The Sandler Quarterly

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Pandemic? Election?....Should someone tell the market?

KEY INSIGHTS

- Positive momentum continues for equity markets and the economy
- Rising COVID-19 cases threaten re-opening
- US election debacle will likely make virus seem mild-mannered
- Interest rates remain historically low with no change in sight
- Fed moves the goalposts on inflation to suit their needs

The world is on a better footing than a quarter ago. Economic activity has rebounded and financial markets have continued to stabilize and recover from the initial panic of March and April. The recovery began earlier than many investors expected, supported by unprecedented amounts of monetary and fiscal stimulus. Measures of economic activity started to turn up in mid-April and continued to improve until recently. At this point, developed economies have reclaimed a little more than half of their lost output.

At time of writing, the economy and financial markets are contending with a second wave of COVID-19. See *Figure 1* below. The re-opening of schools and colder, drier fall weather have coincided with an uptick in daily infection rates across much of the developed world. The race to find and distribute a safe vaccine is on but will clearly not produce results in time to combat the resurgent virus.

The economy continues to face a variety of challenges on the journey back to normal. Many of the sectors that remain depressed are likely to be structurally limited until virus worries abate. Unemployment, while greatly improved, remains elevated. Those who are still jobless may have difficulty finding work until their industries return to normal operation. We are still not out of the woods.

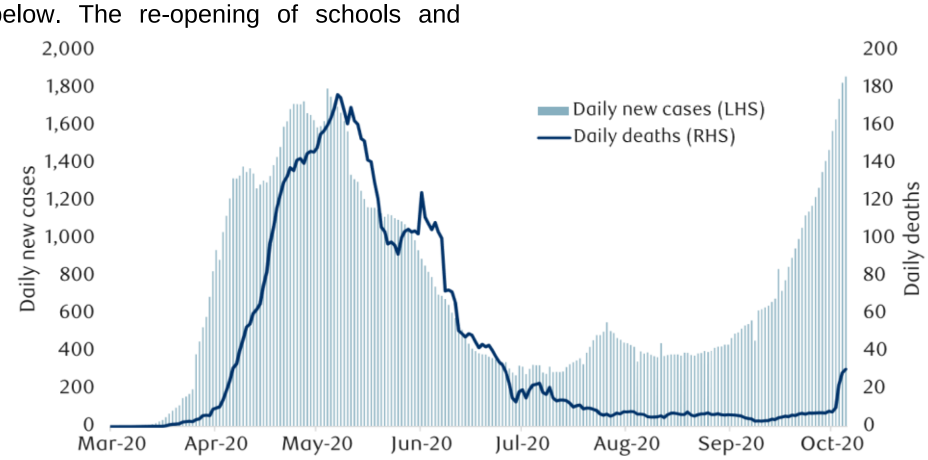

***Figure 1**: COVID-19 cases and deaths in Canada (Source: ECDC, Macrobond, RBC GAM)*

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The Election

With the US presidential election now only weeks away, we are about to enter peak-hysteria mode. The media is about to kick into overdrive. It is our job to limit our exposure and temper our reactions. Many investors tend to fixate on which outcome might be better (or worse) for the market. History tells us, however, that over the long run the market doesn't care. Markets have risen regardless of which party holds office. See *Figure 1* below.

The ultimate outcome will be either a democrat or a republican in the White House. However, the more concerning near term result is a contested vote that could drag on for some time. The attached report, *The "but what if" factor*, discusses this possibility. It reflects on some historic precedent and finds that the market should be able to digest such a scenario.

After Trump's victory in 2016 and the unanticipated Brexit outcome, we swore to never again place any faith in polls. As often as not, they are not worth the effort. That said, either Trump will remain in office or Biden will become President. It is worthwhile to examine what a change in leadership may bring. In the "negative for the economy" column, a Biden victory is expected to deliver higher taxes, increased regulation and a stronger stance on COVID-19. Conversely, it is expected that a number of Biden initiatives would have positive effects. These include fiscal stimulus, less protectionism and more immigration. See *Figure 3*.

The bottom line is that bouts of volatility are to be expected around election time. However, history has shown that remaining invested with a disciplined investment plan and appropriate asset allocation is the key to investing success. The old adage applies more than ever: it's time in the market, not timing the market!

