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QUARTERLY COMMENTARY

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Knocking on the Door

In my last report, I discussed the likelihood of the market taking a break after such a huge run from the bottom in March. That started happening in September after a pretty good summer. I'm not sure if the little ghouls and goblins will be out on the street trick-or-treating this year as they have in the past, but as usual the markets are doing their own scary thing this month right on schedule. The last quarter was a positive one, with the TSX up 3.9% and the NYSE composite up 6.8%. Both markets are still down for the year however and the Canadian market in September was slightly positive while the NYSE was down 2.6%. Volatility is returning to the equity markets as they are now focused primarily on the US election, the next stimulus package and a second wave of the pandemic.

The primary factor that is moving this market up and down is the outlook regarding more stimulus and when it is about to be announced by the U.S. government or the central bank. Both the Republicans and Democrats want a stimulus package, but it is a question of how much, when and what for. If there is no stimulus package agreement before the election it could be very negative for the markets. However, the possibility of a blue wave, a sweep by the Democrats in the House and the Senate, would eventually result in more stimulus (and more debt) in 2021 which is a positive and that may serve to outweigh any immediate concerns.

The promise of greater stimulus and "free money," helps to create a positive environment for a higher stock market in the short-term. But the clock is ticking. Businesses are closing, job growth is slowing, companies are announcing layoffs — and yet the federal government hasn't approved any more stimulus despite a variety of warnings. The Business Roundtable, a group of chief executives from major corporations, warned last week that "communities across the country are on the precipice of a downward spiral" and are facing "irreparable damage".

If history is any indication, the market should be able to deal with either candidate winning, but an uncertain period where we don't know the winner for several weeks would not be ideal. I believe we can look to election night 2016 as a guide to see what can happen in a contested election. Back then US stocks dropped dramatically overnight and gold rose modestly, only to recover the next morning. At the time, the narrative around these moves was that the stock market feared a Trump presidency. However, I suspect the more likely explanation is that the drop occurred because Hillary Clinton did not concede the race until the next morning, and the stock market was fearing a contested election.

I imagine this reaction could happen again, as markets are already fretting over a contested election. I would expect stock market volatility and possibly short-term stock market sell-offs in the weeks leading up to the election. Although I recently took profits in the gold sector because the bullish chart pattern had been broken, if the price of gold again climbs up through $1950, then it will likely resume higher. In this political environment, I would expect gold and Treasuries to perform well and that could continue until there is a declared winner. In such a case, I believe some attractive opportunities will present themselves – especially in the tech sector, which, I expect to continue to benefit from the Fed and pandemic-related themes.

Biden is now leading in the national polls by an average of over seven percentage points and is ahead in most key battleground states. The betting markets, which until early June had Trump as the favourite, have now decisively flipped toward Biden. A Biden presidency is commonly thought to come with headwinds such as higher taxes, increased regulations, and a better chance

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of another COVID-prompted economic shutdown. On top of higher corporate taxes, Biden would impose a 15% minimum tax on profits, a move that would limit the ability of companies to employ various accounting maneuvers to minimize their tax bill. His plan would also double from 10.5% to 21% the existing minimum tax on profits earned by foreign subsidiaries of U.S. firms. Biden's most expensive proposal is a $2-trillion, four-year green energy plan that includes the following targets: moving the economy to net-zero carbon emissions by 2050; no longer using fossil fuels to produce electricity by 2035; and requiring all new buildings built after 2030 to be carbon neutral.

If Biden becomes president, the ability to advance his legislative agenda would largely depend on whether the Democrats also succeed in regaining control of the Senate. Currently, Republicans hold 53 seats and the Democrats 47. In total, there are 35 Senate seats up for grabs in the November election. In 12 cases, the incumbent senator either is a Democrat or caucuses with the Democrats. The other 23 seats are held by Republicans. Democrats need only win three more seats to gain control of the Senate if they also win the White House given that the vice-president casts the tie-breaking vote in the event of an even split. Despite the above-noted higher taxes and regulations, the market could still do well with a Biden presidency as there would be more predictability (and fewer intraday tweets) and a cooling of the "trade war" with Americas main trading partners. Historically the market has actually done a little better under Democratic administrations.

Of course any news that can be interpreted as positive with regard to Covid-19 will have a positive impact on the stock markets around the world. Right now, as of this writing, financial markets (which are forward looking) are optimistic that science will reign supreme and normalcy will return in the next year despite the current surge in cases around the world.

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In the end, no matter who wins, the US government is probably going to spend a lot more money, which should drive the stock market higher. The current recession is probably already coming to an end and the next 12 months after a recession are, typically, the strongest part of the market cycle.

Thank you for your continued trust and confidence. Should you have any questions or concerns at any time or if you would like to have a detailed discussion of your personal portfolio please do not hesitate to let me know.

Sincerely,

Richard

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