PRIVATE CAPITAL MANAGEMENT

# PCM Insights: Post-Election Commentary

**November 19, 2020**

*"A house divided against itself cannot stand."*
– Abraham Lincoln

Amid record voter turnout, Joseph R. Biden, Jr. will likely be the 46th President of the United States of America. Republicans picked up seats in the House of Representatives elections, but the Democrats retained their majority. The outcome for the Senate is still up in the air. Republicans currently have a 50 to 48 seat advantage. Political strategists expect Republicans to pick up at least one seat in the Georgia run-off races scheduled for January 5. In this scenario, Republicans retain the Senate majority to create what investors have embraced as a goldilocks scenario. Much like the 2016 U.S. Presidential election, global markets reacted to election results in an unexpected manner with stocks and bonds rallying on the presumed gridlock in Washington. Stock investors have historically done well during a divided government as partisan legislation becomes less likely and politicians must move to the center to get deals done. It is not lost on us that Joe Biden and Mitch McConnell spent more than 20 years working together in the Senate. Perhaps there is some hope for compromise, but only time will tell.

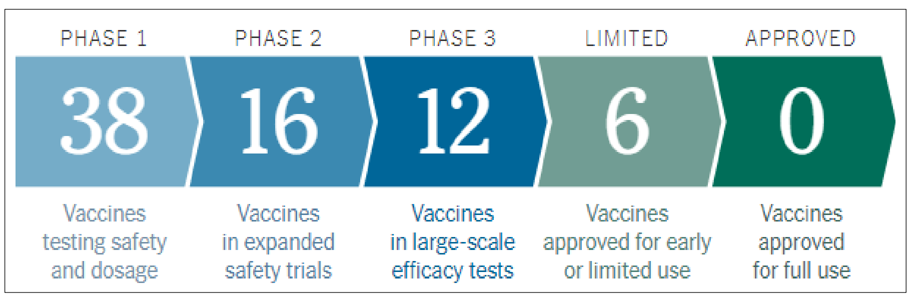
President–elect Biden wasted no time to address the raging Coronavirus pandemic. Biden quickly announced a task force to reassess the current U.S. public health strategy in combating the virus. It is possible we see increased national mandates in prevention, containment, and tracing strategies.

The Trump Administration filed numerous lawsuits accusing voter fraud and other misconduct during the election. State election officials have largely denied that fraud was a systemic issue. As of writing, President Trump has not officially conceded to Biden, which may slow the transition process. America will continue to watch the Peach State (Georgia) for the next two months as surprise Democratic victories would change the narrative considerably.

Here are some post-election themes we are monitoring:

## VACCINE DEVELOPMENT

Investors quickly refocused their attention to the economy and the ongoing pandemic. On November 9, Pfizer and German partner, BioNTech, announced that their Phase 3 COVID-19 vaccine candidate demonstrated a greater than 90% efficacy rate in preventing COVID-19 infections. Pfizer/BioNTech project as many as 50 million doses would be available by the end of 2020 with another 1.3 billion by the end of 2021.[1] In addition, Moderna reported a 94.5% efficacy rate on its Phase 3 COVID-19 vaccine candidate on November 16. Moderna expects to have 20 million vaccine doses available for distribution in the U.S. by the end of 2020 with another 500 million to 1 billion globally in 2021.[2] Both Moderna and Pfizer/BioNTech intend to apply for Emergency Use



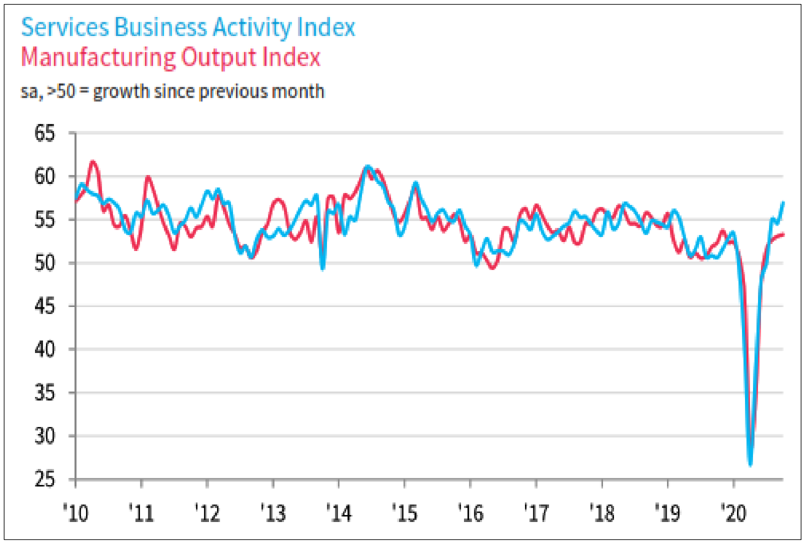

Source: New York Times. "Coronavirus Vaccine Tracker." Accessed 11/11/2020. https://www.nytimes.com/interactive/2020/science/coronavirus-vaccine-tracker.html.