Biden Policy Stance vs. Trump	Short-term Economy	Long-term Economy	Equities	Bond Yields
Stricter COVID-19 Controls	–	+		
Tax Increases		–	– –	
Fiscal Stimulus	+ +	+	+	+
Trade/Immigration		+	+	
Regulations		–	–	
Overall	+	+	–	+

***Figure 3**:* Biden platform and implications *(Source: RBC GAM)*

Inflation and Interest Rates

We spoke at length in our last newsletter about inflation (both of consumer prices and of asset prices). Since then, the US Fed has shifted how it views inflation targets. In a recent meeting they stated that inflation would be allowed to run ahead of the traditional 2% target, as long a long-term 2% average was achieved. In other words, past periods of low inflation will be banked and used to allow future periods

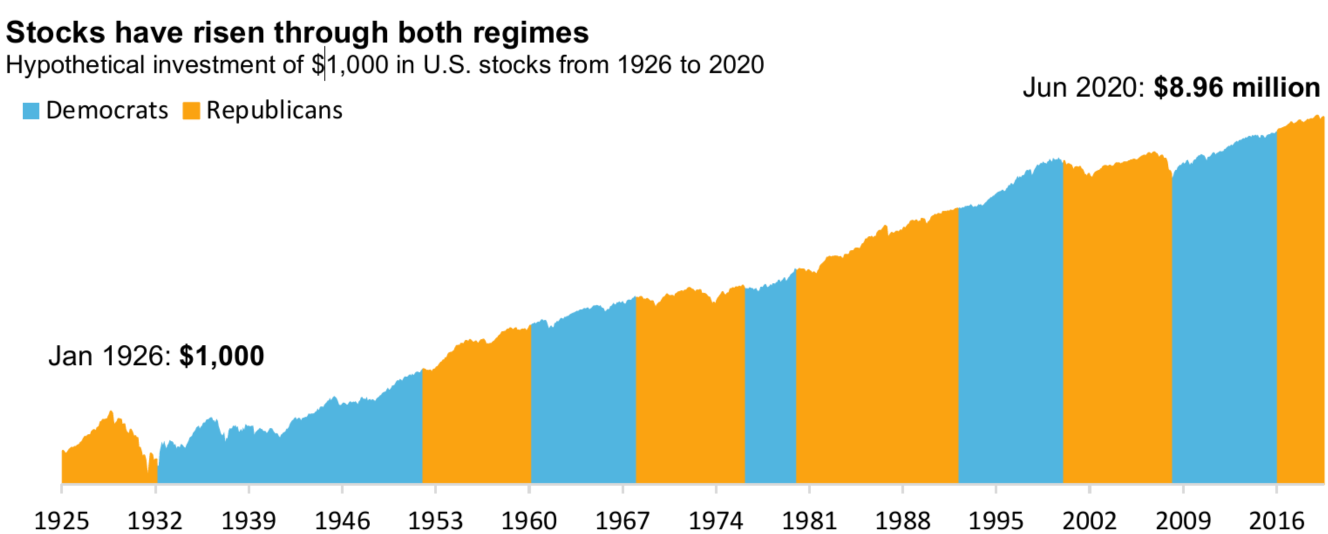

***Figure 2**:* S&P 500 Index from Jan 1, 1970 to Jun 30, 2020 and IA SBBI U.S. large cap stocks index from Jan 1, 1926 to Jan 1, 1970, Source: (RBC)

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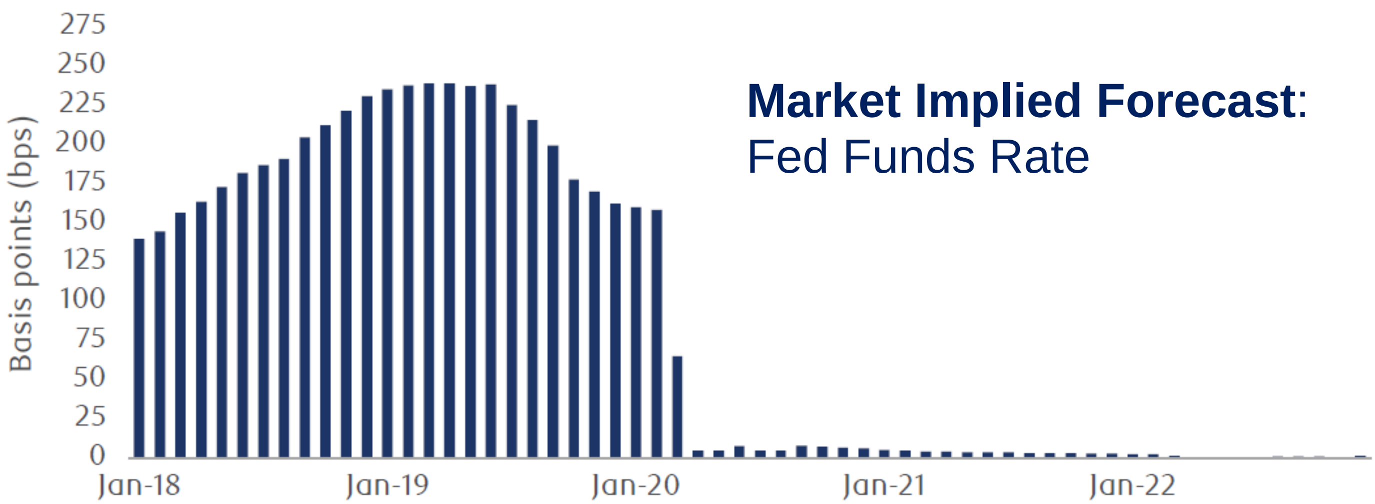

