



BRIEF MARKET COMMENTARY – THOUGHTS ON THE UPCOMING US PRESIDENTIAL ELECTION October 28, 2020

For a variety of reasons, next week's presidential election and the circumstances surrounding it certainly seem unique. It's perhaps one of the most emotionally charged elections in decades. And there's a significant likelihood that we won't know the outcome for several days or weeks after polls close. Beyond a ballot-counting delay, we could ultimately have a disputed or contested election result, creating considerable uncertainty.

Political uncertainty has often weighed on financial markets around presidential elections—and volatility is typically highest when the incumbent party loses. But history shows that any election year declines are usually short-lived and the political party in power is not a significant driver of long-term investment returns. There are simply too many other variables that also impact financial markets and asset prices over time. US presidents may have an impact on markets but so do lots of other factors, such as the actions of foreign leaders, interest rate changes, technological advances and a global pandemic, to name a few.¹ In addition, the linkage between an election result and market impact is not always clear; in 2016, many commentators expected markets to suffer if Donald Trump was elected president, but the opposite occurred.

In our view, developing portfolio strategy isn't based on attempting to predict the short-term market reactions to events like elections but, instead, being prepared for a range of potential outcomes. We stick to our longer-term analytical framework in which we consider multiple macroeconomic scenarios while assessing the risk/return potential for various asset categories and investments. Therefore, we'll approach this election as we've done in the past by looking through to other fundamental drivers of financial markets and being ready to take advantage of potential volatility if presented with attractive investment opportunities. And as the election results and policies that follow become clear, we'll carefully reassess our views and fundamental outlook.

In terms of the current macro backdrop, an unusually wide range of potential economic outcomes exists. In our view, what happens with the coronavirus will have the biggest impact on near-term growth. Yet, fiscal and monetary policy will likely remain accommodative under either presidential candidate.² Thus, our base case assumes a slow, uneven economic recovery that should continue to underpin financial markets and prove favorable for risk assets like equities and credit. After a strong rally from the March lows, however, US equity valuations are a bit stretched, while bond yields are historically low, and volatility is likely to remain high.

Against this backdrop, proper diversification may be as important as ever. We believe portfolios should be structured to participate if an optimistic V-shaped recovery is realized while remaining resilient if the recovery falters and environment remains turbulent.³ From a tactical perspective, we continue to recommend a slight defensive tilt with an elevated cash/short-term fixed income position as "dry powder." In our view, portfolios should also emphasize opportunities that offer more attractive risk-adjusted return potential—specifically non-US stocks and selective high yield credit. We believe the investment case for certain diversifying alternative strategies is also compelling given the extremely low yields across most fixed income sectors.

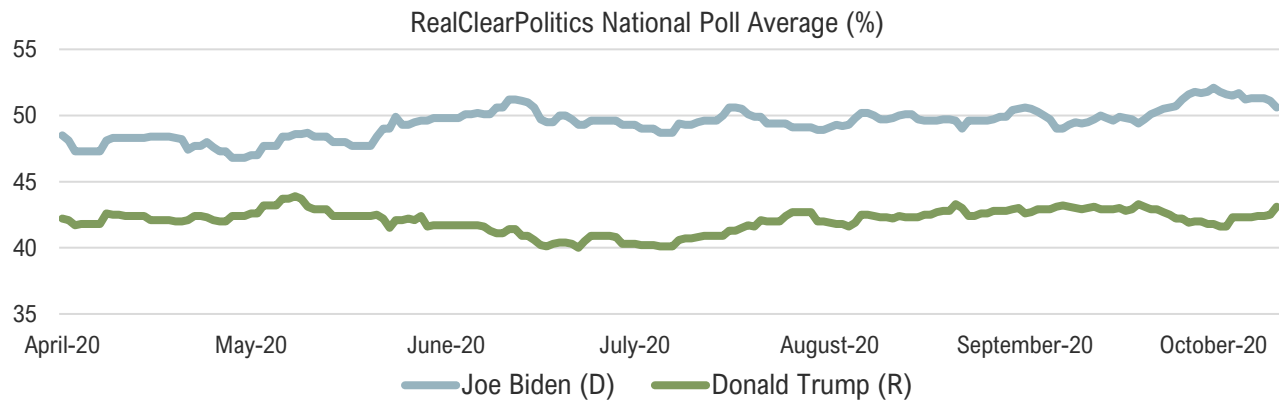
On the following pages we also provide an update on the current state of the presidential election race, a review of historical equity market performance by presidential party in power and a comparison of Trump and Biden's positions on key policy issues.

