

Investment Commentary

Recounting the Election

November 17, 2020

Market Summary

After some early selling on election day, U.S. stocks started rallying and have barely looked back since. The 2.8% year-to-date gain the S&P 500 Index had delivered through the end of October turned into a 11.6% gain as of November 9. Riskier parts of the credit markets have also participated in the rally, while investment-grade bonds declined modestly in October (and in early November) as the yield on the 10-year Treasury note has continued to drift higher from its low of 0.68% on October 1 to 0.96% on November 9 (bond prices move inversely to yields.)

Recent Events

The printing presses had been running almost nonstop for months, churning out millions of ballots for what was expected to be an election with historically high voter engagement. According to a Pew study from earlier in the year, 85% of Americans believed that political debate in the U.S. had become less “respectful, fact-based and substantive.”¹ We were told that the U.S. Presidential election held on November 3 was “life-changing” by the challenger and “the most important in the history of our country” by the incumbent.² Eligible voters agreed. As the final count draws near, the election will have both the highest absentee ballot count in history at 65.2 million and the highest voter turnout—roughly 160 million people or 70% of eligible voters—in 120 years.³ Most media outlets have called the results in favor of Joe Biden. Despite the presumed win for the Democratic Party, Republicans made inroads “down-ballot”—picking up at least five seats in the House of Representatives and retaining control of the Senate, although the final result will depend on an early January runoff election in Georgia.

The Trump administration is actively pursuing recounts in at least three states, but recounts seldom change the outcome. According to an analysis by FairVote, there have only been 31 recounts in 5,778 statewide elections since 2000, and only three of those altered the results.⁴ The first year of a Biden-Harris administration will likely be restricted from making sweeping policy changes by gridlock in Congress. Betting markets, which may have solidified their superiority to polls over the last few weeks, currently expect a 67% chance of this outcome.⁵ Statehood for Puerto Rico and Washington D.C., an end to the Senate filibuster rule, and the Green New Deal are probably off the table for at least the next two years.

It may be premature to glean anything from this election, but the results have shone a light on at least two realities. The first is just how competitive many key races were. Indeed, in an almost mirror image of 2016, the results of the 2020 election were ostensibly decided by a relatively small group of voters in just three states—Wisconsin, Michigan, and Pennsylvania—which between them hold 46 electoral college votes. The second is the immense challenge of forecasting, especially during a period of widescale social and technological upheaval. For example, popular forecaster FiveThirtyEight assigned a one-in-ten chance of a Trump win with an almost three-in-four chance of a “Blue Sweep.”⁶ Several other professional forecasters predicted landslide victories for the Democratic party akin to Reagan’s sweep of Carter in the 1980 election.⁷ To be fair to FiveThirtyEight, their

¹ Pew: <https://www.pewresearch.org/politics/2019/06/19/public-highly-critical-of-state-of-political-discourse-in-the-u-s/>

² CNN: <https://www.cnn.com/videos/tv/2020/08/29/the-most-important-election-in-our-lifetime---again.cnn>

³ NYT: <https://www.nytimes.com/interactive/2020/us/elections/early-voting-results.html>

⁴ FairVote: <https://www.fairvote.org/a-survey-and-analysis-of-statewide-election-recounts>

⁵ PredictIt: <https://www.predictit.org/markets/detail/4353/What-will-be-the-balance-of-power-in-Congress-after-the-2020-election>

⁶ FiveThirtyEight: <https://projects.fivethirtyeight.com/2020-election-forecast/>

