



Economic Update

As autumn approaches and we near the end of the third quarter, the vigorous equity market recovery that began in Q2 continues. As of 9/15/20, the S&P 500® is up 11.5% for the quarter and the Russell 3000 and NASDAQ Composite have both advanced nearly 10%. August, in particular, saw strong steady upward momentum in equities with a notably significant reduction in volatility—resulting in all three indexes posting all-time highs on September 3rd.

But what exactly has been the driving force behind this latest quick and convincing market upturn? We believe there are a number of tailwinds which have factored into the recent surge:

- Perhaps most importantly, the Fed remains very much dovish. A loose monetary policy combined with a broader arsenal of policy tools (e.g., ZIRP and NIRP, QE Infinity and potentially even Modern Monetary Theory) gives the modern Fed a great deal of flexibility. Interest rates remain at historically very low levels, and we expect short-term rates to be pegged near zero for the foreseeable future—in part to stimulate the economy, but also to allow the government to borrow cheaply. With rates this low, equities are likely to continue offering significantly better returns than fixed income in the near term.
- Recent corporate earnings and forward guidance have, for the most part, remained strong throughout the technology sector and certain consumer-related industries. Even hard-hit sectors such as energy, financials, utilities, and transportation appear to have bottomed out and either stabilized or begun to slowly recover.
- U.S. GDP looks to be bouncing off the lows earlier in the year. After posting a 5% annualized drop in Q1 and a staggering 33% plummet in Q2 as COVID-related lockdowns and stay-at-home orders peaked, the consensus estimate is for Q3 GDP to post around a 20% annualized increase as more businesses open back up. This, coupled with a steady drop in the U.S. unemployment rate—from a high of nearly 15% in April to a current level of 8.4%—has provided additional fuel for equity markets.
- Furthermore, the general COVID-19 situation seems to be gradually getting better. Nationwide, both total case numbers and death rates look to be steadily declining week-to-week. Promising progress continues on several potential vaccines. And previously hard-hit areas like NYC and Los Angeles are further opening up.
- The AAI Investor Sentiment Survey continues to maintain a decidedly bearish tilt. For the week ending 9/9/20, just 23.7% of investors are bullish while 48.5% are bearish and 27.8% are neutral. Typically, the bull to bear ratio runs around 38% to 30.5%. Historically, a strong negative investor sentiment bodes well for the stock market as it signals a lot of cash sitting on the sidelines waiting to invest.

It's important, however, to keep in mind that a market recovery does not necessarily equate to an economic recovery. Markets are forward looking—anticipating the business and economic environment 6 to 12 months into the future. The positive momentum we're currently seeing is more indicative of expected economic health in late 2021 and early 2022 than a reflection of where we are today.

This begs the question of whether there's a disconnect between the equity markets and the economy. Certainly there are imbalances. Money has rotated heavily into tech stocks (particularly FAANG stocks) and away from areas such as travel/hospitality and energy. As a result, valuations

may be somewhat skewed at the moment. But as previously noted, there's a great deal of cash that remains on the sidelines—estimated at \$4.5 trillion (up from \$2.8 trillion in February)—ready to be deployed to help rectify some of those imbalances.

The apparent contradiction between a declining GDP coupled with a stock market rally, however, is nothing new. Looking at the 30 recessions the U.S. has experienced between 1869 and 2018, more than half of them (16) saw positive stock market returns—as measured from the start to the end of each recession. These positive-market recessions lasted on average 16 months, with stock returns averaging 9.8% and GDP declining 3.0% on average.

Political ramifications

As if the COVID crisis didn't present enough uncertainty, the November election quickly approaches. We're living in a time where emotions run high and even seemingly apolitical things (e.g., mask wearing) have somehow become polarizing issues that break along party lines. It's therefore even more important to try and remove ingrained political biases prior to making important investment decisions.

