The Long & Short of It
Quarterly Newsletter
Third Quarter 2020

Mencken's Monkey Cage Moment

The third quarter, while very good for mega-cap growth stocks, was challenging for the broader stock market, our nation, and the world. Looking back over 12 months, the adjacent table shows a similar story, with large sections of the economy suffering. Of note are the narrow concentration of winners and the vast gap between winners and losers, all in the face of plagues, riots, fires, and mayhem not seen since perhaps the 1960s.

Index	12 Month Return through 9/30/2020 (%)
S&P 500	+15.2
Russell 1000 Growth	+37.5
MSCI EAFE (TR grs)	+0.9
Russell 1000 Value	-5.0
S&P 600 Small Cap	-8.3
S&P US REIT	-17.9
Crude Oil	-42.8

H.L. Mencken wrote, "Democracy is the art and science of running the circus from the monkey cage." Elections, the most democratic aspect of our governing process, often bring added uncertainty to financial markets. Rising COVID-19 case counts will provide the backdrop for what will be a hotly contested election. The media will seek to maximize viewership through overly provocative statements, convincing viewers and readers that what they are seeing and hearing is unprecedented and sure to ruin our nation—unless it doesn't. The media will insist that today's moment is the most important in history—unless it isn't. In the end, the circus will pack up and move to the next news cycle and begin the show again. While significant, this moment is unlikely the *most* important. And it is certainly not without precedent.

"A Drunken Syphilitic Swindler"

These words were used in 1876 by Rutherford B. Hayes, a Republican, to describe his opponent, Samuel J. Tilden, a Democrat. Accusations of voter fraud ran rampant across several states, much like today. The presidency was ultimately not determined until March 2, 1877 with "The Compromise of 1877," which allowed Hayes to claim the 20 electoral votes he needed to secure the win. In return, Republicans promised to end Reconstruction and allow the removal of federal troops from the South, leading to the deplorable Jim Crow laws whose impact continued for almost 90 years up to the 1964 Civil Rights Act. As with Hayes and Tilden in 1876—and even Thomas Jefferson and John Adams in 1800—today's loss of civility and allegations of election fraud are lamentable but nothing new.

Under the Big Top

Less than a month away, the 2020 election roars with bitter rhetoric and contentious issues: a global pandemic, the state of healthcare, violent protests. Despite all this, a handful of high-performing stocks allow the market to appear strong. What trapeze act is this? How do the markets stay aloft?

Let's head back to 1876 for a moment. At the time, there was neither federal fiscal stimulus nor a Federal Reserve Bank. US government spending was less than 4% of GDP, and therefore Washington DC exercised little control over economic activity and outcomes. Today, federal government spending is approximately 29% of GDP, enabling a relatively large say in determining economic winners and losers. The Federal Reserve very much exists, moving electrons on a screen to make money grow on trees ("free money") with their partner in crime, the Treasury. Mencken's monkey cage may be inhabited by the Wizard of Oz, yet the world continues to heed the warning that we "pay no attention to the man behind the curtain."

Today's backdrop of extensive deficit spending and expansionist Fed policies has allowed the show to go on despite the economic suffering wrought by the pandemic. The big top will be kept afloat by all that free money as three "acts" take the center ring this fall: 1) the coronavirus, 2) market uncertainty over election outcomes and smoothness of transitions, and 3) the magnitude of one's party victory over the other.

COVID-19

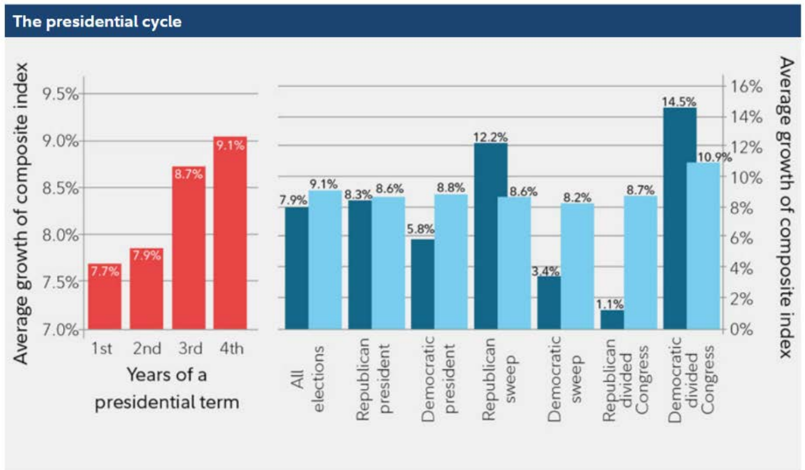
Colder weather and increased indoor activity will likely drive the case count higher. As treatments become more effective and mortality rates decline, people feel less threatened by the virus and the case counts will rise. This is a rather normal progression, but the response by politicians to the spread will be harder to predict. Therefore, though it is a bit morbid, "deaths per day" is a better indicator of the virus's economic impact. If deaths remain steady or continue a downward trajectory, further shutdowns and economic damage may be avoided.

Election Uncertainty = Stock Market Volatility

As uncertainty about the outcome of the election peaks, accompanying stock market declines should bottom. There is already so much consensus of a drawn-out election process, with scary and possibly violent consequences. Much of this anxiety may already be priced into the stock market, though the most disturbing outcomes certainly are not.

Which Party Wins

As consensus forms about winners, two scenarios are likely depending on which party wins. The stock market has tended to fall on Democratic party victories and rise on Republican ones. The adjacent chart indicates as much, but it only covers performance starting from January of a new administration. And Mr. Market discounts the future when determining its current price. This means that by the time January arrives, much of the expected impact of the new administration's policies—sometimes too much—is already priced into the market.



Dark blue bars in the right panel indicate returns during the first 2 years of a president's term. The light blue bars show the 4-year return. Monthly data since 1789 (mix of S&P 500, Dow Jones Industrial Average, & Cowles Commission). Source: FMRCo.

In one sense, the yin and yang of our political parties come down to growth vs. equality. Investors assume a Democratic administration will be hard on economic growth in pursuit of equality and social justice. In a Democratic win, the stock market tends to lag until the administration is up and running. Conversely, the prospect of a Republican administration typically buoys the stock market with hopes for business-friendly policies. But the market often expects more change than actually happens. The subsequent year or two tends to see the initial loss or gain reversed, except in the rare "sweep" when expectations for significant policy changes are met.

Whether investor uncertainty dissipates and consensus is formed before the election, or during election night as it did in 2016, or even weeks or months afterwards as in 2000 and 1876, market volatility will occur. Our goal is to be ready and to take advantage of opportunities presented.

Ringmaster

At Robinson Value Management, our job is to keep our clients' investments safe so they can participate in the wealth creation of the stock market but not be maimed by a permanent and unrecoverable loss of purchasing power. We believe valuation matters in the long term and that some patterns repeat in all the short-term activity—even in some of the surprises. Unknowns will always exist but in the end, one can only prepare extensively and then implement with care and consistency. We are very selective about the risks taken in seeking to generate solid returns. So, dear clients: rest easy and enjoy. The show must go on.

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