Appendix A: Current State of the Race

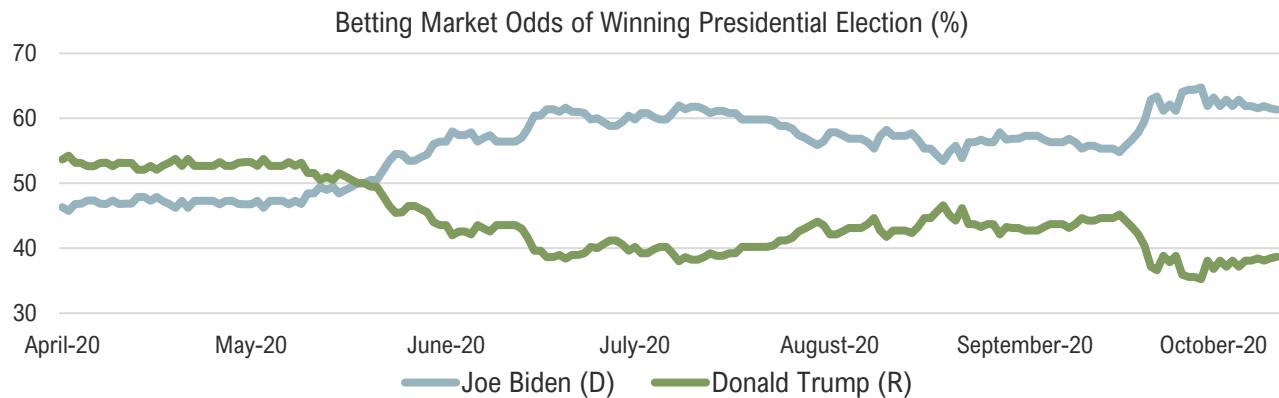
Based on the latest polling data (which we know isn't foolproof), President Donald Trump is trailing former Vice President Joe Biden in the national polls by around seven percentage points and by an average of about four points in key battleground states such as Florida, Pennsylvania, Michigan, and Wisconsin. According to Strategas Research Partners, the betting market odds aren't very predictive but are useful for understanding where the consensus lies. And the consensus moved overwhelming toward a Biden win in late September.

Other indicators, however, suggest that the race is more competitive than the polling would suggest. For example, Trump's approval rating currently stands at about 45%. In looking at past elections, this is roughly the threshold between winning and losing campaigns.⁴ Financial markets also indicate a closer race. For instance, the S&P 500 Index has predicted the presidential election winner 87% of the time since 1928. If the S&P 500 is higher in the 3 months before the election (from August 3rd), the incumbent party has won, and if stocks are lower in the 3-month period, the opposition party has won.⁵ As of yesterday's close, the S&P 500 has gained about +3% since August 3rd.

Finally, given the consistent polling results over the past several weeks, financial markets should already be incorporating some meaningful likelihood (at least 50%) of a Biden victory and a Democratic sweep of Congress. In other words, a Biden victory at this point would not be a market surprise. Nor would a Trump victory—unlike 2016.



Source: RealClearPolitics and Capital Economics as of October 21, 2020.



