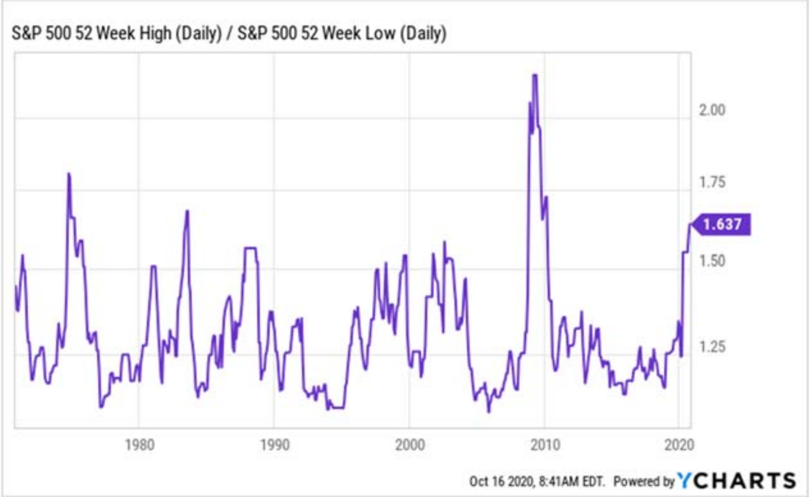
Despite a litany of dramatic events so far in 2020, stocks stand within striking distance of all-time highs. With this commentary, we zero in on a few key areas:

1. The market
2. The economy
3. The presidential election

The Market – 2020: The Year of the Rat

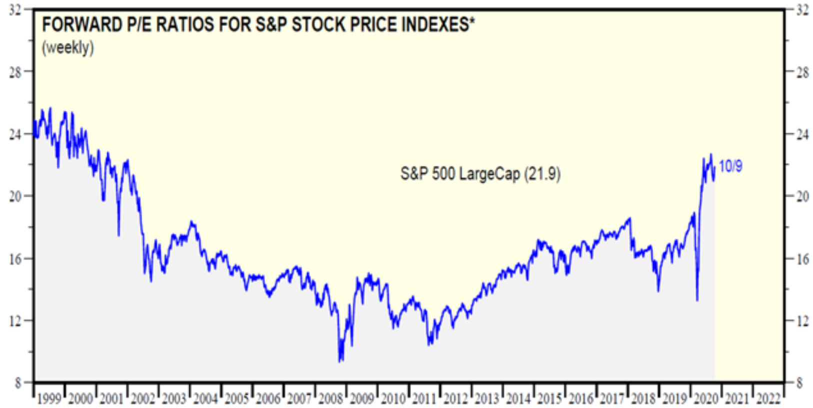
According to the Chinese Zodiac, 2020 is the Year of the Rat. The Rat is the first animal in the order of the zodiac. According to legend, the Rat was hiding in the hard-working Ox's ear, and as the Ox approached the Jade Emperor to claim first place, the Rat jumped out and stole the prize.

At the start of 2020, the hard-working Ox (i.e. 'bull' market) was doing great until the Rat (in the form of a virus) stole the show. Accordingly, investors have been whipsawed. In percentage terms, the gap between the 52-week high and the 52-week low stands among the largest in 50 years.



The psychological impact of such volatility cannot be measured, but it is probably fair to say 2020 has brought out its share of emotions and biases. The good news, to continue the metaphor, is the Year of the Rat is also associated with high survivability and fertility. Instead of an all-out disaster, 2020 has powered through to new highs in the market, and the economy is positioned to grow handsomely in our view.

Higher fundamental valuations have also returned to the market. In fact, forward price-to-earnings levels are now in proximity of the late 1990s and early 2000s – a period frequently associated with irrational exuberance.



Source: Yardeni Research, Inc.

Consequently, it is worth asking if the market is too expensive. We think not for two reasons: 1) low interest rates help justify higher valuations, and 2) valuations may not matter if, as we believe, improvements in the economy become more certain.

Today, interest rates are at record low levels. The 10-year Treasury is a good proxy for overall interest rates. Since March, yields for these bonds have hovered in the 0.5% to 0.8% range. Long-term Treasury yields have never been so low even going back as far as the Revolutionary War.