[1] "Pfizer and BioNTech Announce Vaccine Candidate Against COVID-19 Achieved Success in First Interim Analysis from Phase 3 Study." Pfizer. Accessed November 10, 2020. https://investors.pfizer.com/investor-news/press-release-details/2020/Pfizer-and-BioNTech-Announce-Vaccine-Candidate-Against-COVID-19-Achieved-Success-in-First-Interim-Analysis-from-Phase-3-Study/default.aspx

[2] "Moderna's COVID-19 Vaccine Candidate Meets its Primary Efficacy Endpoint in the First Interim Analysis of the Phase 3 COVE Study." Moderna. Accessed November 16, 2020. https://investors.modernatx.com/news-releases/news-release-details/modernas-covid-19-vaccine-candidate-meets-its-primary-efficacy

Authorization from the U.S. FDA in the coming weeks. Since our last publication on October 15, an additional three vaccine candidates entered phase 2 or 3 trials. You won't be able to get a COVID-19 vaccine in time for holiday parties, but it looks like there may be light at the end of the tunnel.

## ECONOMIC MOMENTUM




Source: "IHS Markit U.S. Services PMI." IHS Markit. Accessed 11/10/2020
https://www.markiteconomics.com/Public/Home/PressRelease/3f1d6083970b4795afc5e988a4c34698

In addition to the prospects for a vaccine, the economy has performed well recently, which may present additional headwinds for future stimulus conversations. In particular, high frequency and macroeconomic data continues to support the premise that the U.S. emerged from a recession in the third quarter of 2020. The unemployment rate nationally fell to 6.9% marking six months of continued declines.[3] Both manufacturing and services PMI continued to improve in October with business activity expanding at the fastest pace since April 2015.

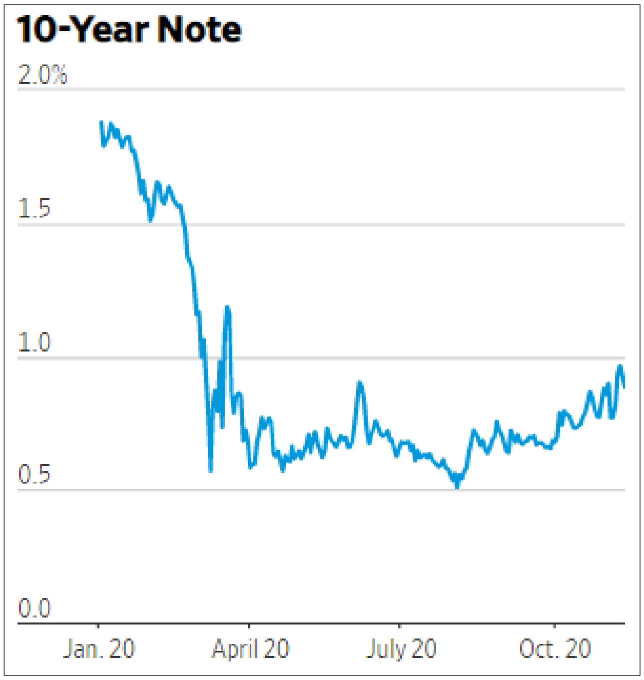
We are hopeful President-elect Biden and members of Congress will continue to work towards another stimulus package, possibly before inauguration day, in an attempt to sustain current economic momentum. But there are no discussions of this nature ongoing currently and there also remains a considerable divide between political parties on stimulus spending; Republicans cite recent economic strength as a reason to pare back the targeted $3 trillion package sought by Democrats. Other obstacles remain such as disagreements over additional aid to state and local governments, contributing to the stalls in stimulus talks we've seen for months. The Federal Reserve's Federal Open Market Committee minutes from November 5 noted there remains considerable downside risk to the economy due to rising Coronavirus cases and further employment weakness. The Committee reaffirmed it will maintain an accommodative stance of monetary policy until inflation persistently runs above its 2% long-run target.[4] Expecting easy monetary policy will continue under the Biden Administration, investors should position portfolios for continued economic recovery while dialing back equity return assumptions consider. This "lower for longer" outlook for rates favors owning higher yielding fixed income securities such as high yield corporates, and certain securitized credits if credit spreads narrow.

## WATCHING INTEREST RATES

Interest rates continue to move higher on improving economic fundamentals. The yield on the 10-Year U.S. Treasury bottomed in early August at 0.50%. As of November 12, the 10-Year Treasury had rebounded to 0.85%. U.S. Treasuries rallied following the election suggesting that investors were hedging against a Democratic sweep and large-scale deficit spending, which would put upward pressure on longer-term interest rates.