When you analyze the historic data, it quickly becomes apparent that there's absolutely no statistical distinction in market performance under Republican or Democrat administrations. Since 1945, a traditional 60/40 stock to bond portfolio has delivered a 6.1% average annual return under Republican presidents, and a 6.0% average annual return during Democrat administrations.¹

Certainly, an administration's platform and policies may have an impact on which sectors outperform. Republican wins have historically provided a tailwind to Defense, Energy and Financial stocks, while Democrat administrations have helped lift the Healthcare, Consumer Staples, Utilities, and Real Estate sectors. Aside from possibly tweaking your exposure to certain sectors and periodically re-balancing your portfolio to maintain an appropriate asset allocation and risk profile, the best thing you can do for your long-term financial prospects is to remain fully invested, stick to your plan, and leave partisan politics out of your portfolio.

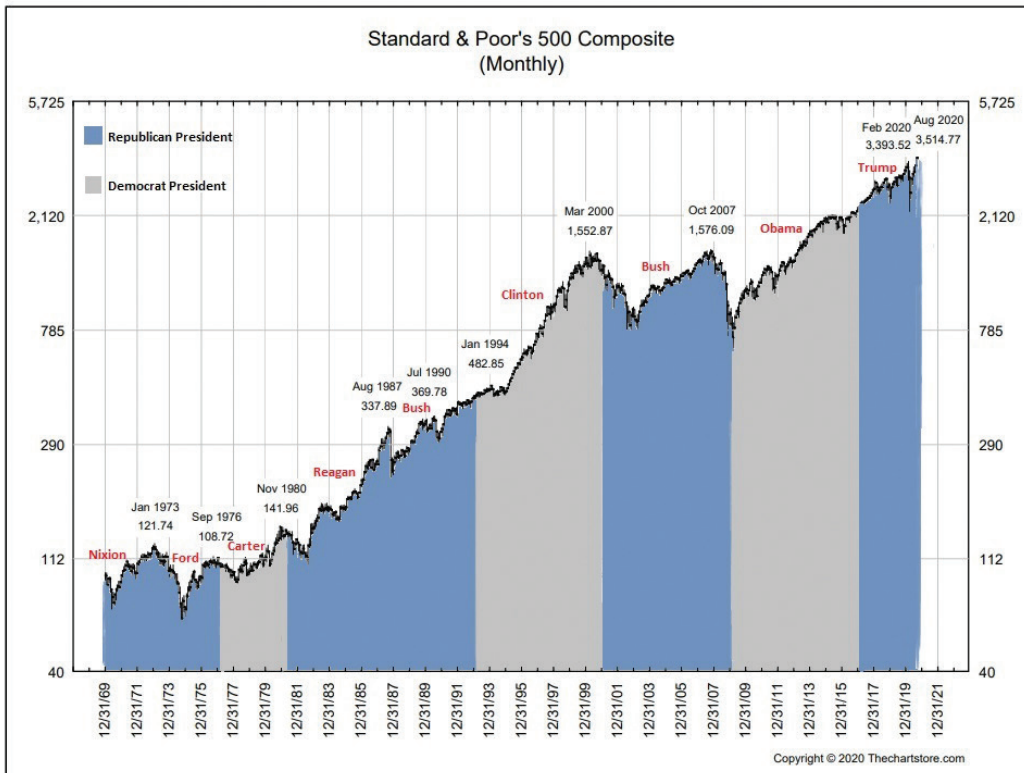
Still worried about the election? Try to adhere to the following three suggestions:

1. Don't listen to the political and economic pundits telling you that one candidate will save or ruin the economy and the stock market. The economy is driven by the actions of millions of people and tens of thousands of institutions—not a single person or political party. Media headlines are designed to capture your attention to generate revenue. So be skeptical of what you read and hear.
2. Stay focused on the things you can control rather than fretting over different possible election outcomes. Meaningful, concrete actions like re-balancing for proper diversification to help dampen volatility will serve you far better than trying to anticipate which policies will prevail and what the resulting economic impact will look like.
3. Consider the chart on the following page. The stock market has gone up—and down—under every single president. Over time, however, the trajectory has always been positive. Getting too hung up on what-ifs about the coming four years means losing sight of the big picture over the next twenty years.