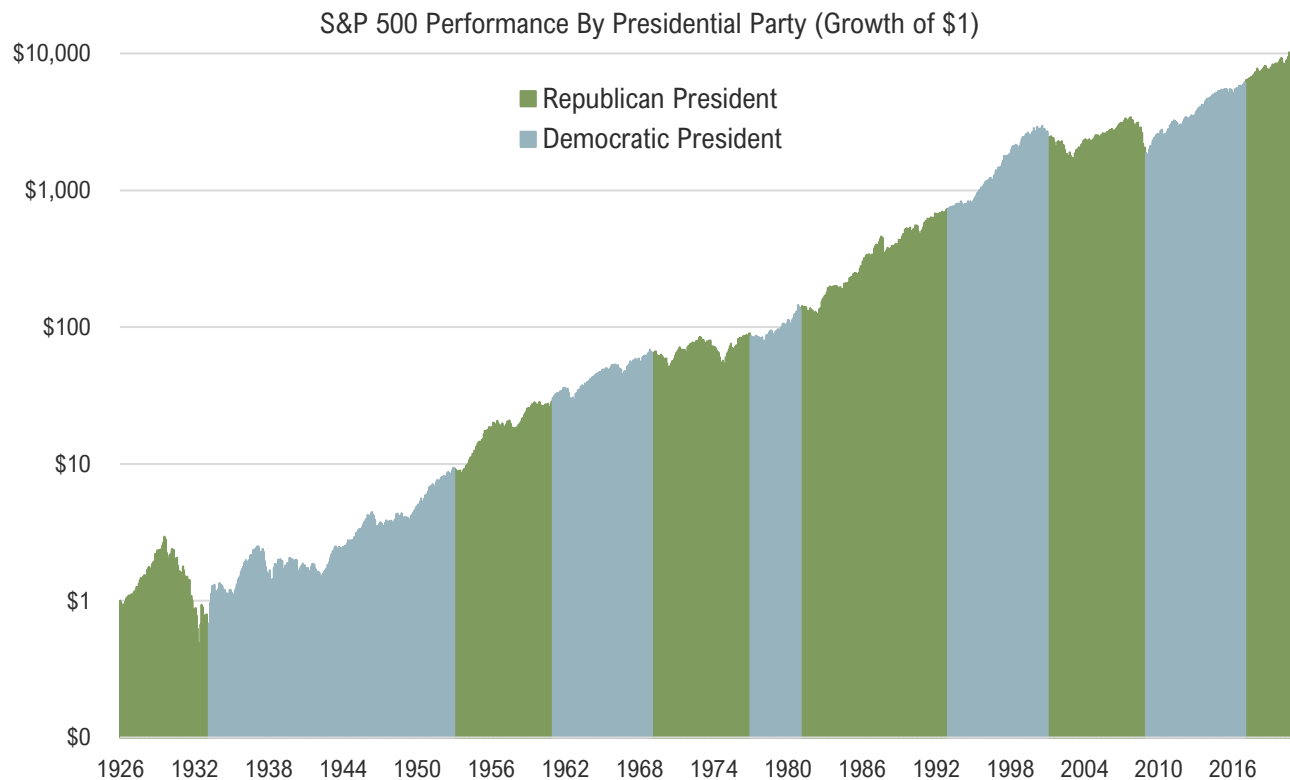
Source: PredictIt and Capital Economics as of October 21, 2020.

Appendix B: Long-Term US Stock Returns and Presidential Elections

Particularly in election years, it's common for investors to assume a connection between who wins the White House and which way stocks will go. Yet, history suggests that financial markets don't necessarily reward or favor one political party versus another. As the chart below illustrates, over the last century stocks have trended upward across administrations from both parties.

Since 1933, Democratic presidents have, on average, seen higher stock market returns than Republicans. For example, the average real (inflation-adjusted) total return for the S&P 500 Index under Democratic presidents was +10%, versus +7% under Republicans. However, nearly all of this average outperformance can be explained by the outsized gains during the tech boom under Bill Clinton and the subsequent dotcom bust and Global Financial Crisis under George W. Bush. Excluding these two presidencies, the difference in returns is practically zero.⁶

Ultimately, shareholders are investing in companies, not a political party. And companies focus on serving their customers and growing their businesses, regardless of who is the White House.⁷



Source: Litman Gregory and Morningstar Direct as of August 31, 2020.

Appendix C: Policy Comparison

The economic policy implications between a President Donald Trump or former Vice President Joe Biden victory are meaningful. However, campaign proposals do not always result in legislation, and what each candidate can ultimately achieve in office will depend on what happens further down the ticket. While current polling data suggests that Democrats are likely to retake the Senate, the odds of this have narrowed as Trump gains momentum in swing states—reminiscent of 2016.⁸ To be sure, a sweep by either party would allow for more legislative action.