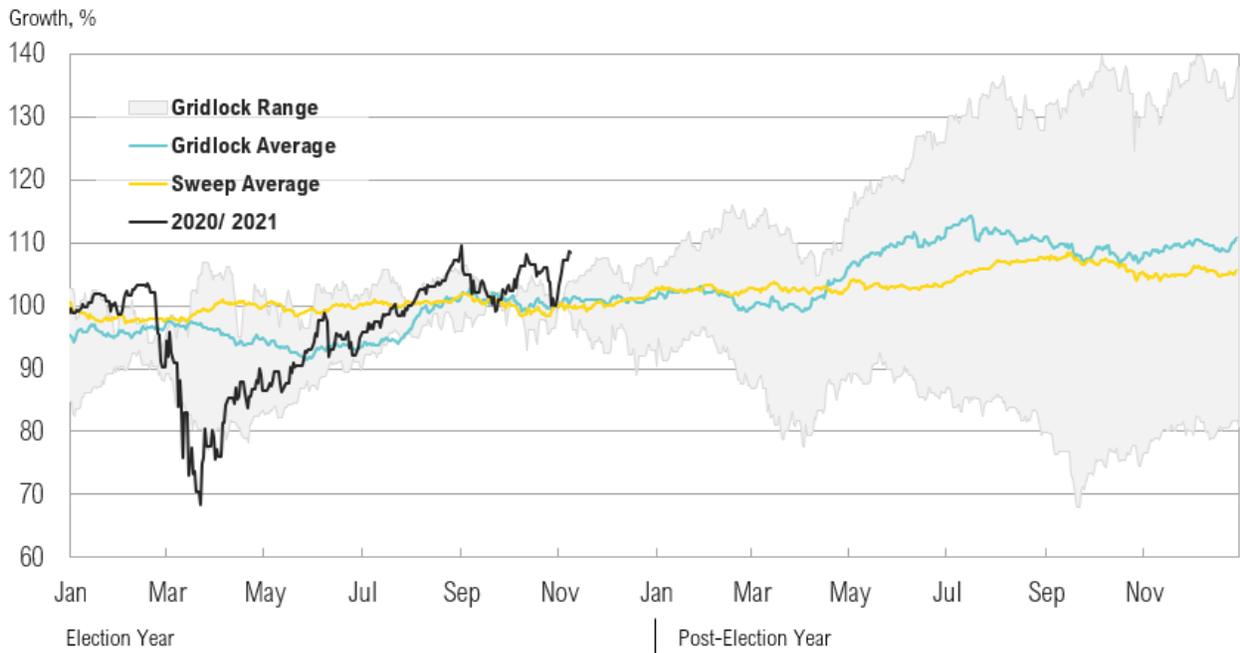
⁷ Yahoo: <https://www.yahoo.com/lifestyle/pollsters-analysts-increasingly-predict-1980-184029960.html>

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forecasted margin for the popular vote may turn out to be relatively close to the final numbers, but the polls they relied on missed final results by nearly eight percentage points in Wisconsin, Iowa, and Ohio and five points in Florida.⁶ The errors were all in the same direction, and these were all “swing” states that could have been pivotal to the final outcome.⁶ Trump won more votes relative to the total population of eligible voters than Reagan did in his conclusive win in 1980 (an estimated 29.9% versus 26.8% for Reagan), and he still lost the popular vote by a not trivial 3.3% (and counting).⁸ Biden, who received 75 million votes representing 32% of the eligible vote, will claim the title of receiving more votes than any other presidential candidate in history.⁸

Historically, markets have viewed gridlock more favorably than swept elections, and 2020 may strike a similar tone, especially considering that gridlock should also remove the potential for any meaningful overhaul of tax policy. In the 24 elections since 1928, markets have averaged a return of 7.7% from November 1 of the election year to the end of the first year of the next Presidential term. The average over that period for gridlocked governments was 10.6%, more than 5% higher than the average for sweeps at 5.5%. The 8.6% return of the S&P 500 in the 9 days since November 1 is higher than any similar post-election stretch in history.⁹

Gridlock Historically Better for Markets than Sweeps, 1/1/1928-11/9/2020



Source: Bloomberg

There are significant challenges facing the incoming administration, but challenges can also present opportunities. New Covid-19 cases and hospitalizations reached new highs in the week of November 9 and continue to increase; however, improvements in therapeutics have contributed to declines in the case fatality rate.¹⁰ Recent news that the Pfizer-BioNTech vaccine candidate, BNT162b2, has demonstrated evidence of being up to 90% effective

⁸ Wikipedia, SpringTide calculations: https://en.wikipedia.org/wiki/United_States_presidential_election

⁹ Bloomberg, SpringTide calculations

¹⁰ The COVID Tracking Project: <https://covidtracking.com/data/national>



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seven days after the second of two doses (28 days after initiation),¹¹ along with the prospects that up to 50 million doses may be available for distribution as early as this year, are welcome developments.¹² The vaccine news could come as a relief to not just higher-risk Americans and weary healthcare workers, but also the less heroic, but nonetheless weary value investors. The announcement on November 9 ignited a powerful rotation out of large-cap growth stocks and into smaller-cap stocks and traditional value sectors, including energy and financials.

One-Day Performance Spread (11/9/2020)

	Index	Spread
Energy vs Tech	S&P 500 Energy vs S&P 500 Info. Tech.	14.9
Large Cap Growth vs Small Cap Value	Russell 1000 Growth vs Russell 2000 Value	8.7
Momentum vs Value	MSCI USA Momentum vs MSCI USA Value	6.9
Large Cap Growth vs. Large Cap Value	Russell 1000 Growth vs Russell 1000 Value	6.0
Growth vs Value	MSCI USA Growth vs MSCI USA Value	5.6
Equal Weight vs Market Cap Weight	S&P 500 Equal Weight vs S&P 500	3.0
Best vs Worst	S&P REIT Hotel/Resort/Leisure vs Silver	30.4

Source: Bloomberg

The relative outperformance of the Russell 2000 Value Index relative to the Russell 1000 Growth Index was 8.7%, the largest single day relative gain since 1992. It remains to be seen if this brief-but-spectacular reversal is the start of a larger trend.

