Market Commentary

October 2020

Equity and Bond Market Update

(as of October 7, 2020)

Index	YTD	1-Year
Dow Jones Industrial Average TR	+1.0%	+9.5%
S&P 500 Total Return Index	+7.4%	+18.6%
Russell 2000 Total Return Index	-2.4%	+9.1%
MSCI EAFE Index (net)	-5.6%	+3.4%
MSCI Emerging Markets Index (net)	+1.2%	+14.0%
Barclays US Aggregate Bond TR	+6.4%	+6.0%

Economic Indicators

	Statistic	Data as of
Unemployment Rate	7.9%	Sep 2020
Gross Domestic Product (GDP)	-31.4%	Q2 2020
Consumer Price Index (CPI)	+0.4%	Aug 2020
Consumer Confidence (1985=100)	101.8	Sep 2020
30-year fixed mortgage rate	3.08%	10/2/2020
Housing Starts (single family)	1,021,000	Aug 2020
10-Year Treasury Yield	0.76%	10/6/2020

Equity markets began recovering from a three-week pullback during the last week of September, and have continued strongly to the upside through the first week of October. At this point, all major indices are in the black for the last twelve months, but October has historically been the most volatile of all months, coming in 36% more volatile than the historical monthly average. With the U.S. election right around the corner and over 5 million voters already casting their votes, the next few weeks may be a back-and-forth battle on a daily basis.

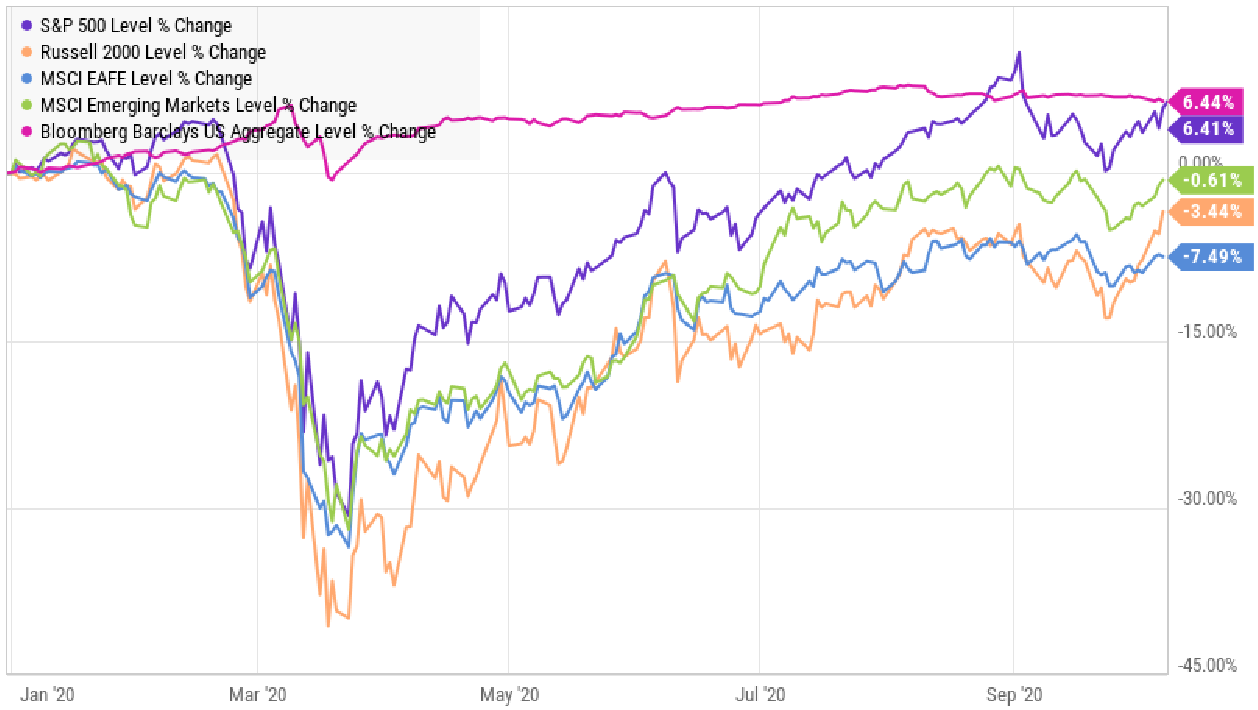
Historically in election years, when the S&P 500 is in positive territory from July 31 through election day, the incumbent party has won. When the market is in negative territory during this period, there has only been one time when the incumbent party has won. So far this year from July 31st, the market has advanced over 5%, so that is a positive for Republicans. On the other hand, there has only been two times out of eleven (or 18%) since 1940 when the current incumbent presidential party has won the election when the president had an approval rating below 50. President Trump's current approval rating is 45. There are quite a few other offsetting statistics that show this election will turn out to be unlike any other, just like the entire year of 2020.

It may be a surprise to some that the stock market performs better under Democratic presidencies, by a margin of +11.1% versus +6.9% annually for Republican administrations (since 1944). However, the House of Representatives controls the purse strings of the U.S. government, and when tracking the stock market by which party controls the House, we get the opposite outcome, with Republicans delivering +10.5% versus +7.9% for Democratic majorities. At this point, it would be quite a feat if Republicans were to take both houses of Congress in this election, with 232 of the current 435 total House seats belonging to Democrats. Since 1944, the best performing mix of control between the President and Congress has been a split Congress with a Democratic President at +13.6% per annum. Many political analysts are expecting this to be the most likely resulting scenario from this election.

