

Drop, Pop, Consolidation...Now What?

As we hit the fourth quarter of 2020, we have seen a volatile market moving in both directions since late February. In the first quarter, the S&P 500 Index experienced a more than 30% drop, followed by a meaningful move higher once interest rates, fiscal policy, and the trajectory of COVID-19 hospitalizations and fatality rates all trended in a market-friendly direction. The Federal Reserve's dramatic reduction in the Federal funds rate provided a boost to economic activity and stock market multiples. In addition, The Families First Coronavirus Response Act (FFCRA), passed in mid-March, provided unprecedented fiscal stimulus.

More recently, the market has stayed within a trading range as the looming election, continued COVID-19 concerns and a lack of a new fiscal relief package has led to more uncertainty. What happens next in the public markets? Our view on the near-term future takes into consideration vaccine progress, fiscal stimulus, the direction of interest rates and, of course, election results. However, a definitive election result should remove some degree of uncertainty and future volatility.

Elections, Fiscal Spending, and Taxes

As we write this in early October, the day-to-day situation of the market continues to be dynamic. Aggregating various, what we view as relatively objective, research sources, we believe there is a roughly 60% probability of a Democratic sweep in the Senate and the White House, with the chances of a Biden victory itself higher. We believe this likelihood is to some degree already priced into the market as the consensus opinion, showing it is generally accepting of a clear, 'blue wave' election result. Should there remain a Republican Senate and a Democratic President, historically the market has been comfortable with the gridlock likely to ensue. However, a Democratic sweep (or Republican sweep for that matter) is likely to lay the groundwork for more fiscal stimulus (to varying degrees). Thus, our view is that a Democratic or even Republican sweep (the latter seeming more unlikely) should be neutral to positive for the market with a few caveats.

What are those caveats? Interest rates are a meaningful key to stock market valuation, with the idea that lower rates lead to more opportunities for economic growth. A large Democratic majority in the Senate would likely cause interest rates to rise due to the presumption of significant fiscal stimulus and related inflation worries. The magnitude of a possible Senate majority is also important. A narrow majority may be the best scenario for the markets as it is more likely to temper stimulus and keep a lid on rates. Clearly the market wants the stimulus, but not so much that it causes an increase in inflation expectations and a spike in rates, in turn derailing the markets.

Tax policy is also a front and center issue affecting the stock market. The market consensus seems to be that a Biden administration would promote fiscal spending well in advance of tax changes. Taxes are likely to go up in the future regardless of who is President next year, given deficit and debt-related issues. However, the sequence and timing of any tax increases will be critical to watch. It is no surprise that, generally speaking, higher taxes are not market friendly. That being said, if tax increases are delayed until we have more resolution related to COVID-19, and spending starts now, the market may react more positively.

Coronavirus Outlook

Vaccine optimism is relatively high with most forecasts anticipating that more than one vaccine will be approved and have rolling availability by the middle of 2021. This would seem to indicate that half of the U.S. population could be vaccinated as soon as the beginning of fall next year. Clearly vaccine progress is a key determinate of future stock market returns. Our view is that the exact timing of vaccine approvals and implementation is less important than the incremental news and outlook leading us in the right direction. Should the vaccine outlook not progress as expected, that would be a major economic and market risk factor.

Positioning and Outlook

As we move towards November 3rd, we are living in a period of significant uncertainty. More recently, President Trump contracting COVID-19 and the polling after the first debate has led to a reduction in expected market volatility. Conventional wisdom now feels the probability of a contested election has diminished. However, the perceived direction of a Biden administration and the complexion of the Senate are also key in considering future market returns.

The GFP view is that interest rates will remain low over the next few years as the Fed has made a clear commitment to doing so. For now, vaccine news seems to be progressing in the right direction as we hit the last three months of a much different 2020 than any of us expected. Thus, we feel that regardless of who wins the presidential election, the public markets, while expensive, should generate positive returns over the intermediate term with thoughtful, well-informed asset allocation. Clearly, there are many risk factors and scenarios that could lead the markets in the wrong direction over the next twelve months, and we need to be ever mindful of this possibility. GFP has carefully allocated across different asset classes, sub-asset classes, and strategies for client portfolios that reduce overall portfolio risk, while still allowing for attractive market upside capture.

In this uncertain time, portfolio balance and the flexibility to be tactical (in the name of hedging risk and/or being opportunistic) are paramount.

We hope you can join us for our quarterly Outlook call on Wednesday, October 21st at 10 am EST (a replay will also be posted on www.gries.com after the call).

Any questions, please don't hesitate to reach out to your client advisor.

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