Figure 4: Market implied forecast – Fed funds rate *(Source: Bloomberg, RBC GAM)*

of higher inflation. Low interest rates coupled with higher inflation is a dreamlike scenario for governments as it makes servicing their debt affordable today (low current rates) and repaying the principal less expensive in the future (higher inflation erodes the value of future debts).

The result of such a policy is that we should expect short term interest rates to remain at zero (or very close) through at least 2023. See *Figure 4*. Low interest rates and potentially higher inflation, coupled with extremely stimulative monetary and fiscal policies will, in our opinion, continue to drive money into other asset classes over time. Equities, real estate, gold, infrastructure, collectables and alternative investments should all benefit from this asset price inflation trend.

In this same vein, it is worth pointing out that rock bottom bond yields combined with inflation (even benign) give rise to negative real yields. In essence, making 1% on a bond may seem fine, but if the cost of living increases at 2% the net effect is a loss in purchasing power over time.

Asset Allocation

Return expectations on the traditional 60:40 equity / fixed income portfolio are being revised down as a result of lower bond yields. Diversification and safe, stable, investment grade bonds are still the foundation of any portfolio but we are seeing investors around the world shifting some exposure away from ultra-low yielding bonds and into other asset classes in search of returns.

It is important that we revisit your asset allocation on a regular basis to ensure it is appropriate to meet both your investment return objectives and your tolerance for risk and volatility. Please refer to the pie chart and accompanying table in your quarterly report to see your personal asset allocation. Speak directly with us to understand how the current environment affects asset allocation thinking.

Taxes

Much has been made of the potential for higher taxes in Canada. Even before the COVID-19 spending spree, there was an expectation that Ottawa would need to find additional sources of revenue. Fast forward to 2020 and it seems inevitable that we will see amendments to the tax code at some point. While we agree with this line of thinking, it is important to consider that we are likely in too fragile a spot right now to entertain the discussion of higher taxes. We expect Ottawa knows this. In our opinion this is likely a 2022 (or beyond) story; worth monitoring but not worth losing sleep over in the near term.

Equity Markets

Global stock markets have displayed remarkable resiliency in the face of the pandemic. In fact, the S&P500 achieved an all-time high in early September. This outcome has left many scratching their heads. Those confused by the sharp recovery in markets may want to consider that earnings lost due to COVID-19 have a muted impact on the present

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value of a business. Today's value of an investment reflects the present value of all future profits. Firms have experienced severe profit pressure during the shutdown and recovery, but the market is focused on future earnings which are unlikely to feature COVID-19 related distortion. Using a discounted cash flow approach, a temporary earnings decline does not have a substantial impact on the market's present value as long as profits ultimately recover to their prior trajectory. In other words, markets are looking across the valley to the long-term earnings power of companies to establish fair value, even though the near-term outlook is murky.

Additionally, as mentioned above, ultra-low bond yields are forcing investors to look further afield for return on their capital. In this environment, equities appear relatively attractive versus bonds despite admittedly elevated valuations.

Gold

Gold also reached a new high in August. Sustained monetary and fiscal stimulus combined with a weakening US dollar and negative real interest rates should continue to support and drive precious metals (and the companies that produce them) higher. Put simply, governments and central bankers have opened the taps and are spewing money with abandon. This may work as a short term solution but will ultimately result in the devaluation of currency and increased inflation. Against this backdrop we believe gold to be an attractive store of value.