For example, in the event of a Democratic sweep, the legislative agenda would likely include raising taxes on corporations and high-income earners—typically viewed as market unfriendly policies. Ned Davis Research estimates that Biden’s proposal to raise the corporate tax rate from 21% to 28% would reduce S&P 500 earnings by about -12%.⁹ This could present a headwind to US stocks while potentially increasing the appeal of non-US stocks. At the same time, the economy may get a near-term boost in a Biden administration from increased fiscal stimulus (e.g. extended unemployment benefits and infrastructure spending) as well as the potential for a reduction in trade tensions relative to the Trump administration. It’s perhaps also worth noting that corporate tax rates have historically been much higher than the 28% level proposed by Biden, and stocks have performed well, including for the roughly 30 years prior to the 2017 corporate tax cut.

At a personal level, tax policy changes could create incentives for changes in individuals’ portfolios and investment decisions. We believe this is an area where a firm like ours can add value in helping families evaluate potential changes to tax-planning and/or tax management strategies based on their specific situations.

Trump and Biden’s Positions on Key Issues

	Trump	Biden
Spending and Taxes	Second round of deficit-financed tax cuts, though likely smaller in size than the \$1.5 trillion cuts over 10 years passed in 2017. That could include reduced individual income taxes, full tax write-offs for business equipment investment and indexing capital gains to inflation.	\$4.5 trillion of additional spending over 10 years, including infrastructure (\$1.3 trillion), higher education (\$750 billion) and housing (\$640 billion). Mostly offset by raising taxes, including raising the corporate tax rate back to 28%, from 21%, reversing the 2017 tax cuts and raising capital gains taxes for high earners.
Healthcare	Status quo maintained. More executive action to tackle drug price inflation.	Offer a public option to all individuals, which could lead to an additional 5-10 million Americans getting coverage—a more modest expansion than the original Affordable Care Act in 2010. Action to tackle drug price inflation.
Regulation	Continued rollback of regulations and push back on introduction of new ones. But the impact on the supply side of the economy appears limited so far.	Push to raise the Federal minimum wage to \$15/hour, though is unlikely to cause a big rise in unemployment. Stricter environmental rules a slight negative for energy and mining sectors.
Trade Policy	Continued escalation of dispute with China, with focus on non-tariff measures, including bans and sanctions. Potential broadening of trade war to include other parties, including the EU and smaller Asian economies.	Introduce stronger Buy America provisions. Would maintain pressure on China over security and economic concerns, with tariffs unlikely to be lifted immediately.
Fed Appointments	Push to appoint more dovish members to the FOMC, including replacing Chair Jerome Powell when his term ends in 2022 with a more dovish or politically loyal candidate.	Would most likely reappoint Jerome Powell as Fed Chair. Congressional Democrats may push Fed to put greater emphasis on socioeconomic outcomes.

Source: *Capital Economics*, “How Will the Election Shape the Economic Outlook?” August 13, 2020.

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As always, past performance is not necessarily indicative of future results, and the value of investments and the income they might generate can fluctuate. CFO-20-27

¹ Dimensional Fund Advisors, "What History Tells US About US Presidential Elections and the Market," September 30, 2020.

² Capital Economics, "Global Economics Update: Deglobalization to Continue Whoever Wins US Election," October 5, 2020.

³ Erin Browne and Geraldine Sundstrom, PIMCO, "July 2020 Asset Allocation Outlook."

⁴ Strategas Research Partners, "Policy Outlook: 2020 Election Chartbook," October 13, 2020.

⁵ Ibid.

⁶ Sean Markowicz, CFA, Schrodgers Investment Management, "Would a Biden Presidency Hurt Stock Prices?" Third Quarter 2020.

⁷ Dimensional Fund Advisors, "What History Tells US About US Presidential Elections and the Market," September 30, 2020.

⁸ Strategas Research Partners, "Policy Outlook: 2020 Senate Election Outlook," October 22, 2020.

⁹ Ned Davis Research, "2020 Election Handbook: A Unique Election Cycle with Some Unexpected Parallels," July 14, 2020.