RAYMOND JAMES®

“Stop Making Sense”

October 21, 2020

The following are the Exclusive and Sole Opinions of the Author.

Hard to explain. The equity markets seem unfazed by the Presidential Election. Informed by the 2016 polling failures the election should be viewed by investors as a toss-up.

The stock market is usually an efficient and accurate predictor of major economic change.

A change in political control could disrupt the economic status-quo substantially.

Higher corporate taxes directly reduce earnings and cash flow and usually share prices. More regulation also tends to reduce profitability.

These higher tax rates and regulatory schemes do not seem to be priced into the market in my opinion.

This leads me to believe that the market is anticipating the reelection of President Trump by a substantial margin.

Investors sometimes seem to believe in pie in the sky theories regardless of previous economic experience. Voters certainly do. Ineffective and harmful policies are constantly revisited, with an expectation of achieving different results. Those are false hopes.

Does not matter who is in charge; bad policies produce bad results. History is a harsh reminder.

I would expect an immediate, negative price reaction if the election outcome disappoints the markets.

The investment downside of a Biden victory seems to be greater than the potential upside of anything other than a Republican landslide. A 25% haircut in the major averages would not seem out of the question as the new administration fumbles toward a new economic order of confiscatory taxes and redistribution of wealth.

I suggest for some that a higher than ordinary allocation to cash and to a lesser extent fixed income could be an appropriate tactic given the uncertain election outcome.

Avoiding the election risk, or reward, by holding excess cash could be a reasonable and cautious approach. Might miss out on a reelection rally, but four more years of a Trump administration could offer potential investment opportunities.

The traditional 60% equity, 40% fixed income and cash, (heavier on the cash), model seems very appropriate for this uncertain time. Since the 2009 bottom, "All your eggs in (the) one basket" of large capitalization growth stocks has generally been an effective strategy. The larger risk was amply rewarded. That risk has only increased as valuations have soared. There is still time to adjust your exposure, as price appreciation may have created portfolio concentration.

The cash allocation should be large enough to supply any current income needs for at least six months, as well as investment funds in the event of a major price decline.

Once the allocation has been considered and adopted, the reinvestment plans can begin.

The economic proposals of the political parties are starkly different.

One common outcome of both parties' platforms is deficit spending which should create inflation across a wide spectrum of goods, services and labor. Both support stimulus. Trump is backing a fat spending bill, compared to an obese alternative from the House.

When, how and where inflation materializes is the more difficult issue. That will depend on the timing, nature and efficacy of the stimulus legislation and the course of COVID.

COVID is a deadly serious disease. However, it is not the first or only pandemic to afflict America in recent history.

Memories of prior pandemics are short or non-existent. Modern mass media and politicians exploit this ignorance to promote fear and division to increase advertising sales and garner votes.

The situation was different in 1969. The influenza pandemic of 1969 was serious, resulting in 100,000 dead in the US and somewhere between 1 and 4 million worldwide.[1] The population of the USA was two-thirds the current size at the time, to put it in perspective.

There were no lock downs, nor mask requirements, etc. The disease went away.[2]

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[1] https://nypost.com/2020/05/16/why-life-went-on-as-normal-during-the-killer-pandemic-of-1969/
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There was no vaccine. A variant of that virus H3N2 circulates today and remains a constant concern of virologists. It is one of the strains usually included in flu vaccines every year.[3]

History suggests some variants of COVID will remain and evolve in the virosphere[4] for as long as there are susceptible hosts.

As the economy reopens, the predicted increase in cases has fortunately been moderate and mortality rates have plummeted. Not surprising, the incidence in the younger population cohorts has surged, as also should have been expected. Young and healthy people have little to fear and are responding by resuming normal activities.[5]

The reality is that most Americans are going to get the virus or a vaccine. The vast majority will have little or no serious health consequences. There is no magic alternative, no cabal of scientists and great thinkers that will make this infinitesimal particle miraculously vanish from the globe.

Establishing widespread immunity as quickly and safely as possible was and remains the primary goal. Flattening the curve was an intermediate goal intended to provide more time to understand the disease and design responses. Those who dissemble about the nature of herd immunity are political foils. The politicians who question the efficacy and safety of the vaccines being developed are doing a huge disservice to their constituents and the nation.

The COVID pandemic will go away, just like the 1969 influenza pandemic. Our memories will fade. The country will go on. While serious, the markets have discounted much of the course of the virus. Discounting the impact of the Presidential election coin flip is practically impossible.

There have been many presidents and administrations. The country has managed to survive the incompetent and venal ones and thrive under better governance.

The 2020 election offers voters two quite different visions of the Country. The choice is between the current path of somewhat free enterprise or a reversion to a “command and control” form of government economic control, like the prior administration.

A new administration will have to be well run, well-staffed, cohesive and hit the ground running to avoid a mid-term debacle. Their plans will need to bear immediate fruit. Not likely in my opinion. Might be a long and difficult two years for the stock markets in the US.

