

Pre-Election Thoughts:

On the eve of Election Day, we are all watching closely as the race for control of the White House and Congress finally approaches the Finish Line. Many investors fear that a Blue wave could release unfettered power resulting in an overly expansive and expensive agenda. However, this possibility might suggest that higher taxes and more regulation will be comfortably offset by more federal spending. No matter your political persuasion, studies show that gridlock is more bullish for stocks than either a Blue or a Red wave. With that thought in mind, we wanted to share some observations as we approach the final stretch – albeit a volatile one.

Since September 2nd, when the S&P 500 peaked at 3588 after generating a 61% total return from the trough of the market on March 23rd, the equity market has experienced two notable drawdowns: a peak-to-trough decline of 10.6% in early September and an 8.9% drop more recently in the second half of October (both based on intra-day pricing). The VIX - a measure of investors' expectations for future volatility - has increased from a low of 20 to a recent intra-day high of 41, while the S&P 500's 12.3% year-to-date total return at its peak has been whittled down to 4.0% (intra-day 11-2-20).

These drawdowns have prompted many investors to ask whether we are on the precipice of another bear market, in line with or worse than what we saw earlier this year. There is no shortage of concerns:

- A surge in COVID-19 infections globally
- Less favorable news on the benefits of Regeneron and Eli Lilly's therapeutics for seriously ill patients
- Greater realization that no one or two vaccines will be the magic bullets to end this pandemic imminently in the U.S. and the rest of the world
- Greater realization of the difficulties of production and distribution of two-dose vaccines and vaccines that require ultra-cold storage
- Increased concerns of a contested election and pockets of social unrest in the coming weeks
- Greater economic policy uncertainty if the U.S. has a democratic sweep with a 54-53 seat majority in the U.S. Senate

It is impossible to ascertain which of these concerns account for the latest drop in equity markets, as most of these worries have dominated the airwaves prior to September. For example, a fall and winter surge in new coronavirus infections has been anticipated for quite some time. Nevertheless, now that the COVID-19 surge is unfolding in the U.S. and in Europe, investors have become concerned about the likelihood of extensive lockdowns and their economic implications.

As we all know, no investor has a crystal ball. It is important to recognize that even when one may have an insight into the likely trajectory of a pandemic or the fundamentals of an economy, it is hard to predict how the markets will respond to any set of data in the short run. We believe that no one can consistently ascertain what facts investors in aggregate have priced into the financial markets. Hence, we recommend staying invested at this time of heightened uncertainty and likely increased volatility, since short-term trading in the absence of cheap valuations is a futile endeavor, in our opinion.