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Andrew Slimmon September 2020 Equity Market Commentary

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1. **The "V" economy**

   I had to chuckle a bit this week when a piece of research crossed my virtual desk from arguably Wall Street's most famous economist, Ed Hyman. The title of his report was "V-Shaped Recovery". In it he detailed all the reasons why the economy "looks like a V".[1]

   Have you heard anyone tell you there was a "disconnect" between the stock market and the economy over the past 5 months? That the stock market was being way too optimistic? They were wrong. The "V" shaped recovery in the stock market accurately predicted the "V" shaped recovery in the economy.

   I am sure I sound like a broken record, but please file this in your "investment insights" folder for the next time somebody tells you why the stock market has it wrong (which assumptively suggests they are smarter than the market).

2. **Four Powerful Forces**

   This recent market correction is just a pullback, nothing more sinister than that, in my opinion. As I said in my most recent Market Alert[2], we had an overbought market coming into September and were ripe for some bad news (fiscal stimulus delay) to knock the market back.

   However, I believe we remain in a **post-recessionary bull market**, with four powerful forces supporting equity prices:

   A. **The Fed.**

      The Fed, in my opinion, is screaming, "take risk….we have your back". As I have often said, we are all familiar with the saying, "don't fight the Fed". If that is the case, why are so many bears (or those sitting with high levels of cash) doing just that? The Fed is only ultra-accommodative when there is a

[1] Evercore/ISI, September 22nd, 2020.
[2] Presidential Elections, The Elusive Market Pullback and A Lack of Opportunities, September 3rd, 2020.

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problem in the economy. And the problem is what the bears are focused on, not on the Fed's action.

B. **The direction of change.**

The stock market responds to the direction of change in the economic and earnings data. Consistent with post-recessionary recoveries, the rate of change today is incredibly positive. Economists and analysts have had to regularly raise their outlooks as the actual economic data and earnings results continue to surprise on the upside. In essence, the experts were too bearish.

C. **A vaccine.**

I have no idea whether we will have a widely-available COVID-19 vaccine soon or not. Plus, the opinions about a vaccine from those with a decided political position have become tedious! But I expect that the continual drip of news about vaccine development will likely keep a floor on equities, preventing a substantial drop. Not to mention, I am regularly on calls when someone states, "when there is a vaccine, I will become a lot more optimistic."

D. **Sentiment.**

Recessions always differ one to the next, yet how investors react is very consistent. They get too bearish in the midst of recessions and miss out on the first big leg up, only to capitulate as the big returns are behind. We saw it in 2009/2010, and in my opinion, it's happening again. Investors are too bearish now, but will get more optimistic once COVID-19 is a memory. In my mind, that will be the time to become *less optimistic*. More on that later.

3. The Presidential election.

This current market correction seems to be consistent with the period leading up to previous Presidential elections. Historically, we have seen a correction in equites in September that ends in early/mid-October during election years.[3]

Two points about the election:

A. In November 2008, we elected a liberal Democratic President, perceived as anti-business, who took over in 2009. **In 2009, the S&P 500 was up 26%.**

In November 2000, we elected a pro-business conservative Republican. **In the year 2001 the S&P 500 was down -13%.**

What determined the S&P 500 returns in 2001 and 2009 was NOT who won the White House, but rather where we were in the business cycle and what central bank policy was. In 2009, we were at the beginning of an economic cycle, having just recovered from a searing recession, while in 2001 we were at the tail-end of a business cycle.

Having only recently experienced a recession earlier in the year, I believe we are much closer to the 2009 scenario than 2001.

B. A contested election is a known risk. We should fear the unknown or *hidden* risks. During the period of the Bush/Gore contested election, the S&P 500 sunk -8%.[4] We were not prepared for that risk. This time we are. It's a known risk, and therefore I doubt a contested election will create the same amount of volatility if it were to reoccur.

4. Known versus Hidden Risks.

Election uncertainty and COVID-19 re-emergence are two of the biggest known risks. I doubt they will have much of an impact on the market. Again, it's the risks I don't hear getting any attention that worry me.

By definition, hidden risks are hard to determine.

[3] Bloomberg/ Deutsche Bank.

[4] Election was November 7, 2000 and the low was November 30th, 2000. Bloomberg.

But here is one:

What would happen to equities sometime next year if COVID-19 were behind us, we were to have an effective vaccine and the economy were to respond to the massive stimulus by really strengthening?

While the four positive forces in #2 describe why I think the path looks good for the stock market today, I think they also point to the possibility that the path would become more problematic under a "COVID-19 is behind us" scenario:

A. Economists and analysts would become much more optimistic, which would mean the rate of positive change would likely become more difficult.

B. The Fed might begin to signal that the previously unprecedented stimulus from 2020 could unwind at some point in the future.

C. If COVID-19 were behind us, could the level of investor optimism for equities potentially be far higher than today? Always a danger sign.

As I said, that is a potential, lesser-discussed risk to consider for 2021.

5. "The stock market is in a mania".

Recently on TV, a hedge fund manager lamented that stocks are in a mania, and there was no place to make money.

Let's put some facts behind that comment.

As of the Wednesday, September 23rd close, while the S&P 500 and the NASDAQ are up YTD, the S&P equal-weighted is down -7% YTD.[5] To state the obvious, that means the average stock is lower than where it started the year.

Therefore, my response to Mr. Hedge Fund manager is, "if you think stocks are in a mania, then you must have thought they were in a hyper-mania at the end of last year, given that most stocks are lower this year."

I believe there are plenty of opportunities to make money in stocks. But the ones down YTD tend to be the more economically cyclical/reopening stocks.

But to buy these stocks, you have to hold your nose and presuppose that at some point we will be past COVID-19 and life will return to normal.

That brings me back to my first point in #1. The stock market rallied ahead of the economy recovering, which many perceived as a disconnect. Money was made getting in front of the economists actually validating the rally.

Likewise, the reopening stocks should rally in front of a vaccine. And many will say there is *a disconnect* because "who would go to a casino, get on a plane or take a cruise?" and "the market has it wrong."

Get the investment insight folder ready!

Andrew

[5] Bloomberg.

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