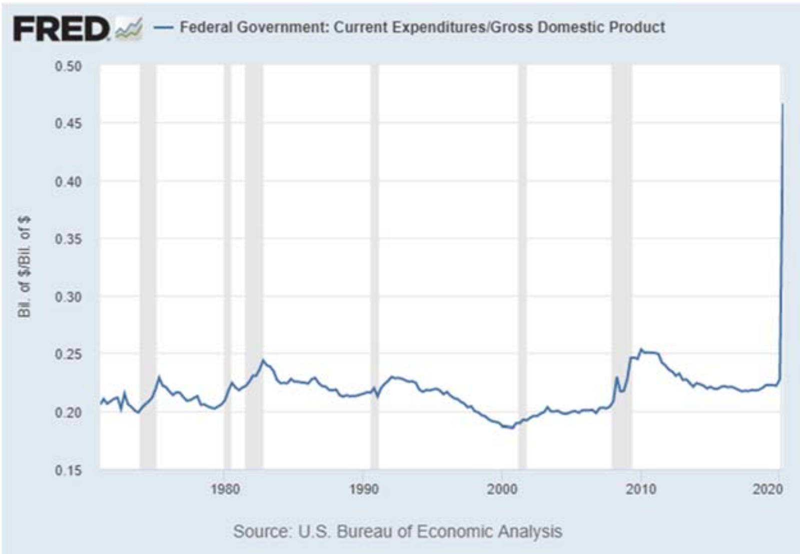
There are several ways of seeing how low rates translates into higher asset values.

- Many homebuyers understand real-estate prices are likely to be higher when rates are low. This is because the buyer will have a lower mortgage payment – and therefore could afford a more expensive house. On a large scale, this boosts home prices.
- Further, businesses typically use rates to discount future cash flows when evaluating projects. Lower discount rates for future cash flows translates into higher present values.
- Finally, income-seeking investors will often prefer stocks when dividend yields are higher than bond yields (rates) – boosting stock prices.

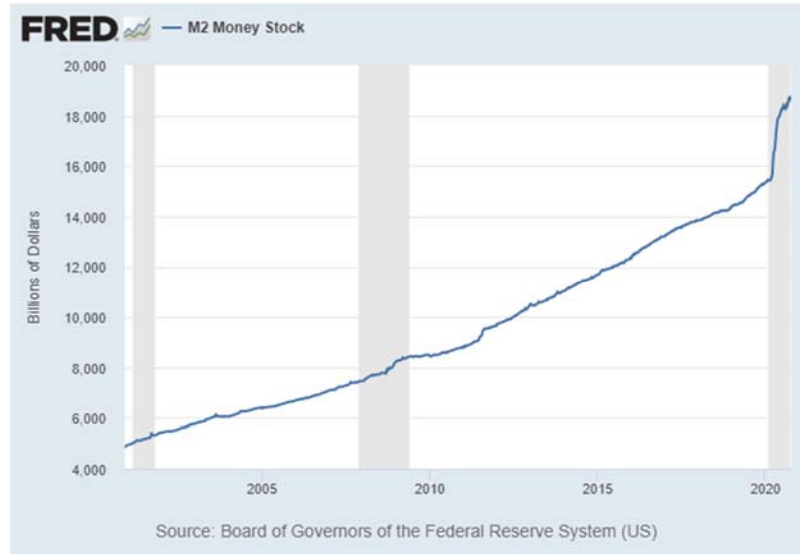
In 2020, for example, the dividend yield advantage is the highest it has been in a long while – offering investors an income advantage of stocks over bonds.

The economy is positioned to do well

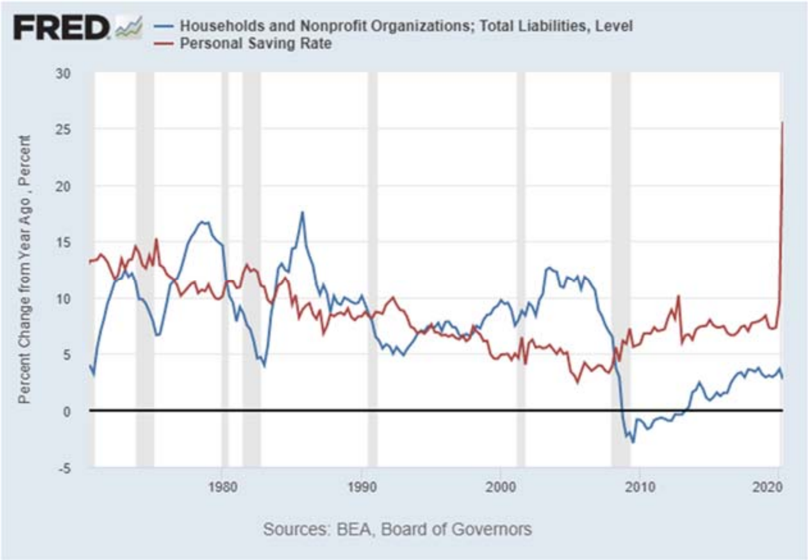
The 2020 Cares Act provided relief to a large percentage of the U.S. population. The support package was very large, boosting federal spending from 25% of the economy to over 45%. Nothing has come close to this over the last 50 years.



In Dollar terms, the Cares Act was over $2 trillion. The following chart shows the M2 money supply, the measure of money in bank accounts, money markets and other cash-like instruments (i.e. currency). The correlation between the timing of the Cares Act and the increase in the M2 money supply indicates the majority of the funds are sitting in bank accounts.



