Catholic Foundation of Southwest Iowa
Market & Portfolio Commentary – October 12th, 2020

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Elections have consequences, but they're not always immediately clear to markets. The 2016 election is a memorable example of an initial market move proving to be more noise than signal, with S&P futures' weakness on election night giving way to a strong subsequent rally. It's a reminder to put post-election moves in the appropriate context before buying into or leaning against them. That may be doubly important this year given the potential for a delayed result and investor confusion about the forward path for US economic policy.

Investors crave precision in quantifying risk. Yet that level of precision is waning when it comes to sizing up risk from events like pandemics, trade conflicts, legislation, and elections. Like it or not, we see investors being pressed into this style of analytical action as the new normal. Geopolitical trends towards multi-polarity, fiscal expansion, and 'slowbalization' are not going away and will have lasting ramifications for market strategy.

But what if a brief moment of policy clarity is about to emerge, giving investors a reprieve from the chaos of 2020? Some emerging information could quickly turn into trends on two key US policy debates. This would give investors some unexpected, and underpriced, clarity

1) **There are seemingly likely paths to fiscal stimulus in the medium term, even if near-term paths dead-end.** First, let's define fiscal stimulus. Fiscal stimulus refers to policy measures undertaken by a government that typically increase government spending in order to boost economic activity. The market debate on the next US fiscal stimulus has been framed for months in terms of whether or not such action would come in the short term. Last week's developments effectively answered 'no' to that question. Yet, it's possible that a stimulus delay wouldn't fully develop into the economic challenge it has the potential to be. Our economists now see evidence that US consumption can carry on for longer without fiscal support, given built-up excess household savings. This is good news as there are many viable political paths towards stimulus over the next three months. We see three out of the four most likely post-election party configurations delivering stimulus by early 2021.The biggest potential stimulus could come in a Democratic sweep, a result that may appear increasingly probable to investors, given a body of polling data that shows Joe Biden with a sizeable and stable lead in sufficient battleground states, and Democrats competitive in key Senate races. In this scenario, in addition to an upsized COVID-19 relief package, we believe that the 'plausible policy path' is further fiscal expansion as Democrats enjoy legislative consensus regarding their spending agenda but not regarding sufficient tax increases to fund it.

2) **Voters appear to be returning mail-in ballots quickly, limiting the risk that investors must wait beyond 'election week' to reliably know results.** Voters were honest in our surveys about their intent to increasingly vote by mail (VBM). State data show VBM requests shattering records. But voters also appear to be returning those ballots much quicker than anticipated. Consider the swing state of North Carolina (NC). VBM requests are already nearly five times their 2016 total. But over 30% of them have already been returned. Of those, over 50% are from registered Democrats. While these numbers don't put to rest concerns about a delayed result (unreturned VBMs in NC remain nearly 20% of the 2016 vote), this would change if the trend continues. Consider that in NC, VBMs can be counted before election day. Hence, their rapid return could have two key effects: 1) Quickening the pace of the overall count; and 2) Reducing the risk that vote count progression sews uncertainty by initially showing large Republican leads that erode slowly on VBM counting. This would reduce the risk that it would take more than a few days beyond election day for investors to reliably know a result. Exhibit 1 shows a similar trend emerging in other swing states. Hence, the skew now appears away from not reliably knowing the result beyond a few days post-election, and we're adjusting our scenario probabilities accordingly. Our base case remains 'Election Week' (70%), but we're increasing the chances of 'Silent Night' (20%) and reducing for 'Election Month' (10%)

In our view, key markets are not geared for such a moment of policy clarity should it emerge before year-end, presenting opportunities for some proactive and reactive tactics. One reactive idea is in US equities, where a dip-buying opportunity could emerge. For example, if a Democratic sweep outcome in the election becomes known quickly, markets could initially reflect concerns about rising taxes before giving way to the benefits of fiscal expansion and, perhaps more importantly, an economy that remains in the recovery phase of the cycle. We think US equities could *ultimately* do well in a Democratic Sweep, as: (1) it carries the highest odds of fiscal stimulus, (2) we think tax increases could be delayed/diluted, and (3) a broader bull market trend remains dominate.

We see an outcome where President Trump remains in office and/or the Republicans keep control of the Senate as a short-term boon to asset markets, as taxes will plausibly remain lower and pro-growth initiatives such as de-regulation will remain strategic prerogatives under a second term for the Trump administration.

Regardless of the outcome, we will evolve and adapt and stand ready to steward the Catholic Foundation assets in a prudent manner with a keen focus on generating attractive long-term results in alignment with Catholic Values. While short term price action could be interesting to watch, we ultimately think that business cycles matter more than which party is in the White House.

See below for year-to-date net return estimates as of 10/11/20:

Strategic Growth Fund: +6.1%
Moderate Growth Fund: +7.5%
Capital Preservation Strategy: +1.3%

US Large Cap Stocks (S&P 500 TR): +9.22%
US Small Cap Stocks (Russell 2000): -0.8%
Global Stocks (MSCI ACWI): +4.3

As always, please do not hesitate to reach out to us with any questions, comments or concerns.

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