MARKET WATCH
ELECTION JITTERS

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"Make sure the patient remains completely fixated on politics."
~C.S. Lewis – The Screwtape Letters

Obviously, the entire focus is on the U.S. election this morning, and while the situation remains fluid, it looks like Donald Trump is once again proving the polls wrong. Though Biden looks like he managed to swing Arizona, Trump has the lead in some remaining battleground states with the race still too tight to officially call for any outlet.

At this stage it looks like the Democrats will hold Congress and the Republicans will maintain the Senate majority. Regardless of who wins the presidency, stimulus (fiscal spending) is still highly likely but maybe lower with Washington remaining divided.

This election saw record turnout, including mail-in ballots that will take time to count in swing states Pennsylvania, Wisconsin, and Michigan as they don't allow counting prior to election day.

There is some economic data out this morning, but investors will remain focused on the election results. Technology stocks are up significantly led by NASDAQ futures, with Industrials and Materials stocks flat to down. Our Buying Power models, which measure the strength of money flowing into a sector continue to suggest inflationary assets such as Materials and Industrials, will out-perform over the next 6-12 months.

With stocks up strongly, oddly, bonds are also rallying driving longer term interest rates lower. It looks like the election uncertainty are driving investors to their old trusty playbook. Long tech and long bonds.

The Associated Press, the unofficial but respected interpreter of election results, hasn't yet called a winner.

For us, this week's election noise is almost to be ignored, the drop in interest rates today being the prime example. Filtering through the noise to see the trend is key here. The 10-year treasury yield's correlation to many risk assets is coming off the MOST positive reading in 20 years. There is an old saying "Correlation is not Causation" as one factor does not always cause the second factor to move in lockstep. Usually something else acts as the catalyst. The 10-year treasury yield generally correlates with investor fear and greed. Historically, when investors are fearful and expect deflation they buy bonds and sell cyclical assets which in turn pushes yields lower and cyclicals lose relative performance, therefore the correlation between interest rates and cyclicals goes positive.

Conversely, when investors are greedy and expect inflation they sell bonds (pushing yields higher) and buy cyclical assets which go up faster than the overall market. Therefore, the rising yields and the rising alpha produce a positive correlation. Currently the correlation between yields and cyclical assets like Industrial stocks are just coming off multi-decade highs and extremely positive. This tells me that the correlation will continue to be positive for the coming quarters as investors, expecting inflation, begin selling bonds and buying cyclical stocks!

Either way, we will follow the trend and keep you posted.

Peter Schenk, CMT, CIM | Portfolio Manager

Words we operate by:

“Deliver to the world what you would buy if you were on the other end. There is huge pleasure in life to be obtained from getting deserved trust. The way to get it is to deliver what you would want to see if you were on the other end.”

-Charlie Munger

“Strive not to be a success, but rather to be of value.”

-Albert Einstein