



In this month's Insight, Nicholas Bohnsack discusses how we can think of few historical episodes – outside the theatre of war – that have been as universal and roundly negative as that brought on by Covid-19 but remain impressed with the resilience of the economy through the summer.



Nicholas Bohnsack is the President & Chief Executive Officer of Strategas Asset Management and a Managing Director of Baird.

No Comparison

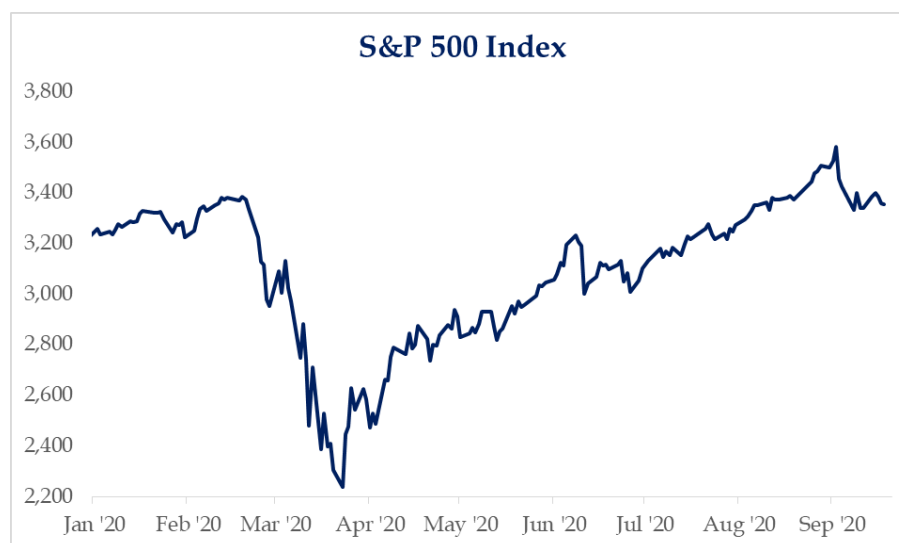
It's become almost cliché to say "2020 is... 'whatever horrible conjuring or other dismissive comment'" comes to mind. While unbelievable in a way, it is entirely understandable given the year we've had thus far. Frankly, we can think of few historical episodes – outside the theatre of war – that have been as universal and roundly negative as that brought on by Covid-19 (and the concomitant fallout from mandating the global economy to a near subsistence crawl). It remains obvious, as we approach the fourth quarter, from reading and watching the news and from conversations with clients that the gnawing persistence of the virus remains extant globally. While it may also be true more broadly, here in the United States, it would seem that after an initial phase of fear and uncertainty earlier this year, life with the virus has come to be experienced in one of two ways: one, a more dire and acutely painful experience defined by loss – the death of a loved one, one's own convalescence or precautionary separation from others, unemployment; and a second, seemingly less consequential experience, better described as a series of interruptions or annoyances from which we are all eager to move past. While it may be too pat to describe the human experience during COVID in such binary terms, particularly given the certainty that there are many who have known both sides of it, we believe it is fair to say that, on the whole, society is learning to live with the virus. Our lives are not going about as they were or even as we hoped they would be, but we are getting on all the same. Those mature enough to acknowledge it's not all about them (which is most of us) are distancing, wearing masks, taking their temperature, and washing their hands, which is allowing schools to reopen, folks to return to work, and a semblance of normalcy to creep back into our daily lives. This provides hope and gets the economic engine moving again. Inasmuch, the economy is picking up steam. We've seen this in fits and starts since June and have been impressed with the resilience of the economy through the summer, despite a clear second wave of cases and the expiry of a number of emergency income replacement policy provisions.

The question now is, how will the recovery play out from here? And what should investors be focused on to best position their portfolios?

With a good deal of assistance from policymakers, it appears we've managed to stave off a protracted Depression-comparable recession and quickly pick ourselves up off the mat. While the economy remains well below previous levels of activity, output, and profitability, it is fair to say we have seen the emergence of notable green shoots, particularly in housing and the consumption of goods. Looking ahead, we see two issues to be mindful of:

- 1) It's possible, as our chief economist Don Rissmiller has suggested, that the easy part of the recovery has already played out. As comparably bad as data were at the low (in the second quarter), it should not have been a stretch to envision data rebounding strongly as the economy reopened (in the third quarter). But now that the easy (mathematical) gains have been made, however – GDP is expected to increase +25% Q/Q AR in 3Q – and in the absence of additional income replacement provision or durable drivers of organic growth, we should expect the slope of economic recovery to soften. The consensus maintains economic growth and profitability will return to previous cycle highs by the second half of next year (CY '21). We're not as confident.
- 2) As comfortable as some have become with the behavioral accommodations necessary to live with the virus, we maintain that in the absence of universal point-of-care testing and an effective vaccine, it will be difficult for the whole of the economy to reopen again. The headline unemployment rate, which surprised many by falling to ~8% last month, remains stubbornly high (and is likely higher, after accounting for inconsistencies in the survey). Again, our focus remains on levels. The U.S. economy would need to add 1 million jobs per month, every month, well into next year just to get up to levels of unemployment seen during typical recessions. Though adding a million jobs per month is a stretch, most would agree that, without a vaccine, it will be nearly impossible. There has been discernible progress made toward the development of a vaccine. Such universal problems engender universal responses. It is likely that questions will persist on both the short- and long-term effects of the initial vaccines that get to market. However, their development and distribution will be a critical step in reopening the service economy, which remains weak.

