The Great Reset

As per Henry Clay, A good compromise is when both parties are dissatisfied with an outcome. And we believe this is how the recent election has left many voters. But maybe, this mutual dissatisfaction will turn out to be a good compromise for our nation. **We call it the Great Reset.**

Last week, we outlined our near-term expectations for capital markets based on several election outcome scenarios in conversations with clients.

Like many, our most likely expectation was a blue-wave or inflation trade. Here, significant COVID relief stimulus and the desire of Democratic lawmakers to push through outsized spending measures would ultimately resuscitate economic growth. This could support Cyclical stocks, or companies and industries that are tied to Financials, Materials, Chemicals, and Industrials. In this scenario, Value oriented stocks (or stocks trading at depressed prices relative to their dividend, earnings, or sales potential) could outperform growth (or stocks that trade in excess of current earnings, dividend, or sales fundamentals) as interest rates and bond yields could generally increase. Unfortunately, the economic consequence is the need for greater tax revenue, provided through higher personal, corporate, and estate taxes. Remember, stimulus is nothing more than spending without offsetting income. And the concern of significantly higher taxes (corporate and capital gains) was the basis of our "big mistake/little mistake" argument in recent months, which suggested clients take a more conservative stance toward current market valuations (both equity and fixed income alike).

The second outcome we discussed was a divided government scenario, whereby Biden becomes President, whilst the Senate remains under Republican control. Here we suggested that capital markets should expect more of the same. While government expenditures could be more constrained, given the Senate may be less inclined to approve outsized spending, the Federal Reserve could eventually step in and provide the needed liquidity (through monetary stimulus) that Congress could or would not. As a result, Technology related stocks and Growth oriented sectors could once again find support as interest rates, bond yields, and inflation would remain subdued.

The third and most unlikely outcome was that Trump would remain President, but both the lower and upper houses of Congress would be under Democratic control. This was the Armageddon scenario and a significant tail risk (low probability) in our view, as any legislative progress could come to a grinding halt, and capital markets could enter a tailspin.

Well, as we know now, our base case (blue wave) scenario played out until about 7 pm on election night, at which time a violent shift unfolded. Driven by potential Trump victories in crucial battleground states, alongside the re-election of once-vulnerable Republican Senators, prediction markets were turned upside down, flipping an almost 30-point Biden lead to Trump.

As a result, equity futures rallied. The 10Yr Treasury yield came in (yield down, bond price higher). The inflation trade turned into a deflation trade, and investors who were caught short in NASDAQ heavy Technology names started to (and continue to) cover positions. In early trading on Wednesday, the S&P 500 was up by over 3%, while the 10Yr TSY began a descent from as high as 0.93% the night earlier to close the trading session at 0.77%. These trends continued through Thursday, as the S&P finished up another 1.95%

So now what? At the time of writing this note, Biden is only four Electoral College votes from becoming President-Elect, and the door for President Trump is almost shut. But despite the presumed "divided government" deflation trade (scenario 2 above), we believe the path forward for the economy and capital markets will still be the inflation

NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

trade (scenario 1 above), just not as robust and not as rapid. And the key now will be the sequencing of the recent uptick in COVID transmission and an eventual medical solution.

Based on our research, we feel a viable and effective vaccination is closer than many believe. There are 11 coronavirus vaccine candidates in phase 3 trials and 49 in earlier stages. Pfizer has said its vaccination candidate could still secure emergency use authorization late this month. Moderna has indicated its candidate could get emergency use authorization in December. And AstraZeneca has said its late-stage trials for the COVID-19 vaccine it is developing with the University of Oxford are on track to produce results later this year, with a potential rollout soon after. Further, there are at least 78 antibody therapeutics for COVID-19 in various development stages around the world. So, as we learn more and more about this disease, together with therapeutic advancements and vaccination progress, we expect the economy to restart in earnest by early Spring 2021.

