"Titanic forces are arrayed against each other: Fed and Treasury versus disease and recession".

Three major macro issues are for the most part driving the commentary and thus the valuation of equity markets, in particular the S&P 500. The three are; the pandemic, the economy and the US election. The negative effect on the economy of the lockdowns and job losses has caused massive support to be brought to bear both from central bank liquidity injections and government bailout payments. Howard Marks of Oaktree Capital has an outstanding investment mind and he summed up succinctly the current market; "Titanic forces are arrayed against each other: Fed and Treasury versus disease and recession". As the S&P 500 nears all-time highs, the obvious winner to this point is the former. The question on everyone's mind remains how long and how strong can such support continue if a weakening economy requires it. The answer of course is unknown but will be based on the desire and also the ability of the Fed and Congress to stay the course. Chairman Powell of the Fed has been clear that whatever is needed on the monetary front will be supplied, and with no sign so far of inflationary pressures in the economy he has that ability. A continuation of government largesse such as extra unemployment benefits and direct payments to citizens, seems a bit more tricky. Democrats appear to be all in on extending support payments while Republicans are more reluctant whether due to a more conservative nature, a fear of socialist policies or just the general peevishness that permeates Washington these days. As for the ability to continue to rapidly increase the federal government budget deficit and debt burden there are no barriers in the short term but the necessity to pay the piper somewhere down the road is reason to be very apprehensive. On the other hand Modern Monetary Theory is attracting more adherents particularly amongst Democrats and it states that a sovereign nation such as the U.S. can use the printing press to cover fiscal spending without concern for paying it back. I am sceptical about the concept but at least for now some compromise will be reached in Congress and the consequences will be left to be dealt with at a later date.

What I am sure is having a positive impact on both financial markets and the economy globally, particularly in the U.S., is the swift and massive intervention by central bankers and

I am in no position to predict where this pandemic is headed other than to say any hope I had that a return to some form of normalcy in the near term has disappeared. Re-openings around the world have been disappointing as increased rates of infection have reoccurred. Until a vaccine is discovered (maybe sooner than we think) or there is a "herd immunity" (not even close) the disease will continue to have some level of negative impact on global economies.

Equity markets have maintained a positive outlook for the economy and earnings based on what can only be described as less awful economic releases. While the bounce back from the disaster that was the March/April period in the U.S. has been impressive, applauding an unemployment rate in excess of 10% seems overly optimistic. It is difficult to truly understand what is happening in the economy when the numbers reported are subject to unknown assumptions, seasonality, annualizations and of course future revisions. Also adding to the confusion is the number of dichotomies present in today's economy. For instance, unemployment is up but so is household income and spending, (due we suppose to government support payments); and housing is strong but mortgage defaults and bank loan loss reserves are rapidly rising. What I will say is that closing businesses (temporarily or permanently) and putting people out of work (temporarily or permanently) cannot be good for the economy.

Then there is the looming election which is likely to be more impactful as we get closer to November (assuming it isn't delayed). Biden is leading in almost all the polls but there is lots of time for that to change. I sense the rise in support for Biden is as much an anti-Trump movement as a pro-Biden one. Such support can be tenuous if not backed by real policies that voters can get behind. One policy a Democratic sweep almost guarantees is higher corporate and capital gains taxes. Trump continues to play to his "base", often in a rambling if not incoherent way. He will need more than his base to win and the question is can he attract enough others who are currently on the fence? As an aside, does it bother anyone besides me that almost all the players in this drama are old?

As I write this letter the S&P 500 is edging into all-time high ground and NASDAQ is there already. History tells us, if history matters anymore, that a breakout to new highs needs to surpass that level by 3% to confirm, which is about 100 points. We will wait and see but regardless of the outcome the message of the market is more positive than I or many others had assumed given the pandemic and its effect on the economy. What are some of the counter arguments to the bearish themes that have been and are being expressed? As the market has risen so have the levels that would support prices during a decline. The large cap tech stocks have in large measure been responsible for the higher index prices which has promoted the argument that such narrow leadership warns of lower markets to come. While not entirely discrediting that contention, we have recently seen improvement in some broader based indices such as the Russell 2000 which suggests the number of stocks participating is improving. Much has been written about overvaluation but it's an old market maxim that the P/E multiple should rise as interest rates decline. Thus, given historically low interest rates isn't it appropriate to have an historically high P/E multiple. Finally, the widespread opinion that the market is not reflecting the real world can partially be dispelled by breaking the market down into relevant sectors. Companies that are benefitting from people being forced to stay home and use computers and mobile phones to interact with the outside world have done extremely well. Other sectors such as department stores (down 60%) and airlines (down 55%) have accurately reflected the economic pain.

In summary I still believe we have come too far too fast. The market says I'm wrong.

Disclosures