[3] "The Employment Situation – October 2020." Bureau of Labor Statistics. Accessed 11/10/2020 https://www.bls.gov/news.release/pdf/empsit.pdf.
[4] "Federal Reserve FOMC Statement." U.S. Federal Reserve. Accessed 11/11/2020 https://www.federalreserve.gov/newsevents/pressreleases/monetary20201105a.htm

Rising rates are generally a headwind for fixed income returns, but it is unclear how far and fast they will rise. Shorter maturity, higher coupon, and lower quality credits have held up well since August's inflection point. We suggest investors take a deeper look at their fixed income positioning. Bond duration (interest rate sensitivity) has been stealthily increasing as issuers are extending debt maturities, and investment grade corporate bonds highlight this dynamic particularly well. Duration is your friend when rates are falling, but works against you in the opposite environment. Given this backdrop, market sentiment suggests low rates are here to stay and a reassessment of investor expectations for fixed income returns going forward may be prudent. Future bond returns are likely to be lower than historical returns as will their diversification benefit. As a result, we continue to look for alternate sources of income and return that provide diversification to traditional global stock / bond portfolios, including, structured notes, hedged equity, and real estate.




Source: Wall Street Journal. Accessed 11/12/2020. https://www.wsj.com/market-data?mod=nav_top_subsection

## MARKET LEADERSHIP

Will the leadership of FANG stocks (Facebook, Amazon, Netflix and Google) continue with the Biden Administration? Large technology companies have enjoyed a remarkably strong period of outperformance relative to the rest of the market. Investors sought refuge during the pandemic in companies such as Apple, Microsoft, Amazon, Facebook, and Alphabet. Demand for these companies' products and services surged as shelter-in-place orders were imposed and as online learning and remote working skyrocketed. A limited dispersion in profitability among companies has been particularly pronounced this year, with the top five companies in the S&P 500 driving index returns.


Source: "Concentrating on Market Concentration." Goldman Sachs Asset Management. 9/08/2020

Stronger than expected efficacy results from the Pfizer/BioNTech COVID-19 vaccine candidate caused a dramatic trading reversal on November 9. Large value stocks outperformed large growth stocks by 597 basis points on a single day! This was one of the biggest one-day reversals since the Dot Com era. Beaten down sectors such as leisure, hospitality, airlines, and financial services rallied on the hopes of our economy opening sooner than anticipated. Improving returns from the bottom 495 stocks is a good thing. Did this move reflect a deeper concern about the Biden Administration's stance on big tech? We do not think so. Given the state of the economy and higher priority items, it seems unlikely that Biden would pursue an aggressive anti-tech stance during his administration. Big Tech donated considerable amounts of money to Biden's campaign. Moreover, Vice President-elect Kamala Harris was a district attorney in San Francisco with ties to the Silicon Valley technology industry. We will be monitoring the current Department of Justice's antitrust case against Google as it continues into the Biden Administration for more clarity.

## TAX REFORM

Assuming Republicans retain control of the Senate, we do not expect major tax reform will happen in 2021. Biden's tax plan focuses on increasing income and capital gains taxes for those earning above $400,000 annually, increasing the corporate tax rate to 28%, reducing the estate tax exemption, and adjusting the basis step-up rules at death. Taxpayers who would have an estate tax liability if the estate-tax exemption fell to $3.5 million should have a conversation with their PCM advisor and estate attorney. Higher income households should be ready to navigate new tax law next year, but we don't recommend realizing gains and/or accelerating income in 2020 based on speculation alone. Significant tax changes likely hinge on Democrats taking the Senate majority, a seemingly low probability event currently. We suggest taxpayers revisit their original year-end gifting and tax plans for 2020. This may include bunching charitable donations, gifting appreciated stock, funding a donor advised fund, realizing capital gains to fill a low tax bracket, and/or considering Roth IRA Conversions. Will Biden and House Democrats seek to repeal the State and Local Tax Deduction (SALT) Cap of $10,000 per household? The House Democrats tried earlier this year, but were rebuffed, when the HEROES Act failed to pass in the Senate. It appears likely that the Biden Administration and Congressional Democrats will push for higher income and/or capital gain taxes, but the outcome remains highly uncertain.

## RENEWABLE ENERGY

Solar stocks soared ahead of the election on the hope that a Democratic sweep would pave the way for massive infrastructure spending on a clean energy revolution. While the sweep likely will not materialize, it is clear the Biden Administration will focus on climate change and renewable energy in a meaningful way. The global economy is a long way off from replacing traditional energy sources, but we see momentum continuing for sustainable energy solutions as well as investment therein.

## LOOKING TOWARDS THE FUTURE

Next year will bring a new administration with new priorities. However, change tends to be incremental rather than monumental when campaign promises meet political realities. The recent election results should not change your long-term investment plan, nor will it change ours. We will continue to look for opportunities and avoid setbacks for your financial wellbeing. Thank you for your continued trust.

Sincerely,
The Private Capital Management Team