

Q3, the U.S. Election and What to Expect for the Year Ahead
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Global activity as measured by home sales, industrial production and aggregate employment levels showed further signs of improvement over the third quarter. Near-term sequential progress continued to rise as coronavirus-related restrictions on routine activities were lifted. While the worst of the recession appears to have passed for the U.S. and Europe, activity levels remain well below full potential while several high-profile biotechnology and pharmaceutical companies work diligently on a vaccine.

When the U.S. economy began reopening in April, consumer sentiment began to improve significantly. This trend typically begins during recessions and lasts into the early cycle phase. Industries most directly impacted by the virus, such as hospitality, travel and restaurants accounting for roughly twenty percent of U.S. jobs and economic output may remain difficult to fully rebound until a vaccine is approved and widely distributed. Meanwhile daily Covid-19 related deaths continue to fall in most countries as the virus runs its course and medical professionals learn to deal with the disease more effectively.

Despite a sharp correction in September (-3.59%), the MSCI World Stock Index ended the quarter higher (+7.52%), helped by stronger earnings revisions, a weaker dollar and low bond yields. Quality stocks edged out growth stocks in Q3 and in September too. Value continued to lag during the quarter as it has for some time. On a sector basis, cyclical stocks were the winners, and energy the losers over Q3.

During Q3, the bond market remained relatively stable after a volatile first half of the year. The Treasury yield curve steepened slightly with short term yields moving lower and long-term yields rising modestly. Corporate spreads continued their tightening trend in July and then flattened in August and September. Overall, the spread between the BBB rated bonds and the ten-year Treasury has narrowed by about 20 basis points during the third quarter.

During the annual Jackson Hole Symposium in August, Fed chairman Jerome Powell adopted a dovish tone on policy outlook. Powell announced the change to the committee's policy statement on inflation, where they will allow inflation to run above 2% once the economy improves. The Fed intends to maintain the long-term average of 2% price increases. Powell's shift in his stance on inflation signals that interest rates will likely remain low for many years. In both the July and the September FOMC meetings, policyholders voted to maintain the Fed Fund target rate at the 0 to 25 basis point range.

With the U.S. election just a few weeks away, investors are focusing on possible outcomes and how they might affect their portfolios. Market observers may remember the wild price swings which occurred in the weeks before and after the 2016 election. Four years ago, President Trump disrupted both the Republican Party and ultimately the American government with unconventional populist policies directed towards helping middle-class Americans left behind during the prior eight years of the Democratic presidency.

Setting the stage for this year's runoff is a resurgent, but still wobbly U.S. economy shaken by the global health crisis. Currently, the U.S. unemployment rate stands at an elevated level of 8.4% with over 12 million Americans getting by on weekly unemployment checks. The U.S. gross domestic product (GDP) is running at an annualized rate of almost ten percent below last year's level.

Disruption and transformation have been the hallmarks of this millennium and now the tide is changing on both the political and macroeconomic economic fronts as the virus disrupts everyday life. Voters must soon decide which party best represents both their economic and personal health interests.

On the economic front, some market strategists are predicting that increased government spending under a Biden administration could help offset lower corporate earnings as taxes are inevitably raised. Others believe a major shift in the presidency and possibly even the Senate would be a near-term headwind as investors generally dislike uncertainty. Most likely, will be further sector rotation within the major averages. For example, the healthcare and energy industries could be broadly impacted by new policies on regulation and pricing.

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Expect a Biden team to protect the Affordable Care Act (ACA) while attempting to offer a public health option which covers primary care with little to no co-payments. Medicaid could also be expanded to states which did not initially step up under the ACA. With more people covered under Medicaid and Medicare, government programs could then begin to negotiate healthcare prices lower – a key initiative of the Democrats. Other cost containment measures may include having an independent review board monitor and make recommendations on specialty pharmaceutical costs and placing caps on existing drug prices. In short, the healthcare sector would face increased scrutiny, higher costs and lower prices. On the other hand, volumes might improve as more people gain access to the system.

The Democrats also desire to revolutionize America's energy sector by reducing fossil fuels and increasing reliance on alternative energy. Biden would likely remove tax deductions for oil and gas companies while reinstating the electric vehicle credit. Infrastructure could also see a boost in the event of a Democrat sweep. Biden wants to spend \$1.3 trillion over ten years paid for by raising taxes on high earners. However, the top one percent of U.S. earners already pay 40 percent of the country's taxes and a move against the country's most industrious citizens could result in lower productivity - a negative for real GDP growth.

Overall, risk markets would probably perform better after a Trump victory given his more pro-business policies. Traditional GOP favorites such as the defense industry, energy and banking would benefit from this outcome. Above all, I favor innovative companies with strong management teams who are able to withstand the slings and arrows inevitably coming from both sides of aisle. In the near term, investors are concerned about a hung election where neither party concedes on election night. Analysts consider this a likely outcome as many Americans will choose to mail in votes. Expect allegations of miscounts and election fraud to surface in the event of a tight race.

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Stock Market Performance

	10/12/20	W-o-W	M-o-M	Y-o-Y
DJIA	28,714	2.0%	3.8%	7.1%
S&P 500	3,477	2.0%	4.1%	17.1%
MSCI World	2,448	1.8%	3.4%	12.3%
S&P/TSX	16,563	0.9%	2.1%	0.9%
BSX	1,832	4.1%	-0.3%	-10.0%
FTSE100	6,012	1.2%	-0.3%	-17.0%
DAX	13,111	2.2%	-0.7%	4.8%
CAC	4,979	2.2%	-1.1%	-12.1%
Nikkei	23,559	1.1%	0.7%	8.1%
Hang Seng	24,650	3.7%	0.6%	-6.3%
Shanghai	3,358	4.4%	3.0%	12.9%

Key Rates and Prices

Currencies	10/12/20	Month ago	Year ago
EUR	\$1.18	\$1.18	\$1.10
GBP	\$1.30	\$1.28	\$1.27
JPY	¥105.37	¥106.16	¥108.29
CAD	\$0.76	\$0.76	\$0.76
CHF	\$1.10	\$1.10	\$1.00
AUD	\$0.72	\$0.73	\$0.68

Fixed Income

3M LIBOR	0.22	0.25	2.00
3M Treasury Bill	0.10	0.11	1.67
2Yr Treasury Note	0.16	0.13	1.60
10Yr Treasury Note	0.78	0.67	1.73
Fed Funds Rate	0.25	0.25	2.00

Commodities

Gold/oz.	1,921.52	1,940.55	1,489.01
Silver/oz.	25.01	26.73	17.54
Copper/lb.	3.07	3.06	2.63
Oil	39.98	37.33	54.70

Global Economic Calendar (October 12th - October 16th)

Mon:

Tues: Redbook (US); NFIB Small Business Optimism Index (US); Treasury Statement (US)

Wed: MBA Mortgage Applications (US); EIA Petroleum Status Report (US); Atlanta Fed Business Inflation Expectations (US)

Thurs: Jobless Claims (US); Money Supply (US); Fed Balance Sheet (US); EIA Petroleum Status Report (US); EIA Natural Gas Report (US)

Fri: Bakers Hughes Rig Count (US); Treasury Intl Capital (US); Retail Sales (US); Business Inventories (US)

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