The Advisor

A quarterly publication from Ables, Iannone, Moore & Associates, Inc.

Market Update – *Third Quarter, 2020*

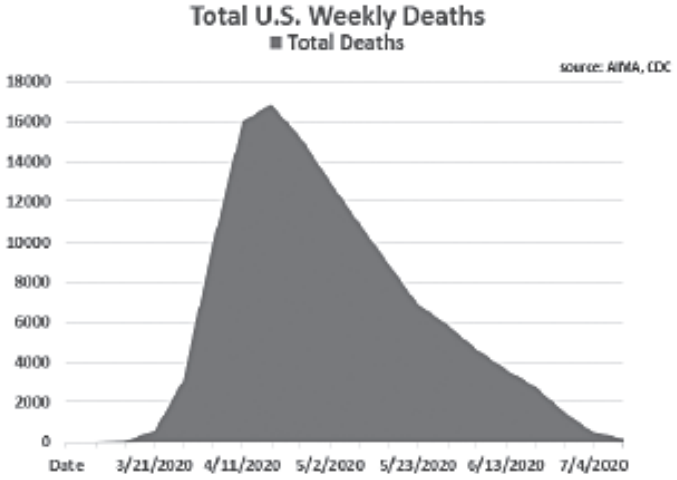
THE VIRUS AND THE BULL – Last quarter we titled our newsletter The Virus and the Bear as the onset of Covid-19 plunged worldwide markets into deep bear territory. It was an historic selloff in record setting fashion. As the second half of the year kicks off with the third quarter now underway, we find yet another historic market performance by the S&P 500 and the Dow Jones Industrial Average recording the best 50-day post-bear market recovery, ever, powering the best quarter in over 20 years.

But there is more to the story. Nothing about what has happened over the last several months is normal. We did not experience a regular downturn in the business cycle. We did not find systemic risk laden throughout various corners of our economy that brought us to our knees, similar to the Great Recession. There is no precedent case or conditions to compare and contrast, let alone benchmark, what we have all experienced. The reason? This was a government mandated shutdown of commerce which included restricting behavior, movement and personal freedoms in order to stop the spread of a virus.

How is it even possible that markets roared higher in the face of a global pandemic that was billed to be one of the most devastating of all-time? To be clear, that statement is not hyperbole. Remember, millions of Americans were predicted to die, accompanied by millions more around the globe. Businesses and commerce came to a halt. Communities worldwide were forced into lockdown. Tens of millions of Americans lost their job. Simply stated, the world, as we knew it, stopped.

How should we think about not only what happened but what is to come? There is a lot to unpack but before we get started, we need to revisit a concept that we have discussed before - *the market is a discounting mechanism*. That is a fancy way of saying the market is always trying to look over the horizon and predict what is coming next. In other words, it is a real-time place of price discovery. As the market digests information, it puts a price on the present for what the forecast of the future is worth. Keep this concept in mind as you continue reading. There may not be a more salient piece of insight to help us all understand exactly what is going on in the markets and what might come next.

The first stop in explaining the market response sits squarely on the fact that the Armageddon prediction was false. Suffice it to say the models were wrong. Not only were they wrong, but they were off by orders of magnitude. Millions of Americans are no longer believed to be on the doorstep of death from Covid-19. In fact, data



from the CDC shows the death rate is and has been falling, confirming several contributory factors including Covid-19 is weakening, immunity is increasing and/or more prevalent than previously understood and our medical professionals are quickly improving the healthcare of patients. If you are more of a visual person, in the chart, we have compiled the total U.S. weekly deaths using data directly from the CDC. It is our belief the market has put a premium on this data surrounding the lethality of the virus and that has helped, in part, fuel the rally.