Given this thesis, we expect a "Bear-Steepener" environment will emerge, whereby interest rates, overall, could generally increase (albeit modestly). At the same time, the short end (Fed Funds Rate) may be anchored in-place the by the Federal Reserve. In this "reflation" scenario, expect Industrials, Materials, and Financials to outperform. These sectors could also benefit as: 1) the Senate may be willing to push through COVID stimulus sooner rather than later, and 2) an infrastructure bill is the ultimate kumbaya legislation following a contested election and in advance of mid-terms. From a credit (bond) perspective, we expect that Governments may underperform Credit, so expect Preferred Equities, short-duration BB Corporates, and even Convertible Bonds to outperform.

For investors with large stockpiles of cash on the sideline, we continue to advocate dollar-cost averaging in the near-term, as markets remain fluid. Longer-term investors should consider starting to peel back fixed-income exposure and slowly bolt-on risk-appropriate equity positions. We'd love to hear your thoughts.

Disclosure: The information in this publication and references to specific securities, asset classes and financial markets are provided for illustrative purposes and do not constitute an offer to sell, or solicitation of an offer to purchase, any securities, nor does they constitute an endorsement with respect to any investment area or vehicle. This material serves to provide general information to clients and is not meant to be legal or tax advice for any particular investor, which can only be provided by qualified tax and legal counsel. Certain information contained herein is based on outside sources believed to be reliable, but its accuracy is not guaranteed. Investment products (other than deposit products) referenced in this material are not insured by the FDIC (or any other state or federal agency), are not deposits of or guaranteed by Northeast Private Client Group, and are subject to investment risk, including the loss of principal amount invested. Portfolios are subject to investment risks, including possible loss of the principal amount invested. In addition, foreign investments may be less liquid, more volatile and less subject to governmental supervision than in the United States. The values of foreign securities can be affected by changes in currency rates, application of foreign tax laws, changes in governmental administration and economic and monetary policy. Investors should consider the investment objectives, risks, charges, and expenses of ETFs carefully before investing. This and other information are contained in the fund's prospectus, which may be obtained from your investment professional. Please read it before you invest. Investments in ETFs are subject to risk, including possible loss of the principal amount invested. This information is being provided to current Northeast Private Client Group clients and should not be further distributed without Northeast Private Client Group's approval. S&P 500 Index is a market index generally considered representative of the stock market as a whole. The index focuses on the large-cap segment of the U.S. equities market. Dow Jones Industrial Average is a widely used indicator of the overall condition of the stock market, a price-weighted average of 30 actively traded blue chip stocks, primarily industrials, but also includes financial, leisure and other service-oriented firms. Russell 2000 Index measures the performance of the smallest 2,000 companies in the Russell 3000 Index of the 3,000 largest U.S. companies in terms of market capitalization. NASDAQ Composite Index is a market value-weighted index that measures all NASDAQ domestic and non-U.S. based common stocks listed on the NASDAQ stock market. Each company's security affects the index in proportion to its market value This commentary contains forward-looking statements and projections. Actual results may differ from current expectations based on a number of factors including but not limited to changing market conditions, leverage and underlying asset performance. Northeast Private Client Group makes no representation or warranty, express or implied that this information shall be relied upon as a promise or representation regarding past or future performance. This material contains the current opinions of the author but not necessarily those of Guardian or its subsidiaries and such opinions are subject to change without notice. Past performance is not a guarantee of future results. Indices are unmanaged, and one cannot invest directly in an index. Data and rates used were indicative of market conditions as of the date shown. Opinions, estimates, forecasts, and statements of financial market trends are based on current market conditions and are subject to change without notice. Securities products and advisory services offered through Park Avenue Securities LLC (PAS), member FINRA, SIPC. OSJ: 200 Broadhollow Road Suite 405, Melville, NY 11747, 631-589-5400. PAS is a wholly-owned subsidiary of The Guardian Life Insurance Company of America® (Guardian), New York, NY. Northeast Private Client Group is not an affiliate or subsidiary of PAS or Guardian. **2020-111867 Exp. 2/21**