If 2020 has taught us anything it's that remaining invested through periods of uncertainty is the secret to investing success. Panicking at the bottom or trying to pick the top is not a winning strategy. The coming weeks are likely to bring further volatility that our best-in-class investments will navigate through once again. Stay the course!

	Q3 2020	1 Year*
Indices		
S&P/TSX	3.91%	-3.23%
Dow Jones	7.63%	3.21%
S&P 500	8.47%	12.98%
Nasdaq	11.02%	39.61%
Euro Stoxx	-1.25%	-10.53%
Japan Nikkei	4.02%	6.57%
India Sensex	9.03%	-1.55%
VIX (Volatility)	-13.34%	62.38%
Commodities		
Gold	5.89%	28.07%
Silver	27.62%	36.71%
Copper	11.05%	17.08%
Oil	2.42%	-25.61%
Natural Gas	-4.79%	-31.22%
Currency		
CAD	1.91%	-0.61%
EUR	4.34%	7.54%
JPY	2.35%	2.49%
AUD	3.75%	6.10%
GBP	4.19%	5.13%

*As of September 30th, 2020

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RBC WEALTH MANAGEMENT

Global Insight Weekly

U.S. ELECTIONS & MARKET MATTERS

The “but what if” factor

Kelly Bogdanova – San Francisco

We all know the market hates uncertainty. So what happens if November 3 comes and goes and we don’t know who the next president is? We explain why we think the market should be able to stomach this disconcerting scenario.

Increasingly, investors are asking about a range of atypical U.S. presidential election scenarios and, specifically, how these could potentially impact the stock market.

The most common questions asked are: What if the election is contested and/or what if there isn’t a clear winner on Election Day?

Postal routes

The expected surge in mail-in ballots due to COVID-19 restrictions and related health concerns has increased the possibility that election results could be delayed. Some states and courts have established new vote-counting rules that would push back official certification of results.

For example, in Wisconsin and North Carolina, both considered swing states by political analysts, mail-in ballots will be accepted up to six and nine days, respectively, after the November 3 Election Day as long as they are postmarked by that date.

If the overall race is tight, and if the vote count is close in such states on the night of the election, the delays could generate some uncertainty for the market. But we think the market is largely prepared for this as it is being well telegraphed.

Flashback to 2000

What if the election is contested? This is a separate issue entirely. This could involve a close race in one or more states—close enough to trigger an automatic recount. (Each state has its own rules and procedures for recounts.) Or, a contested election could occur if other types of issues trigger litigation, such as evidence of election irregularities that could impact Electoral College votes.

One thing is for sure: If there is a contested election we should expect litigation, litigation, and more litigation in the courts, and we should expect a media and social media feeding frenzy.

There is only one example of a contested presidential election in the modern era, back in 2000 when the vote count between George W. Bush and Al Gore was tight in Florida, a swing state rich in electoral votes.

The close Florida results triggered an automatic statewide machine recount. At one point, Bush’s lead had shrunk to only 327 votes. As events unfolded, the Bush and Gore teams fought in state and federal court, with multiple lawsuits and appeals, about whether manual vote recounts should be conducted (remember the “hanging chads”?).

Two cases ultimately made their way to the U.S. Supreme Court, and its rulings favored the Bush team. The decisive case

Market pulse

Click here for authors’ contact information. Priced (in USD) as of 10/1/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see page 6.**
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Wealth Management

