PCG Capital Market Chronicle

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NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

Objects In Mirror Are Closer Than They Appear

Our nation is now only 11 days from the 2020 elections. Last night the country endured the second and final debate between President Trump and former Vice President Biden. Despite a more policy-oriented and orderly discussion, we believe few, if any, potential undecided voters have reassessed intentions. Prediction markets continue to suggest Biden is 24 points ahead of Trump, while more traditional polling data give Biden a more modest 8-point lead.

But we remind investors that back in 2016, 11 days before the election, prediction markets gave former Secretary of State Clinton almost a 75-point margin over then-nominee Donald Trump. Further, more traditional polls put the odds of a Clinton Presidency at over 70%, and as high as 99%, with as much as a 4-point lead 11 days before November $8^{th,}$ 2016. So as our title suggest, come November 3^{rd}, we believe many elections, including the White House, may be closer than they appear. And just like in a car, investors need to proceed with caution.

As a result, we continue to field calls from clients seeking direction in what is perhaps the most uncertain period for investors since the beginning of the COVID pandemic. On the one hand, increased COVID relief measures, as well as other government fiscal spending programs could work to support owners of small and medium-sized businesses. And while an increase to the minimum wage could help drive disposable income higher and further support growing retail sales, it is unclear how a nation-wide minimum wage increase would impact small business owners who are already struggling to make payroll. Also, a "blue wave" could increase individual, corporate, and capital gains taxes, which could limit spending, suppress profit margins, and cause owners of equities to sell down stocks (more so than during the typical tax-loss harvesting at year-end). But it is unclear how quickly the TCJA of 2017 would be eliminated or if there would be a phased sunset and thus allowing for fiscal stimulus to take hold.

Adding to these considerations, if polls start to tighten again, markets could begin to re-price the notion of a contested election. As a reminder, the 2000 Bush/Gore court battle cost investors as much as 8-9% in the S&P 500. So with only 11 days left to election day, we are finding our crystal ball is not so crystal clear, and the decision tree associated with election outcomes and investment opportunities has added several branches. Equity volatility has ticked higher since the beginning of the month and is almost 2x that of pre-COVID levels. Also, the 10Yr TSY has backed-up to about 0.85%, which is the highest level since June 2020.

Earlier this month, we suggested that the near-term vector for the equity market was higher, and S&P has done just that. But we also emphasized the "near-term" nature of our trading call. Now we sit 11 days away from an election, which may introduce clear and quantifiable economic and capital market risk. So now we take our trader hat off, and put on our green eyeshades, as we try and navigate post-election and through year-end.

We continue to preach the notion of "big mistake vs. little mistake" for longer-term investors. The "big-mistake" would be to brazenly invest capital in either direction, either 100% to bonds or 100% to equities. Equity valuations are rich, and bond yields are still among the lowest in history. So leaning too hard into either asset allocation, could expose investors to being offside near-term. So a more prudent notion, but exposing investors to a potential "little mistake," is to hedge out equity risk with fixed-income exposure and cash. While a more balanced position would work to offset any run in equities or bonds, we believe that limiting downside risk should be paramount over the next 2-3 weeks. **We'd love to hear your thoughts !**