We already have seen over three and a half years of policies put in place by the current administration, so we will not focus so much on what that expectation would be. During the period since Trump's inauguration on January 20, 2016 to today, the best performing broad sectors were Information Technology, Consumer Discretionary, and Healthcare; the worst performing were Energy, Real Estate, and Communications Services. The vast majority of the differences in all sectors of the U.S. economy have come since we saw the pullback in the fourth quarter of 2018.

So where should our focus be if there is a Biden win? First, a Democratic sweep of both the Presidency and both houses of Congress would translate into easy passage and implementation of most of the hot topics we have been hearing from that side of the aisle. An increase in corporate and personal taxes, a wave of sustainable energy initiatives including infrastructure projects, healthcare re-reform (spelling intentional), and rolling back of Trump-era deregulation policies back into place, just to name a few. Economy-wide, the most negative impact would come from increases in the corporate tax rate from the current 21% to 28%. All sectors of the U.S. economy would be affected by this, but the ones that benefitted the most from Trump's Tax Cuts and Jobs Act of 2017 would be hurt the most: Communications Services, Utilities, Consumer Discretionary and Financial Services.

Major Market Indices Price Return (YTD as of October 7, 2020)



On the other hand, a unified Democratic Congress and administration would eliminate some of the gridlock we have unfortunately seen under the current mix of government. On the positive side, this would mean easier passage of secondary stimulus legislation that has been holed up currently in Congress through negotiations with the current administration. Again, no matter what you agree or disagree with regarding ongoing stimulus that the U.S. economy and workers desperately need in the midst of ongoing shutdowns, this scenario would at least streamline the process.

Prior to passage of the Affordable Care Act (Obamacare) in 2010, the uninsured rate was 18.2% in 2010, and then 16.6% in 2013 (prior to the Act's full roll-out). After passage of the ACA, the uninsured rate went down to 10.4% in 2016, and then started ticking up to 12.1% by the end of 2019. If there is a concerted effort to put certain provisions or ideas back into place from the ACA, or expand healthcare coverage in other ways, the uninsured rate would presumably again start to tick down. This would be good for the Healthcare sector which was in the top 50% of all major sectors each year running from 2011 – 2015. The managed care industry would most likely benefit, which would include all the major health insurance companies, but pharmaceutical companies may see pressure..

We have already seen the energy sector suffer from the COVID-19 pandemic and economic shutdowns, and continue to see the sector extremely weak through the market recovery that started in late-March. Although the sector was very strong coming out of the market low in March, it has consistently been moving down since early June while the remainder of the market has either gained or at least held its ground. One logical reason behind this underperformance may be that the market is giving us its own view of who will win the presidency. Obviously, traditional oil and gas will not be in a good position under a Biden presidency. There has been a lot of talk lately about what has (and has not) been said about topics like fracking, tax credits for "green" sustainable energy initiatives, extended tax credits for consumers buying electric cars, timelines for net-zero emissions, etc., but it is most obvious which way a Biden administration would be leaning.

On the other hand, companies in industries classified as strong in "ESG" principles (with the E standing for "Environmental") would be a good place to focus, such as renewable energy, electric automobiles, clean technology, materials and electronic waste, and raw material sourcing, among many others. One last caveat, the government fallout for a full-blown green initiative by a new administration does not come without a hefty cost. The American Action Forum estimated that the proposed Green New Deal could cost between $51 - $93 trillion over the next ten years. That's $600,000 per U.S. household. The low estimate of that number is twice as much as the national debt we have encompassed over more than 100 years. The cost alone will most likely involve quite a bit of pushback on many green initiatives from both sides of the aisle.

Some last few words…

We all have different views of how we see the world, especially the one in which we are most invested, the United States. Along with that, obviously, comes different views on how, and by whom, our great nation should be led. None of the information and ideas in this commentary are by any means predictions, but simply things to think about as we come closer to, and surpass, November 3rd and the weeks thereafter.

Keep a few things in mind as we go through the next month:

1. First, and foremost, your investment objectives and strategies do not have a shelf life of one month. If you have a time horizon of anything less than three years, more importantly just one month, then you should already have your investments positioned to reflect this.

2. No matter what the political makeup of our legislative and administrative branches of government have been (Unified party government; Unified Congress with contra-party president; or Split Congress), on average, there has NEVER been a period where we experienced negative returns. There may have been single years where we have seen this, but even the worst performing market scenario (Republican president with a unified Democratic Congress, which has taken place in almost 30% of the years since 1944), we experienced an average annual return of +4.9%.

3. We could see a strong November-December rally if Trump wins re-election, and exactly the opposite if Trump loses. However, in similar historical scenarios the negative sentiment involving a change in the resident party of the White House has often reversed in the post-election year.

4. Lastly, do not forget that the Federal Reserve has just short of explicitly guaranteed that they will keep interest rates at zero for the foreseeable future, no matter what the political climate eventually is. Even if inflation does creep back into the scenario, the Fed will most likely allow the rate to run over their comfort level of 2% to "make up" for the low inflation environment we have experienced for many years. Whether this is a good policy or not, we can be assured that they will be very accommodative to returning to pre-COVID U.S. growth and GDP levels.

Always keep in mind that fear, panic, and optimism are not investment strategies, but rather emotions that drive short-term markets.

Please contact Lifestyle Asset Management, Inc. at (281) 612-2035 or by email at **pjackson@lsaminc.com** should you have any questions or comments.

Sources:

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