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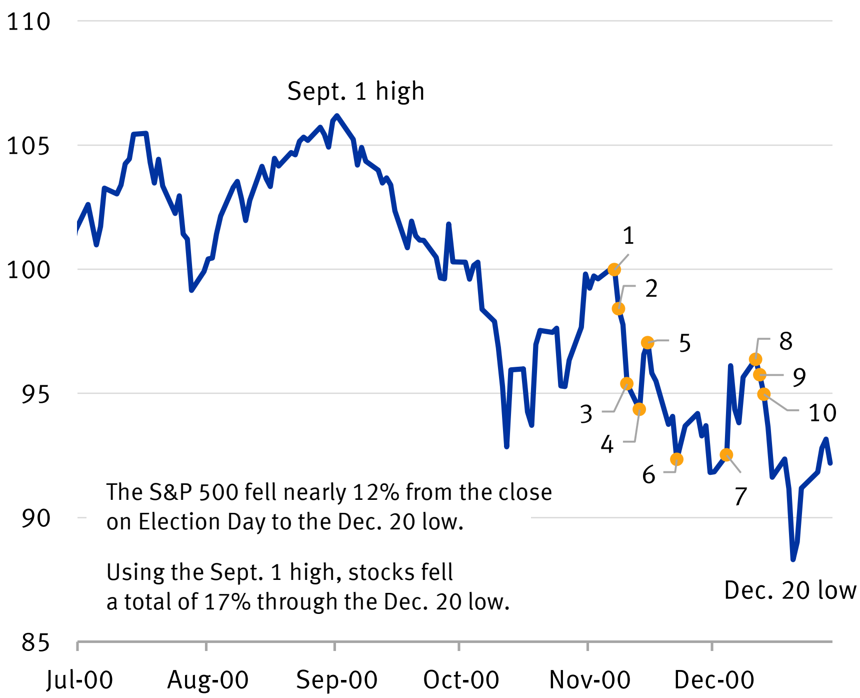
S&P 500 performance surrounding the Bush vs. Gore Florida recount in 2000*



1 - Election Day

2 - Initial Florida vote count very close; Bush leads. Gore concedes, then retracts.

3 - Mandatory statewide machine recount nearly complete. Bush lead shrinks to 327 votes.

4 - Federal judge denies Bush request to stop manual vote recounts.

5 - Broward County begins manual recount.

6 - Bush asks U.S. Supreme Court to block Florida Supreme Court decision allowing manual recounts. *(Bush v. Palm Beach Co.)*

7 - U.S. Supreme Court vacates (throws out) Florida Supreme Court decision; remands it.

8 - U.S. Supreme Court halts manual recounts in a separate case, *Bush v. Gore*.

9 - U.S. Supreme Court reverses ruling of Florida Supreme Court in *Bush v. Gore*, which ends the recounts. 5-4 decision. This effectively awards Florida's 25 electors to Bush.

10 - Gore concedes Bush won the election.

* S&P 500 performance in 2000 indexed to the closing price the day before Election Day (100 = 11/6/00). Past performance is no guarantee of future results.
Source - RBC Wealth Management, RBC Capital Markets U.S. Equity Strategy, FactSet, Stanford Law School, Associated Press, The New York Times, Pittsburgh Post Gazette

was a 5-4 ruling that halted the manual recounts altogether. This effectively awarded the state's 25 electoral votes to Bush, making him the 43rd president.

The S&P 500 fell 12 percent from Election Day on November 7 to the market bottom on December 20, which occurred one week after Gore conceded.

Consider that the market was not at all prepared for this election drama, including the multiple court battles or the Supreme Court's intervention. The events came like bolts of lightning out of the blue. There was no precedent. It was a complete surprise, so the major stock indexes had difficulty absorbing it all.

This election cycle, various atypical scenarios are being discussed openly, including by those in power in both parties—by the president, the speaker of the House of Representatives, other elected officials, and many political strategists and pundits. For voters, such scenarios can be disconcerting—at best. But from an investing perspective, the scenarios are not a secret. The market is well aware this may not be a seamless or normal election outcome. We think this knowledge and the events of 2000 make the market better prepared this go-around.

We also think it's important to remember the Bush vs. Gore dispute is just one instance. One historical event does not make a trend for the market.

Furthermore, today's equity fundamentals, economy, and monetary and fiscal policies differ from that period. For example, as the Bush-Gore recount drama was unfolding, the wildly overvalued tech bubble was beginning to burst—in hindsight, a major historical event for the market. As we have written previously, we do not believe Tech stocks are in a bubble phase today like they were back then.

Stick with your plan

Investors should be aware that a market selloff materialized during the 2000 contested election, and that there are short-term volatility and downside risks associated with the current election. But we would not adjust long-term equity allocations based on atypical election risks, especially since such an event would likely be transitory in nature.

If unusual post-Election Day events occur and even if there are multiple lawsuits, the caravan will keep moving on. The major companies listed on U.S. stock exchanges will be there once everything gets sorted out. And the situation will get sorted out. There is just too much at stake for big business, and more importantly for the country, for us to argue otherwise.

Regardless of who is elected president, and which party controls the House and the Senate—and importantly, regardless of whether there is post-Election Day drama—we see scope for at least moderate U.S. economic and earnings growth, and therefore higher stock prices, in the next 12 months.