Tax implications

One topic clients may want to discuss with their advisor is planning for possible tax law changes that might occur if Biden wins and Democrats also take control of the Senate. These could include:

- A roll-back of federal estate and lifetime gift tax exemption amounts to \$5MM
- An increased top income tax rate
- Higher capital gains tax rates



The path of the pandemic

There still remain a great deal of uncertainties surrounding whether the nation will experience a second surge of COVID infections as the weather becomes colder, people head back indoors, and businesses and schools continue to migrate from remote to in-person operations. Developments on the vaccine front appear promising, with a number of potential therapies in clinical trials. Whether an effective vaccine will be approved, and how quickly it can be brought to market, distributed and administered remain open questions at present.

If a vaccine cannot be found, it's likely the virus will linger and we'll experience regional flare-ups from time to time causing prolonged market uncertainty throughout 2021. Additionally, any continuation of lower incoming tax revenues combined with higher outgoing stimulus payments, could see the deficit and debt continuing to mount. This could bring about a weakening of the U.S. dollar and potentially trigger higher inflation. Long-term interest rates have begun gradually rising over the last couple months which may be another portent of inflation on the horizon.

Looking ahead

Even at 8.4%, the current unemployment rate remains markedly higher than pre-pandemic levels. GDP, while rebounding, remains lower than it was at the start of the year. Although Q2 appears to have been the trough of this recession, plenty of risks remain. It's certainly possible that GDP growth will continue to improve through year-end and into 2021. But how rapidly things improve will likely depend on a multitude of factors mentioned above as well as the impact of newly implemented Federal Reserve policy. The Fed has indicated a willingness to allow inflation to drift above 2% and/or the unemployment rate to crater without taking any action to cool down the economy. They've also signaled a continuation of "easy" accommodative monetary policy for the foreseeable future.

As a result, stock P/E's may remain higher than normal as interest rates along almost the entire curve are negative in real terms. Investing in high grade fixed income (e.g., Treasury bills, notes and bonds, CDs, or bank deposits), therefore, will struggle to generate enough income to offset the cost of inflation. Essentially, by fleeing to the supposed safety of bonds, you'll actually be losing money when adjusted for inflation. For higher returns, investors will need to consider taking on more risk.

Administrations come and administrations go. Recessions come and recessions go. Your long-term financial plan, however, doesn't need to change from one to the other. When uncertainty and fear begin to weigh on you, take solace in the wisdom of Warren Buffett who describes the stock market as "a device for transferring money from the impatient to the patient." Remain unflappable.

1 "Annual Returns on Stock, T. Bonds and T. Bills: 1928 - Current," Stern NYU



**Emergency
COVID-19
Needs &
Fall Events**

B LBB Charitable, the giving arm of BLB&B Advisors, in August announced grants of \$40,000 to several area cultural institutions that continue to struggle with closures or reduced revenue due to the COVID-19 pandemic. Grants were awarded to The County Theater in Doylestown, The Ambler Theater, The Bucks County Historical Society Mercer Museum, and ACT II Playhouse. BLBB Charitable made these one-time grants outside its mission focus of education and leadership opportunities to preserve important community institutions in its own backyard. BLBB Charitable also made one-time emergency unrestricted grants to three of its Education and Leadership Impact multi-year grantees (including Bucks County Opportunity Council and ACHIEVEability) that have seen a substantial increase in needs by their community.

This month, BLBB Board member, Dean Karrash (*photo at right with wife Maria*), was on hand to dedicate Mary, Mother of the Redeemer School’s new STREAM Innovation Lab, funded with a BLBB Charitable grant. The Innovation Lab will become a flexible and all-encompassing environment for students to research and create, using inquiry to learn about the design and engineering process.



In 2020 to date, BLBB Charitable has committed more than \$740,000 in **Education and Leadership Impact Grants**, in addition to its support of the community service and giving of BLBB employees through its corporate matching program. This fall, BLBB Charitable or BLB&B Advisors are sponsoring the following events and we hope to see you there (even virtually): Alpha Mid-Atlantic Golf Tournament; The Travis Manion 9/11 Heroes Run; Wissahickon Trails’ Green Ribbon Gala; Bucks County Historical Society Cocktails by the Castle; Together for a Cure: An Evening Beyond Celiac; and the Briar Bush Nature Center’s Feather Our Nest Gala.



L to R: Doug Huntley, Clif Haugen, John Lawton, Laura Brewer, Dean Karrash



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