On the other side of the equation, the stock market has – with some volatility and questionable underpinning – showcased far greater optimism. After a rally led by the sharp rebound in bellwether growth names, market leadership has clearly broadened over the last month to include more traditionally cyclical sectors. If there is any concern that valuations for the big tech names had gotten a little topy, investors do not appear to be taking it out on all stocks. Indeed, the Fed acknowledged earlier this week what the market has been telegraphing for months – monetary policy is likely to remain remarkably easy for years to come. Strategically, it's difficult to not interpret this as bullish for asset prices. Where there is concern about the economy's ability to meet the market expectations, our chief market technician Chris Verrone makes an interesting point: rarely do investors like the way the economy looks five months off the low.

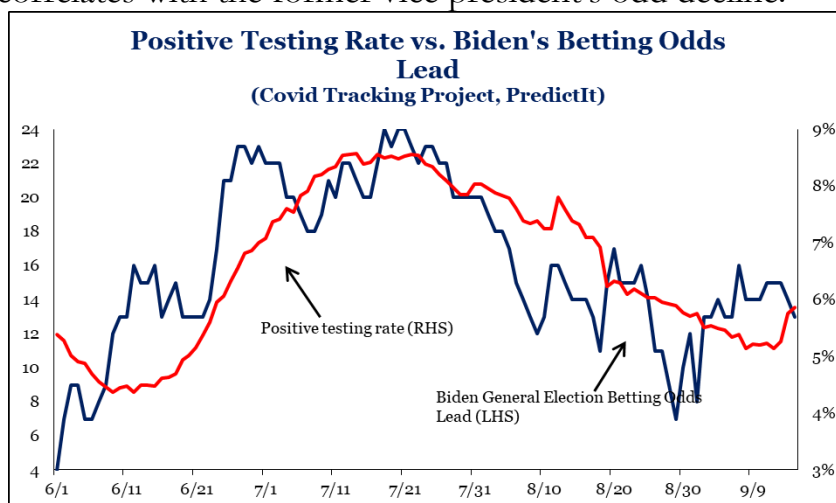


For the time being, we remain comfortable maintaining both an above-benchmark allocation to Equities (64% vs. 60%) and to Cash (9% to 2%). While we have debated increasing our exposure to Equities in recent months (and have chosen not to), we are resigned to funding such an increase from traditional Bond exposures, as opposed to reducing Cash. The equity market is giving a strong cyclical signal; the bond market is showing the opposite. While bond yields are stable – as opposed to falling – we should, if the economy is improving, get to a point where bond yields work higher. This may, at least in part, be adding fuel to the move up in equities. Given the relative flatness of the curve, an above-benchmark allocation to Cash is protecting against a selloff in Bonds as much as it is protecting against a move lower in Equities.

50 Days to Go

With the conventions well behind us and the intensity of focus on broader societal issues – public health, the economy, social justice – many of the traditional policy blocks (taxes, defense) that define the differences between parties and candidates have been minimized. With roughly 50 days to go before Election Day, we're watching three areas to handicap the race and the impact on client portfolios:

- 1) As stand-alone events, presidential debates have historically offered great theater, but rarely moved the needle on the outcome (e.g., Secretary Clinton was widely considered to have won on the substance in her debates with Donald Trump in 2016). However, given the atypical nature of the campaign this cycle, they are likely to matter more, and this will include the debate between Vice President Pence and California Senator Kamala Harris.
- 2) Democrats are still on offense in their bid to reclaim the Senate, but the gap has clearly narrowed. In early August, Democrats were on pace to pick up as many as +6 seats; today, polling suggests the lead has fallen to +3, which would only get the Senate to 50/50. Many states are in play. As the President's poll numbers have improved, so, too, has the GOP's chances in retaining a majority in the Senate. We're watching Arizona (where the GOP is slipping) and Michigan (where the GOP is gaining), but Colorado, Maine, North Carolina, Montana, Iowa, and Alaska are all in play...
- 3) COVID. As the chart below highlights, an upward trend in the number of cases correlates highly with an increase in the odds that Joe Biden will be elected President; a fall in case counts correlates with the former vice president's odd decline.



While 2020 may indeed be one for the history books, it's far from over. Stay healthy. Stay focused.

| Strategas Recommended Asset Allocation (Sep'20) | | |
|--|---|--|
| | Equities | Bonds |
| Overweight | US LC Growth US MC Growth | IG Corporates |
| Neutral | Dev AC Core US LC Value US LC Core US MC Value US MC Core US SC Core EM AC Core | Agencies ABS/CMBS US Dollar EMD TIPS High Yield Banks Loans |
| Underweight | | US MBS U.S. Treasuries |

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