Baird Market and Investment Strategy

Stock Market Update

July 22, 2020

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Please refer to Appendix – Important Disclosures.

Thoughts on risks and portfolio management in advance of the Presidential Election

We've had a number of inbound requests for our thoughts about the November elections and possible portfolio implications. This is what we have been sharing:

A few thoughts on the upcoming presidential election:

1. The market doesn't tend to really focus on election outcomes until September (typically after both conventions and the Olympics). While the situation might be somewhat different in 2020 given the scaled-back conventions and the absence of the Olympics, we still think it is early to be too focused on whether the market is considering election outcomes.
2. A larger point is that the market is not likely to react much to the outcome of the presidential election one way or the other this time around assuming the outcome is pretty clear. A hung state (like Florida in 2000) could cause problems but otherwise we don't think there will be that much of an impact overall. The risk of social tensions being exacerbated in the run-up (and wake of) the election seems to be rising. While not specifically actionable right now, it is something to keep in mind as we head toward the fall.
3. Even if there is a Democrat sweep, raising taxes in the near term is not likely to be a high on the agenda item. Rather it might be a leverage point to push changes on things like CEO compensation or share buybacks.
4. In terms of specific outcomes, it might be useful to remember that over the past 100 years, stocks have fared a bit better under Democrat presidents than under Republican presidents, on both a nominal and after-inflation basis.

While election concerns may seem like a reason to become more conservatively positioned, the truth is there are often any number of reasons that we could come up with to temporarily reduce equity exposure. Without a robust framework for considering portfolio risks/opportunities, chances are we would just go from one thing to the next. We want the evidence to drive the conclusions and not let narratives determine what we see. It may be appropriate to tactically reduce equity exposure later this summer/fall, but right now the overall weight of the evidence remains tilted in favor of the bulls.

More broadly, we believe firmly that a robust financial plan should take into account the reality that investment risk and investor risk tolerances fluctuate over the course of a market cycle. This argues for building dynamic asset allocation levels (i.e., allowing for higher levels of equity exposure when the weight of the evidence in bullish and lower levels of equity exposure when the weight of the evidence is bearish) into a financial plan. We discussed this and other asset allocation considerations in our latest Investment Strategy Outlook (published earlier this month).

By way of example, here are the latest updates from the Tactical ETF portfolios, which we manage for Baird clients. The improvement in the weight of the evidence in May allowed us to increase overall equity exposure while maintaining diversified exposure within the US and around the world. We can stay in harmony with the message of the market (even if we have specific concerns) and allow overall diversification to help manage risk. If the weight of the evidence changes and/or new leadership trends develop, we will adjust our portfolios accordingly.

Tactical Allocation Portfolio: https://bit.ly/2Os8FLd
Tactical Equity Portfolio: https://bit.ly/2Wnam0N
Tactical Opportunity Portfolio: https://bit.ly/2ZwSqDa
Tactical Yield Portfolio: https://bit.ly/2OuUkxL

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