The next chart shows the personal savings rate among consumers has climbed dramatically (red line) while the amount of household liabilities has not increased in 2020 (blue line). This effectively implies that the average consumer is not financially being squeezed despite the recession and higher overall unemployment and, in fact, are sitting on quite a bit of cash.

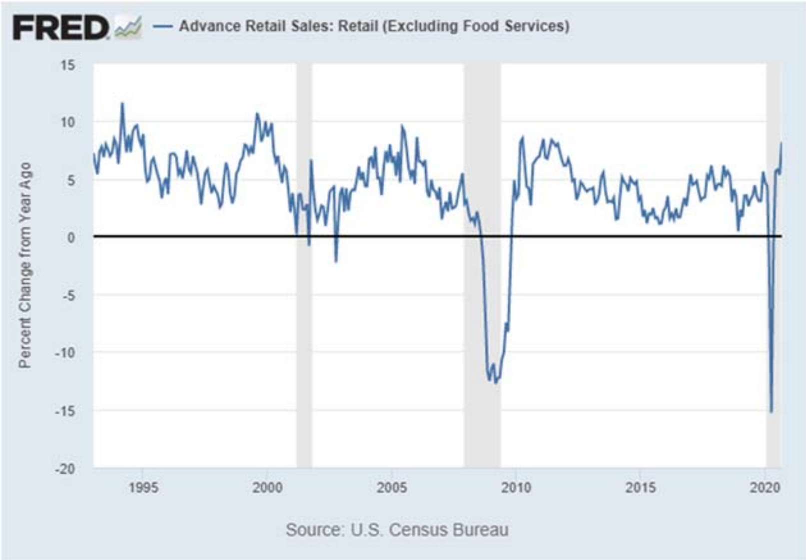


The three prior charts show the government has provided a massive amount of stimulus directly to consumers. While many recipients desperately needed the funds, the bulk of the stimulus has not yet found its way into the economy. With a rise in personal savings and debt remaining, on average, at pre-pandemic levels, a tremendous amount of potential spending may boost economic activity once consumer confidence returns to normal levels. While consumer confidence remains low (not depicted), we believe a pick-up is indeed forthcoming.

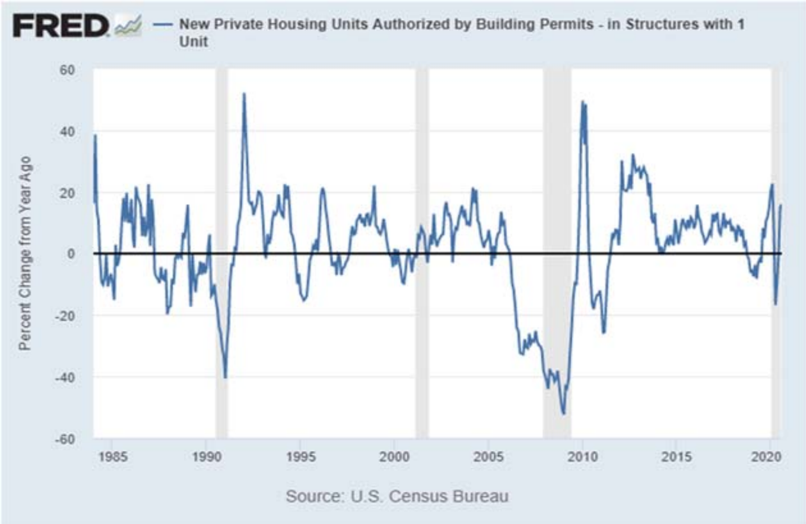
So, when will this happen?

We expect overall economic activity to be back on course by mid-2021. At that point, not only will confidence have returned, but the likelihood of a broadly distributed vaccine would be high. In the meantime, many signs of a return to normalcy are encouraging.

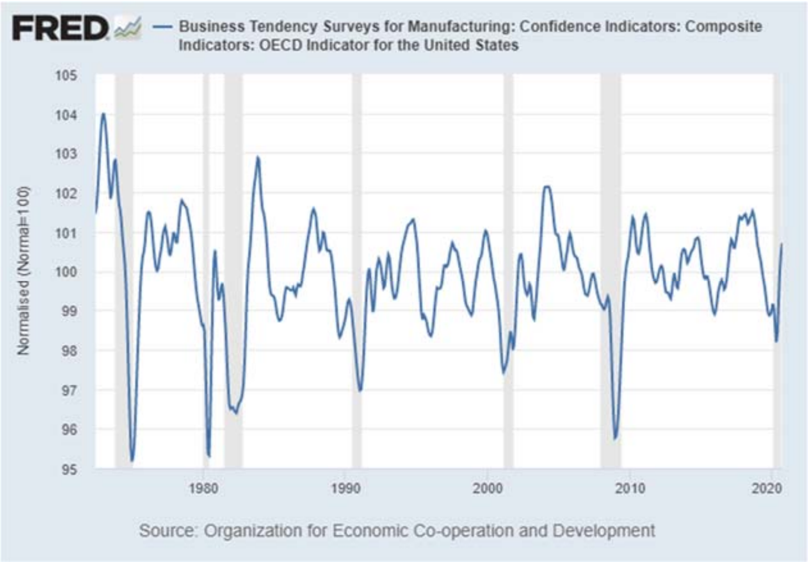
Retail sales growth is strong relative to history.