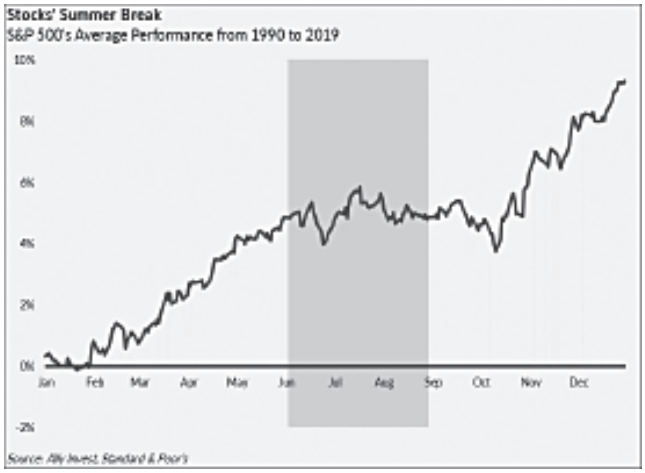
Moving beyond the virus and any progress towards a vaccine, there are several key drivers that will

continue to influence this market as we move deeper into the second half of the year.

The Federal Reserve

We want to take a few lines to discuss the Fed's monetary policy because it is a topic that is often misunderstood. There is little debate denying the Fed impacts the market. In fact, you will hear the market is overvalued and inflated simply because the Fed is printing money. That is not entirely accurate. Fed operations do impact the interest rate environment which can make risk assets (read stocks) attractive; however, the Fed does not actually print money. Rather, through securities purchases, the Fed supplies reserves in order to meet the banking sector's demand for risk-free assets.

In times of great uncertainty there is an insatiable demand for money and banks need reserves as collateral against their obligations such as deposits. These reserves are not dollar bills being dumped directly into the economy. If that were the case, inflation would be out of control. We would be Argentina, whose monetary policy does allow for printing money. The U.S. does not face those same inflationary pressures because the reserves the Fed are supplying can only enter the economy when banks use them to support increased lending, thereby creating money. The takeaway is this, yes, the Fed has interjected with monetary policy in an unprecedented manner in order to meet the unprecedented demand for money caused by Covid-19. The market's read-thru has been let's get back to the business at hand now that we know the Fed is willing to meet the demand and guarantee the system will not collapse.



Seasonality is a Thing

We'll keep this section brief and let the chart above do the talking. It shows the S&P 500's average performance by month of the year. The darker shaded area is the summer months. Notice the decline between June and July. This year, we had a 7% selloff in the S&P 500 in early June. Historically, a recovery follows before the equally volatile autumn months. What will the rest of this summer bring? It is impossible to know but this chart should give you a level of perspective and confidence when volatility strikes again.

Presidential Election Year

If we were hard pressed to name one thing Wall Street does not like it would be uncertainty. The market hates the unknown. Currently, our political environment is full of, you guessed it, uncertainty. Historically speaking, a first-term president gets reelected to a second term. Our friends at CFRA remind us that only four first-term presidents (Taft, Hoover, Carter, Bush[41]) were denied reelection during the 20th century. Regardless of your views, political change is a breeding ground for uncertainty. Presumptive Democratic nominee Joe Biden is the face of change to this market as is a clean Democratic sweep in Congress come November. Do not read that as a judgement on the Biden agenda – read it through the eyes of the market and consider the uncertainty it finds around potential changes to the corporate and individual tax rates and the regulatory environment that may impact the financial, healthcare and energy sectors.

Bottom line, market volatility is coming, just know it. And when it comes, relax and understand it is a normal function of healthy market operations. Replace fear with faith and use history as the guide - it tells us attractive opportunities will come to the patient investor.

To our clients, thank you for the opportunity to serve your investment needs and please do not hesitate to contact us if you experience any material changes in your personal situation or would like to discuss any specific matters. To our other readers, if you would like a complimentary review of your investment accounts or any other financial matters, please do not hesitate to contact us. As fiduciaries, we will happily provide you with an unbiased opinion based on your specific situation.

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