Looking Forward

It is not possible to predict exactly where all the “chess pieces” will land in Washington nor how those pieces will shape policy in the coming years, but there are reasons to be optimistic. Even without clarity on the exact path of fiscal policy, monetary policy remains extraordinarily supportive of markets. On November 5, the Federal Open Market Committee (FOMC) noted in its press release that it will continue its quantitative easing program at a pace at least equal to the current \$120 billion per month. Chairman Powell said the FOMC could do more if needed.¹³ The notion that taxes will not need to be raised to fund another round of stimulus could help clear at least one major obstacle in the way of Congress getting something done should more stimulus be needed. On the virus front, the estimated efficacy of the Pfizer vaccine could place it among one of the most effective of all the major vaccines at 90% (versus 40% to 60% for the seasonal influenza).¹⁴ That said, there are valid concerns around production and distribution given the unusually low temperatures required to store the vaccine.¹⁵ We understand that the challenging circumstances this year has brought about can cause uncertainty for investors around what to do with investment portfolios. Given the continued rally in risk assets, RMB believes this is a good time for investors to evaluate exposures in portfolios as the possibility for a pullback increases for those investments. We will continue to look for additional opportunities to selectively increase risk, if/when further stock market pullbacks develop. In the meantime, we continue to focus on dislocations in various niche markets that present attractive risk/reward opportunities.

¹¹ Pfizer: <https://www.pfizer.com/news/press-release/press-release-detail/pfizer-and-biontech-announce-vaccine-candidate-against>

¹² WSJ: <https://www.wsj.com/articles/pfizer-covid-19-vaccine-when-will-it-be-ready-and-everything-else-you-need-to-know-11604942932>

¹³ Rev: <https://www.rev.com/blog/transcripts/jerome-powell-fed-press-conference-transcript-november-5-calls-for-more-economic-stimulus>

¹⁴ CDC: <https://www.cdc.gov/flu/vaccines-work/vaccineeffect.htm>

¹⁵ CNN Health: <https://www.cnn.com/2020/11/10/health/pfizer-vaccine-distribution-cold-chain/index.html>



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All market pricing and performance data from Bloomberg, unless otherwise cited. Asset class and sector performance are gross of fees unless otherwise indicated.

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Index Definitions

- The S&P 500 Index is widely regarded as the best single gauge of the U.S equity market. It includes 500 leading companies in leading industries of the U.S economy. The S&P 500 focuses on the large cap segment of the market and covers 75% of U.S. equities.
- The S&P 500 Energy Index comprises those companies included in the S&P 500 that are classified as members of the GICS® energy sector.
- The S&P 500 Information Technology Index comprises those companies included in the S&P 500 that are classified as members of the GICS® information technology sector.
- The S&P 500® Equal Weight Index (EWI) is the equal-weight version of the widely used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight, or 0.2% of the index total at each quarterly rebalance.
- The S&P REIT Hotel/Resort/Leisure Index comprises those companies included in the S&P 500 that own, acquire, develop, lease, manage, and operate hotels, resorts, and other entertainment facilities such as amusement parks.
- The Russell 1000® Growth Index measures the performance of the large-cap growth segment of the US equity universe. It includes those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values. It is constructed to provide a comprehensive and unbiased barometer for the large-cap growth segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect growth characteristics.
- The Russell 1000® Value Index measures the performance of the large cap value segment of the US equity universe. It includes those Russell 1000® companies with lower price-to-book ratios and lower expected growth values.
- The Russell 2000® Value Index measures the performance of small-cap value segment of the US equity universe. It includes those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. It is constructed to provide a comprehensive and unbiased barometer for the small-cap value segment. The index is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set and that the represented companies continue to reflect value characteristics.
- The MSCI USA Momentum Index is based on MSCI USA Index, its parent index, which captures large- and mid-cap stocks of the U.S. market. It is designed to reflect the performance of an equity momentum strategy by emphasizing stocks with high price momentum, while maintaining reasonably high trading liquidity, investment capacity and moderate index turnover.
- The MSCI USA Value Index captures large- and mid-cap U.S. securities exhibiting overall value style characteristics. The value investment style characteristics for index construction are defined using three variables: book value-to-price, 12-month forward earnings-to-price, and dividend yield.
- The MSCI USA Growth Index captures large- and mid-cap securities exhibiting overall growth style characteristics in the U.S. The growth investment style characteristics for index construction are defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate, long-term historical EPS growth trend, and long-term historical sales per share growth trend.
- Formerly known as Dow Jones-UBS Silver Sub-Index (DJUBSSI), the Silver index is a commodity group sub-index of the Bloomberg CI composed of futures contracts on Silver. It reflects the return of underlying commodity futures price movements only and is quoted in USD.

