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October 1, 2020

This past quarter saw substantial improvements in the underlying domestic economy (GDP estimated up 25%) as well as equity returns (S&P 500 up 8%). Consensus expectations suggest continued positive economic progress over the next 12-24 months although at more modest levels of growth. The Covid-19 virus will remain the most impactful variable, but given the expectation that a successful vaccine will become available for widespread distribution by the summer of 2021, we believe additional negative Covid impacts on the economy will be somewhat limited and manageable. Federal stimulus and monetary policies in place should continue to support our economic transition to a post-Covid environment.

Despite apparent excesses in the valuations of some equity market leaders (the FAANGS plus a few others), many areas of the overall market (e.g. financials, industrials, healthcare & retail) still offer reasonable valuations and attractive future prospects. We appreciate the importance of dividends and especially dividend growth holdings in our clients' portfolios. Management discipline prioritizing dividend growth throughout the business cycle produces an enterprise that is inherently more stable in weaker economic periods. These types of businesses also have the financial flexibility to then strategically address evolving economic environments to improve their relative competitive position. We found dividend growth to be especially helpful in our clients' portfolios during the financial crisis a decade ago, and it contributed to our outperformance in the years following the crisis.

We also believe that business confidence will soon be verbalized by more companies and demonstrated by increased capital investment. Investors have been left in the dark over the past two quarters as companies stopped discussing their expectations for the future. Business leaders are likely to be more confident in the future directions of their businesses especially since they will be generating increasingly higher levels of cashflow each quarter. This should also help investor confidence and potentially lead to increased investor interest in many of the underappreciated areas of the current market.

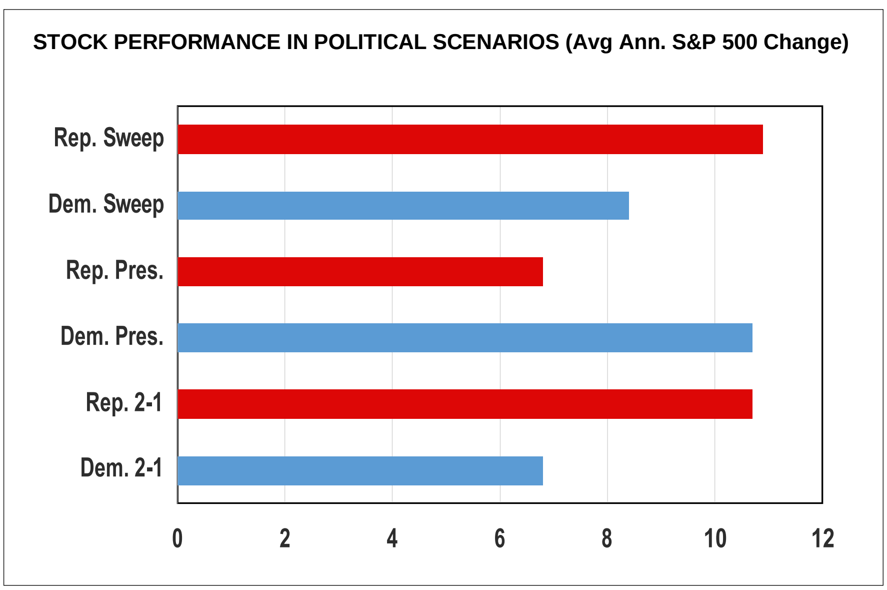
We expect this relatively positive macro outlook to take place while the Covid virus continues to inflict devastating damage at the individual level. It's naïve to expect the number of infections and global deaths not to eventually double from current levels. And as we have mentioned before, survivors and many others will be facing more dire personal circumstances. It will remain difficult on the streets even if macro trends have improved.

In this somewhat conflicting macro and micro description, a famous metaphor from Abby Joseph Cohen of Goldman Sachs is helpful. She refers to the US economy as the supertanker economy. Times may currently be rough but the supertanker has already begun its turn; and the economy should only improve as the supertanker plods its way towards a calmer, more normal world.

The election analysis below comes from our friends at Argus Research, who recently published this summary of stock performance in various political scenarios over the past 75 years. The conclusion is that while elections matter and have consequences on policies, etc.; stock market performance has historically not been affected greatly by election outcomes.

From Argus:

Investors are nervous as the U.S. presidential election approaches. The S&P 500 is about 10% below its all-time highs. The VIX Volatility Index is back up near 30. The popular Wall Street wisdom is that the best outcome in Washington is gridlock. Investors perceive that when one party has hegemony — which we define as controlling the presidency, House, and Senate simultaneously — ideology supplants pragmatism and compromise; expensive and impractical legislation is passed; and the market suffers. Our analysis of S&P 500 performance since 1945 does not substantiate that widely held perception, however. Our work suggests that the market has actually outperformed in years in which one party prevailed, though the results fail to establish a clear pattern. We start with the base-line annual average market performance since 1945 of 10%. Political scenarios that topped this average included a Republican president and Congress (+11%), and Republicans controlling the White House and either the House or the Senate (+11%). But, in years in which the White House was occupied by a Democrat, stocks also outperformed (+11%). Heading into this election, current odds favor a Democratic president, a Democratic House and a toss-up for the Senate. At stake is a party's ability to set tax and fiscal policy and a trade regulatory agenda, while also selecting the Cabinet and members of the Federal Reserve. Indeed, there's a lot on the line.



Argus Research Company, "Daily Spotlight: DC Gridlock is Overrated", September 28, 2020, page 1.

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