1. For Applied Equity Advisors (AEA), June has capped off a good quarter and successful year-to-date.

   Congratulations to the AEA team, portfolio manager Phillip, portfolio specialist Leslie, our analysts: Hannah, Roby and Steven and our trader, Jack. They made the transition to “work from home” for AEA seamless and successful.

2. If ‘Don’t Fight the Fed’ is so obvious, why are so many doing exactly that, evidenced by continued high levels of pessimism and piles of cash on the sidelines?

   The Fed is only ultra-accommodative when something is terribly wrong with the economy. They do not normally pump liquidity when everything is perfect. Yet investors focus more on the problem than the Fed’s actions.

   Last week, one Fed official described the current economic environment as “the thick fog of uncertainty” and “downside risks prevail”, calling for “a sustained commitment to accommodation along with fiscal support.”

   There isn’t a more comforting message for investors. It’s the “all-clear” signal for risk assets, in my opinion! The Fed is your friend.

   However, also last week, a different Fed official said that 2021 “will see an above-trend growth.” This seems to be a message that the liquidity pump could be shut down or at least reduced next year. Don’t expect the Fed to be as accommodative next year.

   I believe 2020 is likely to be a surprisingly good year for equities, but 2021 might disappoint.

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The returns of the market referred to in the commentary are those of representative indices. The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. Past performance is no guarantee of future results. See Disclosure section for index definitions.
3. As highlighted in the charts in last month’s commentary, secular growth stocks are in a bubble similar to 1999-2000. Bubbles ultimately pop, and the carnage is painful. Yet, bubbles can inflate far longer than bears expect.

We also showed that the best time to buy value stocks has been when exiting recessions.

BUT it’s not a straight line up and to the right in the value names. Weak holders tend to be shaken out due to the uncertainty of the economic recovery. Especially when there is rampant speculation in secular growth stocks, as we see today.

The question is when to sell the winners and buy the laggards?

4. As a “core manager” we can manage the style transition in our portfolios gradually. Our positioning in the US has migrated from broadly less value / more growth at the beginning of the year to more value / less growth for our three active strategies today.3 This was a gradual transition which should continue in the direction of value.

In our opinion, managing this transition within a core portfolio is far easier than trying to determine the best time to pull the ripcord on a growth manager and allocate to a value manager.

5. Lately we have received a number of questions about Europe.

Remember, we only have a fixed amount of assets to allocate across all regions. In our view, Asia ex-Japan and the US are far more fertile areas to invest capital than Europe, or Japan, for that matter.

We are willing to bet that value stocks in the US will work, because we expect the US to experience a strong economic rebound in 2021 as per the above quote from the Fed. We are less convinced of a strong economic rebound in Europe, and that would be required given Europe’s heavy weight toward cyclical sectors.

6. One final point on regional weightings. In our global strategies we are underweight the US, but only due to our significant allocation to Asia ex-Japan. In our opinion, when the books are closed on 2020, Asia ex-Japan will be the only region of the world that will have outperformed the US.

7. What about the US Presidential election and its impact on the market?

Here are some facts:

a) Since 1929, the stock market has performed better under Democratic Presidents than Republican.4

b) Since 1912, in the 100 trading days leading up to a Presidential election, the market has rallied every time a Republican was ultimately re-elected and traded down 80% of the time when a Democrat candidate unseated the Republican.5

c) Since 1900, there have been six Presidents who have run for re-election when the economy has experienced a recession at some point in the two years before the election. With the exception of Calvin Coolidge in 1924, none of the six were re-elected. On the flip side, without a recession, we have re-elected the sitting President every time.

If the result of the upcoming election were purely consistent with history, Joe Biden would be elected in November. The market would be weak ahead of the election, but ultimately it would do fine.

For those who need a “but this time could be different” scenario, here are two:

a) Biden is viewed as a centrist candidate. Therefore the market may not react as negatively as it has in the past with the thought of a potential Democratic President.

b) Clearly when it comes to re-elections, we vote with the economy and our wallets. It’s hard to argue with the data. If the economy is in a

3 Based on Morningstar core/value and growth ratings as of July 20, 2020.


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recession, then the wallet is thinner, especially for those who have lost their jobs.

But is the wallet thinner this time? A University of Chicago study found that 68% of workers who received unemployment insurance through the CARES act have had benefits that exceed their lost earnings. More notably, the average benefit is 134% of lost earnings. Therefore, for many, the wallet is actually thicker.

Andrew

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6 FEE. Foundation for Economic Education. June 15, 2020

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