November 6, 2020

11/6/2020		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	28,323.40	1821.80	6.87	2.18	-0.75	3.02
S&P 500	3,509.44	239.48	7.32	1.71	8.63	14.14
NASDAQ	11,895.23	983.64	9.01	0.73	32.57	41.03
S&P MidCap 400	2,026.95	126.77	6.67	1.66	-1.75	1.38

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.16	Euro/Dollar	1.19	1.94
5-Year	0.37	Dollar/Yen	103.31	-1.18
10-Year	0.81	GBP/Dollar	1.31	1.66
30-Year	1.61	Dollar/Cad	1.30	-2.28

Source: Bloomberg/FactSet

What Caught Our Eye This Week

While financial markets were largely attuned to the Presidential election this week, the lack of a "blue wave" (Democratic control of both the White House and Senate) and resultant divided government may have a greater impact for stocks and bonds. First, any anticipated efforts by Democrats to increase regulation on the largest companies within the information technology sector are likely to be less intense. The Nasdaq 100 Index advanced over 9% this week as investors embraced the idea that a confluence of factors may mean additional upside for its technology-heavy constituents. Easier trade relations with China could boost profit margins. An elongated recovery brought on by less economic stimulus would moderate potential increases in interest rates and ease valuation concerns. Second, should Democrats fail to control both the White House and Congress (a less likely outcome), generous Federal aid to shore up the finances of state and local governments hit hard by the coronavirus pandemic may not materialize to the degree previously envisioned. In addition, difficulty in implementing large income-tax increases may decrease the post election demand for tax-exempt/municipal bonds.

Economy

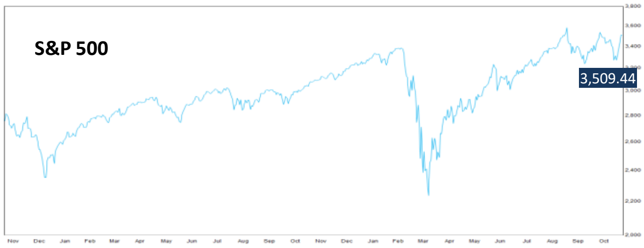
The economic headliner this week was the nonfarm payroll report, which was released on Friday. This report showed payrolls increasing by 638,000 in October, and the unemployment rate declining from 7.9% to 6.9%. The broad U-6 measure of unemployment also declined, dropping from 12.8% to 12.1%. The labor force participation rate increased from 61.4% to 61.7%. Examining the different employment sectors, leisure and hospitality gained 271,000 jobs, retail added 104,000, and manufacturing secured 38,000 jobs. The payroll diffusion index, which measures the number of industries that increased employment last month dropped from 70.3 in September to 68.6 in October. Overall, nonfarm payrolls have increased for six consecutive months. In other news this week the ISM manufacturing survey increased from 55.4 to 59.3 in October. This level firmly beat expectations and is the highest level in two years. The new orders metric surged from 60.2 to 67.9 and 15 of 18 industries reported expansion. Finally, on Wednesday, the ISM nonmanufacturing survey posted a slight decline, dropping from 57.8 to 56.6 in October. On a positive note 16 of 18 industries reported growth.

Fixed Income/Credit Market

Interest rates across the U.S. Treasury (UST) curve increased as much as 20.5 basis points (bps) during October. The benchmark 2-year and 10-year spread steepened 17.6 bps to close October at 72 bps. The steepening was driven partially by the projection of a "blue sweep" and the notion that the outcome would ensure a multi-trillion dollar stimulus package expeditiously. The result was a mixed performance for the fixed income sectors we follow. The top performers were international Treasuries, high yield bonds, and international bonds which returned 1.02%, 0.45%, and 0.35%, respectively. The underperformers were high quality long-term bonds, senior loans, and high quality intermediate term bonds which returned -1.87%, -0.83%, and -0.68%, respectively. With the Presidential election hanging in the balance and an all but certain divided Congress, the 10-year Treasury has dropped from a peak of 0.94% during overnight trading hours on November 3rd, back to 0.82% at Friday's close. The consensus is that final election results will not trigger any major tax hikes nor regulatory changes, therefore putting downward pressure on U.S. Treasury yields.

Equities

Even with all the uncertainty surrounding the U.S. presidential election, stocks managed to post their strongest weekly gain since April. The equity market strength is largely considered to be due to an assumed split Congress which should translate to the continuation of a favorable tax environment. Furthermore, according to FactSet, a fiscal stimulus package is likely to happen over the near term in the $1 trillion + range. Outside of all the noise from the election, corporate earnings have been very strong. As of Thursday, according to FactSet, 80% of the S&P 500 have reported Q3 earnings with roughly 86% of companies beating consensus estimates. In aggregate, earnings have been more than 19% above expectations. With all of this said, coronavirus infections continue to move in the wrong direction. On Thursday, the U.S. logged a record of over 120,000 new coronavirus infections. All sectors finished the week in the green with information technology being the relative outperformer posting a 9.70% gain and energy being the relative underperformer gaining only 0.81%.



Our View

The political uncertainty of the last few weeks has been overhanging the financial markets and is partially the reason why the equity markets have been on a roller coaster ride. The week, heading into the election equity, markets were preoccupied by the diminishing prospects for a fiscal stimulus deal, rising coronavirus case counts and talk of a contested election. Stocks experienced their worst weekly decline since March. Despite the lack of a clear election outcome and the lack of a blue wave that many anticipated, the equity market rallied anyway this week and reversed the recent selloff. The likely election result is for divided government with the Republicans retaining control of the Senate assuming the Georgia runoffs break their way. Assuming divided government holds, the next round of stimulus will probably be less robust, and it may take longer to arrive than if the Democrats had total control as a result of last Tuesday's election. We should expect a continuation of our structural deficits of approximately $1.1 trillion over the next few years. It also means that we will not see a significant change to tax rates over the near term, which removes a significant near-term concern for many investors. With a large structural deficit as the core fiscal policy element and the Federal Reserve intent on remaining stimulative until the unemployment rate falls below full employment, it seems the die is cast for economic reflation over the next few years. The Fed has been quite clear that it only intends to tighten monetary policy when it forecasts inflation to average greater than 2% over the medium term. The coronavirus and the government's response will impact the slope of the recovery over the next year, but as the cycle extends out into 2022 it would not be a surprise to see inflation approaching conditions that would warrant a normalizing response from the Fed. In the short-term, investors need to deal with this period of electoral uncertainty and stay focused on long-term investment objectives.

COMING UP NEXT WEEK		Consensus	Prior
11/12 CPI ex-Food & Energy SA M/M	(Oct)	0.20%	0.20%
11/12 CPI NSA Y/Y	(Oct)	1.3%	1.4%
11/12 Initial Claims SA	11/07	737.5K	751.0K
11/13 PPI ex-Food & Energy SA M/M	(Oct)	0.15%	0.40%
11/13 PPI NSA Y/Y	(Oct)	0.40%	0.42%
11/13 Michigan Sentiment NSA (Preliminary)	(Nov)	81.1	81.8

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