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MARKET COMMENTARY October 27, 2020

Dow Jones Industrial Avg.	27,781.70	Standard and Poor's 500	3363.00
2020 (YTD) -2.7%	3rd Qtr. +7.6%	2020 (YTD) +4.1%	3rd Qtr. +8.5%

"What lies behind us and what lies before us are tiny matters compared to what lies within us." Ralph Waldo Emerson

Dark Skies Loom - A hotly contested Presidential election will be completed in one week, yet unlike the historical norm the results may not be finalized for days or even weeks after election day. Indeed, there is a distinct possibility there will be legal challenges to the counting and validity of the unprecedented volume of mail-in and early ballots. To add to the tension surrounding the election, both campaigns have been disrupted by the country's efforts to cope with the devastating effects of the Covid-19 virus. Although this has impeded the in-person appearances of both candidates, it has had a more detrimental impact on the President's campaign because of his preference for large gatherings or rallies. He also suffered a setback when his campaign schedule was interrupted when he contracted the virus. On the other hand, the former Vice-President (V-P) Biden and his advisors have been able to maintain a low-key approach because polls have consistently shown him to have a lead approaching double-digits. V-P Biden's low-profile approach must remind Democrats how similar it is to the tactic employed unsuccessfully by Hillary Clinton in 2016. Although it may make some Democrats uneasy, it likely gives the President cause to believe he can still prevail.

The Final Face-off – The two candidates have met for their second and final debate. To many voters, the first debate left much to be desired, so both candidates were wise to spend time describing what goals they have for the country if they are victorious. Neither candidate provided a compelling vision in their first debate. Sadly, the moderator, Chris Wallace, allowed the exchange to deteriorate into a free-for-all. Given the stakes, each candidate attempted to take advantage of their final opportunity to convince voters he should be their choice on election day.

A Blue Wave? – Many voters are unaware there are two critical contests of national importance on the ballot next week. In addition to the Presidential contest, there are 36 Senate seats being contested in one-third of the states. If the Republicans lose their slim majority and former V-P Biden is successful, the 'blue wave" will be achieved, which means the Democrats would have control of the Presidency as well as both houses of the Congress. This means there would be a high likelihood they would attempt to pass transformational liberal/progressive programs, which are part of their party's platform. Voters must remember adding some of these programs promises to be quite costly, and this will be added to the many TRILLIONS of dollars already being spent to compensate for the economic impact of the virus. The true cost of this profligate spending and the associated debt will become clear as interest rates begin their inevitable rise. Our country is approaching an inflection point reminiscent of the experience in the early 1980's when interest rates began their long secular decline. Now a reversal of that trend is in the offing. If there is a protracted rise in rates, it will cause an explosion in debt service costs and cause havoc with the federal budget. With no wiggle-room in the budget, new initiatives will be hard to justify, in fact it may mean sizable cutbacks to existing programs. Can you imagine if politicians have to prioritize their spending and make some difficult decisions? Would they be able to do that?

My Choice – From the perspective of an economist and an investor, neither candidate has convinced me they deserve my vote. President Trump has shown he can spend with the best of them. After signing, with no hesitation, the first three trillion-dollar coronavirus relief package, he has continually relented to meet House Speaker Pelosi's outlandish $2,000,000,000,000,000 demand. Recall the great negotiator's initial position was one trillion dollars, yet his latest number is $1.8 trillion … and more is possible. Some negotiator! He has demonstrated throughout his real estate career that he regards debt as an indispensable tool. The President has done nothing to reign in this country's unprecedented deficit spending, yet still is promising to cut taxes. He just cannot resist.

Former Vice President Biden's plans are equally unsettling. He blames the President for the pandemic and its impact on the economy, but he has made it clear one of his first priorities is to increase taxes. He claims his targets are those earning more than $400,000 and corporations, which he regards as the primary beneficiaries of the President's major tax cuts of a few years ago. The questions are "Is it wise to raise taxes when the economy is struggling to recover from the virus-related recession?" and "Will increasing corporate taxes retard the recovery of businesses and employment?" Former VP Biden has indicated he would not hesitate to close businesses again if he felt the virus reached unacceptable levels. As with the President, he has exhibited no concern for the alarming level of the national debt and deficits, instead he has indicated a desire to propose large, new spending programs for infrastructure and green energy,

Investment Implications – Until the outcome of the election is clear, the longer-term prospects of the economy remain undefined. However, between now and the end of the year the economy is expected to continue its upswing unless the second wave of the virus asserts itself. Unemployment has continued to decline, and consumer sentiment remains surprisingly strong. Investors have been nonplussed in the face of the pandemic-related slowdown and all the noise emanating from Washington about the size and timing of the next virus aid package. As the days grow short the unease resulting from the Presidential campaign has intensified. Stock prices have remained near all-time highs with occasional bouts of price weakness. Given the third quarter earnings reports, it appears likely the NASDAQ and the S&P 500 will finish the year solidly in the black, while the Dow Jones Industrials have continued to struggle to make it into positive territory. Once the Presidential victor is declared, investors will adjust their portfolios to reflect some of the policy changes mentioned earlier. As has been the case since late March, investors have had to contend with a bifurcated market with a small percentage of high tech stocks soaring in price while the vast majority of stocks haven't been able to achieve any meaningful gains. Expect further churning actions over the next several months until our next President is in office and the plans for his administration are made clear.

Allocation Challenges – As the end of the year approaches, it is wise to consider rebalancing one's portfolio. One long range trend presents a particularly perplexing challenge. What adjustments can be made to compensate for the extended decline in interest rates? A common middle-of-the-road portfolio allocation was 40 percent bonds and 60 percent stocks. The bond portion was meant to provide income, safety and be a stabilizing factor. Now for many portfolios, fixed income provides less income than an S&P 500 fund or ETF. Many retired investors have felt compelled to overweight stocks to have the possibility for capital gains to supplement the modest dividend income they receive. However, this has exposed them to the added risk and volatility associated with owning equities. In order to reduce the risk of having an overweighting of stocks in a portfolio, investors must consider expanding their horizon by considering the inclusion of uncorrelated asset classes, such as real estate, overseas markets, precious metals, other commodities, or even cryptocurrency (e.g., Bitcoin). It is prudent to reduce exposure to the domestic market, and particularly to the heavy concentration in high tech stocks. It will also increase diversification and reduce volatility while helping to boost income as well.

Call us if this approach interests you and we will sit down with you to discuss if it is appropriate for your circumstances. Also, at this time we would normally remind you of your required minimum distribution (RMD) but due to Covid-19 the IRS has waived all RMDs from retirement accounts. Make sure to vote, and then get ready for an enjoyable holiday season even if we are all in "lock down". JML