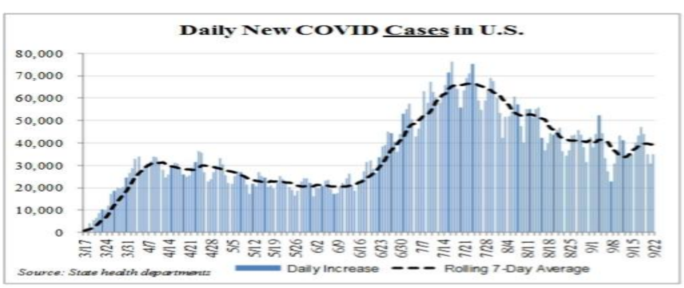


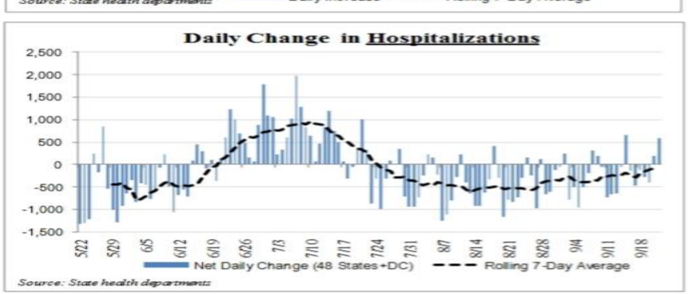


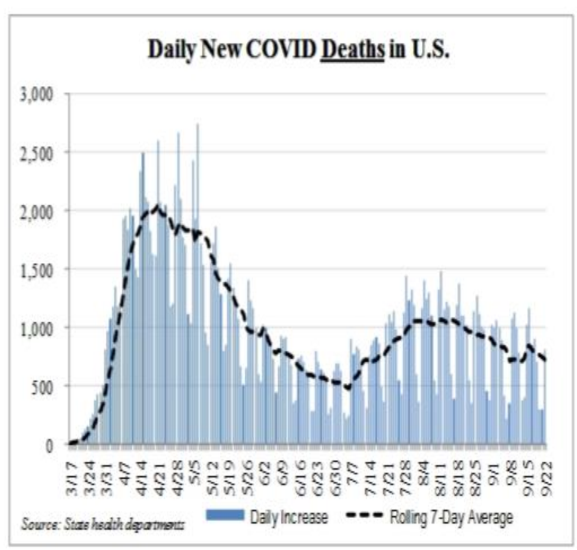




Perhaps the most important information for all investors (and non-investors) is what the trends relating to the coronavirus are. While short-term trends can be erratic, and “hot spots” may appear at any time, it looks as if there is a definite trend of fewer cases, hospitalizations, and deaths. In addition, there are multiple drugs, with high expectations for their effectiveness against COVID-19, in phase III trials with expectations that an effective vaccine(s) will be available by year-end or early in 2021.







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The Bottom Line

As we have described above in script and illustration, we believe there is evidence that the U.S. and global economies are recovering from the disastrous effects of the coronavirus pandemic. There is still a long way to go before any of the world economies approach pre-COVID levels, but the positive trends of the equity markets (a pretty reliable discounting mechanism for future results) are indicating that the confidence of professional investors for a recovery is high.

Our confidence is good, and our outlook remains positive, but we are very much aware of the concerns and pitfalls that remain. The election, the slowing improvement in employment, somewhat “stretched” equity valuations, stock market returns highly concentrated in a single sector (technology), a few weakening technical issues (market breadth) and COVID-19 are all factors to be monitored closely. And we will.

Strategy and Actions

Our current investment strategy remains in place e.g., maintain balanced, well diversified, high quality focused portfolios. Equity portfolios will emphasize the Healthcare, Technology, Consumer Discretionary and Industrial Sectors, while fixed-income portfolios will retain short-maturity and quality focused.

As we have done during the past several years, we will use periods of volatility and temporary uncertainty to take advantage of opportunities to moderately reduce or increase equity exposure while staying within the portfolio guidelines that have been established. As always though, and as we have said many times previously, our actions will be to focused on maintaining our investment philosophy and disciplines and focus on longer-term results, avoid reacting to short-term “noise” and to always be aware of one’s need for cash flow, liquidity and desire to avoid extreme volatility.

We thank you again for the opportunity to serve you. We highly value our relationship with you and would welcome any question, comments, or critique’ that you would like to share. We very much look forward to getting back to more normal times.

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for, tax, legal or accounting advice. You should consult your own tax, legal and accounting advisors before engaging in any transaction.

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[i] U.S. Bureau of Labor Statistics; March & April, 2020

[ii] U.S. Department of The Treasury, March 27, 2020

[iii] Factset Research Systems, 9/26/2020

[iv] Barron's, 9/28/2020

[v] NYU Stern School of Business, Stocks, Bonds & Bills

[vi] U.S. Treasury Department

[vii] Bespoke Investment Group, The Bespoke Report 9/25/2020