Homebuilders have been quite busy.



And, overall, businesses are confident.

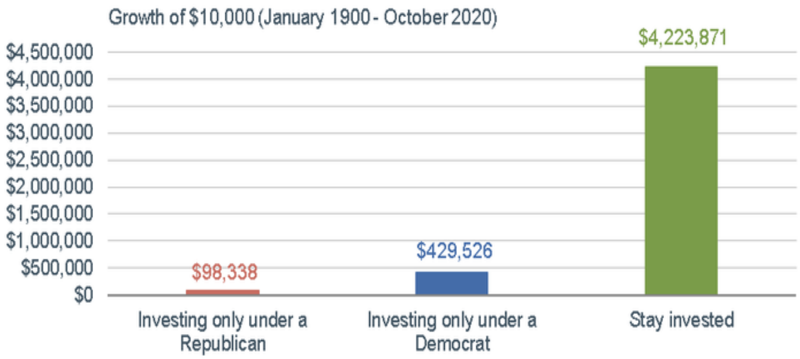


These charts are consistent with a growing economy and not one in decline. Since the average consumer appears to have the ability to live normally again, economically speaking, a return to normalcy may be largely about feeling normal again.

The Presidential Election

One aspect of the "Year of the Rat" story that cannot be ignored is the 2020 Presidential Election. While there are plenty of things to pick apart regarding potential changes in leadership, taxes, regulations, or trade, history is a strong guide in our view. Specifically, getting behind one party too strongly typically means leaving a lot of food on the table so to speak.

In fact, staying on the sidelines (in cash) while any one party sits in the White House has not been a good strategy. Below we see a comparison of a buy-and-hold strategy (green bar) versus two other strategies – one that invests only when the Republicans reside in the White House (red bar) and the other that invests only when the Democrats reside in the White House (blue bar).



Source: Charles Schwab & Co., Inc.

The winning strategy is clear – politics and investing do not historically mix well no matter how strong the logic. Of course, this is not the message many hope to ear. However, when one objectively peels back the layers, there are plenty of pros-and-cons on both sides of the isle.

More importantly, earnings growth, profit margins, and valuations of businesses tend to have a much larger impact on the market's return potential. Consider the economic overview above and the likely corresponding upside to the economy and therefore stock prices. Despite politics, the economic set up is strong in our view.

Summary

Despite a crazy year, 2020 has so far not been as bad as it could have been. The potential economic upside is strong enough that politics may not matter. In our view, now is the time to stay the course – sticking to your long-term asset allocation plan. As the Year of the Rat gives way to the Year of the Ox, we expect millions of Americans to get back to work in 2021 along with continued stock market volatility and growth.

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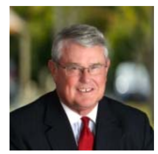
Mr. Brown is a partner and the firm's Chief Investment Officer. He was the founder of Laureola Asset Management, a private investment firm that merged with Aviance Capital Partners. Mr. Brown was a Director for Prudential's Strategic Investment Research Group, managed a due diligence team at Smith Barney, and was a sell-side analyst for UBS. He has been managing investment portfolios since 2005, and his research has been published in multiple peer-reviewed professional journals. Mr. Brown earned a Master of Business Administration (MBA) from Drexel University and a Bachelor of Arts in Economics from Indiana University of Pennsylvania. He holds the Chartered Financial Analyst (CFA) designation and is a past president of the CFA Society of Naples.



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Mr. Neel is a founder, partner, and Senior Portfolio Manager for the firm. He was the Senior Resident Officer at Bessemer Trust, Resident Manager at Brown Brothers Harriman, Chief Executive Officer and President at Dreman Value Advisors, and Portfolio Strategist and Equity Mutual Fund Manager at Kemper Financial Services. Mr. Neel has managed portfolios for pension plans, foundations, mutual funds, and high net worth individuals throughout his more than thirty-five years in the investment industry. Mr. Neel earned both a Master of Business Administration (MBA) and Bachelor of Arts in Economics and Political Science from Michigan State University prior to serving four years as an United States Naval Officer. He holds the Chartered Financial Analyst (CFA) designation.

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