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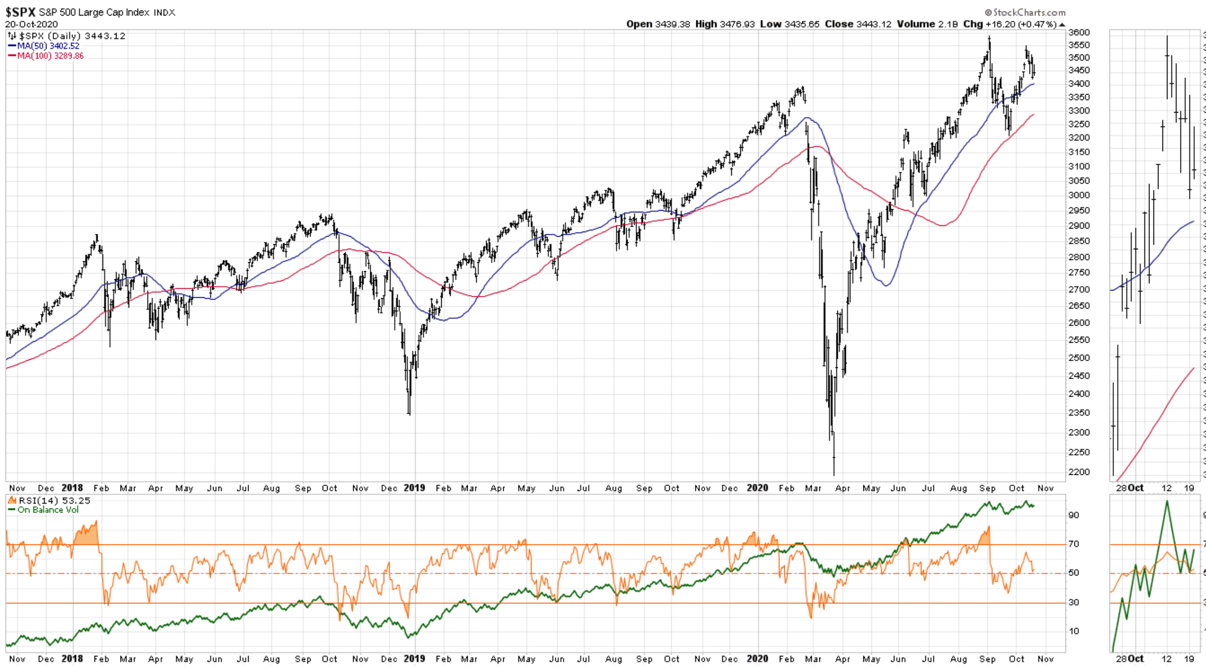
[3] https://www.fda.gov/vaccines-blood-biologics/lot-release/influenza-vaccine-2020-2021-season
[4] https://www.nytimes.com/2020/03/24/science/viruses-coranavirus-biology.html
[5] https://bestpractice.bmj.com/topics/en-gb/3000201/prognosis

Going into the election:

Stock markets continue to be buoyant, aided by some modest rotation into previously unloved sectors and issues.



Interest rates are rising at the long end of the yield curve. The FED has great sway over the short-term rates. Long-term rates are probably beyond their control, regardless of their new “tools”. Rising rates, if occasioned by economic demands are desirable and part of the “business cycle”. Rates driven higher by inflation and government debt funding are not.

Commodity prices have rallied.

Energy prices are likely to rise, oil could easily move back over $50 a barrel because of a lack of investment in new production.

The consolidation of domestic energy producers has accelerated as the future of prices comes into focus. Multibillion-dollar acquisitions are premised on this anticipated price increase.

In summary, the first order of business for many investors is to raise and maintain a “cash cushion” because the market’s reaction to the election may be significant and negative, in my opinion. If the incumbent is reelected, these funds may need to reenter the market likely driving prices sharply higher. If the challenger wins, the investable funds will probably stay on the sidelines and potentially increase, offering little support to stock prices.

Probably all market sectors that will be affected by the election outcome. Some more, others less. To some extent there has been some adjustment already, although market forces are dominant.

The bulls have been running with the large capitalization indexes, active management has been unable to keep up. A continuation of the status quo suggests maintaining this strategy, with some modification. A change in policies makes reinvestment more challenging.

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The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market. The Relative Strength Index (RSI), developed by J. Welles Wilder, is a momentum oscillator that measures the speed and changes of price movements. The U.S. Treasury Bill Index is an index based on the auctions of U,S. Treasury bills, or on the U.S, Treasury's daily yield curve. It is commonly used in determining mortgage rates for mortgages with an unfixed component and as a performance benchmark for investors in the capital markets as it represents a rate of return that investors would be able to get from almost any bank, with minimal effort. Treasury indexes are proprietary. The calculations of treasury indexes and their components vary by the financial institution calculating the index. The Commodity Research Bureau (CRB) Index acts as a representative indicator of today's global commodity markets. It measures the aggregated price direction of various commodity sectors.

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