Eagle Strategies LLC

The Eagle Edge

Quarterly

MARKET & ECONOMIC OUTLOOK

September | 2020

On the Radar Screen

1. **The U.S. election cycle has captured the attention of mostly everybody, investors and non-investors alike.** The potential for civil unrest, social change, and policy reversals tied to the election process and outcome is greater than at any point in living memory. Vote!
2. **The pandemic continues to weigh on economic activity.** Prior rounds of fiscal stimulus served to boost consumer income and support businesses. The failure to pass additional support legislation will likely coincide with weaker growth data as we move through the fall.
3. **Efforts to more strictly regulate the technology sector appear to be advancing at both the state and national level**. Developments here could profoundly impact the business models of a handful of firms that account for much of the market return in recent years.
4. **The global contagion is anything but vanquished**. We monitor for a potential reacceleration in new infections as colder weather sets in for the northern hemisphere. While treatment has improved and mortality rates fallen, COVID remains a dangerous pathogen, and continues to dramatically influence consumer behavior.

PROTECTION. RETIREMENT. INVESTMENT. ESTATE.

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"The U.S. has gone from being a pillar of stability to a vector of instability"

– Chatham House rules prevent citation

"The market makes the news; the news does not make the market." – Bob Farrell, Merrill Lynch. For anyone not living off the grid, perhaps even for those who are, the discord being raised in political and social arenas has become deafening. A well-functioning democracy relies upon debate and dissension at its core, but the current elevated level of conflict strikes many, us included, as unusual and worrisome. Add the powerful crosscurrents already facing the markets—an unprecedented economic shock, persistent COVID case volumes, and a fading fiscal impulse—and investors are left with a challenging environment indeed.

Amid these widely recognized risks, we see many signs of complacency within capital markets. U.S. stock indices are not far below all-time highs, trading at an atypically high multiple to projected profits. The ratio of put options (protective instruments) to call options (speculative instruments) is relatively low, signaling a similar lack of concern amongst investors. The implication is that markets don't appear to be attaching much of a discount to the various risks that lie on the horizon. Should those risks materialize in any consequential way, it would not be unreasonable to endure a sharply adverse market reaction.

Don't ever confuse motion with progress. One of the more immediately pressing concerns is the impact of the pandemic on economic activity and corporate profitability. The mandated lockdowns in the spring which caused a surge in unemployment and a sharp contraction

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in corporate revenue were also married to large stimulus legislation that sought to replace much of those lost cashflows. That legislation has largely expired at this point, or soon will, yet the effects of the pandemic on consumer behavior persist. Barring a breakthrough in Congress, it seems likely that the rebound in economic activity seen over the summer months will stall as growth in consumer incomes peters out and household spending falters.

A sequel to the CARES Act appeared to be a forgone conclusion this summer. However, as time passed, that proved not to be the case. Fiscal hawks within Congress balked at Democratic demands for funding that ran well in excess of a trillion dollars. Several subsequent bills including a "skinny" package from Senate Republicans and a compromise bill proposed by the bi-partisan Problem Solvers caucus in the House have gone nowhere. As of this writing, House leadership is discussing a modestly pared back variant of their prior proposal, but this appears to be little more than messaging.

With the election around the corner and Senate confirmation hearings soon to suck up all the oxygen in the room, it is unlikely for a deal to surface. Investors should prepare for economic data releases to soften further in the weeks ahead.

"A common feature of speculative manias is widespread 'new era' thinking that leads investors to believe that past rules are superfluous." Jason Trennert, Strategas Research. We've been struck by the speed with which stock prices rebounded from pandemic-induced lows in March to achieve new highs just a few months later, despite ongoing economic weakness. How does one explain the rally and justify the nosebleed altitude of valuations? A refrain we've heard repeatedly is that by adopting a zero-interest rate policy and pledging to keep it that way for years to come, the Federal Reserve has fundamentally altered the rules of the game. Past heuristics no longer apply—it's different this time. That's a phrase that should raise the hair on the neck of every investor!

We are sympathetic to the notions that 1) a historically low discount rate justifies a historically high price multiple, and 2) with bond yields close to zero, there are few viable investment alternatives to stocks. But our sympathy with those views runs only so deep. Interest rates are likely to remain quite low for several years, but that does not render this a permanent state of affairs. Any eventual increase in rates, which would likely be preceded by a rise in inflation expectations and could come sooner than many suspect and would necessarily require that valuation levels reset lower.

As to available investment alternatives, seeking safe harbor in cash or other stores of value while awaiting more attractive equity price levels seems a perfectly prudent strategy, especially given the daunting array of risks now in play. At the margins, it is precisely that strategy we are pursuing within the portfolios for which we are responsible: maintain a larger than benchmark cash balance and waiting patiently for the next storm to arrive before putting that money to work in equities. Our suspicion is that we won't have long to wait.

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Insights from Multi-Asset Solutions' Portfolio Managers

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About Risk

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Stocks and bonds can decline due to adverse issuer, market, regulatory, or economic developments. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer's ability to make such payments may cause the price of that bond to decline. A bond's prices are inversely affected by interest rates. The price will go up when interest rates fall and go down as interest rates rise.