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QUARTERLY INVESTMENT PERSPECTIVES: **Q4 2020**

Third Quarter Recap

Global stocks continued their positive momentum during the third quarter, with the S&P 500 returning 8.9%, and international equities, represented by the MSCI EAFE Index, returning 4.8%. For the the first three quarters of 2020, global stocks have experienced mixed returns. Large cap stocks in the U.S. are up around 5% while mid, small, and international stocks are still in negative territory. The reason for the return discrepancy between large caps and nearly all other equity markets is primarily due to composition. Technology companies, which have experienced minimal disruption from COVID, make up over 20% of the S&P 500. By comparison, small cap U.S. and large cap European markets have greater exposure to consumer and financial companies, which have been hit harder.

Bonds continue to generate positive returns, as interest rates remain low and investors continue to push money into safe haven assets. The Ten-Year U.S. Treasury Bond ended the quarter with a yield of just 0.68%, near its lowest level in the last 60 years. Looking abroad, bond yields are even lower, as hard as that is to imagine. Japanese 10-Year Bonds yield 0.03% and German 10-Year Bonds yield *negative* (0.56%). Though the Barclays U.S. Aggregate Bond index has returned 6.8%, YTD, its forward returns are projected to be much lower as the index yields just 1.18%.

As we churn through the final quarter of 2020, the focus remains on the pandemic and the election, both of which will continue to generate market moving headlines, much as they have all year. Joe Biden's expanding lead in the polls has made it seem likely that the Democrats will control the White House. However, the combination of distrust in polling data after 2016 and the potential for unclear results due to mail in voting and staggered voting dates makes the post-election day results even more muddy. Markets are likely to experience volatile trading until the results become clear. Given our polarizing political climate, it is easy to believe blanket statements that a victory by the opposing party will lead to a disastrous outcome for the economy. In our view, the market values certainty first and foremost - whether it is over tax rates, stimulus amounts, or business regulations. Regardless of how Congress and the Presidency shake out, it is our view that the outcome is not necessarily the biggest risk but moreso the time it takes for an outcome to be determined due to the change in voting standards with COVID.

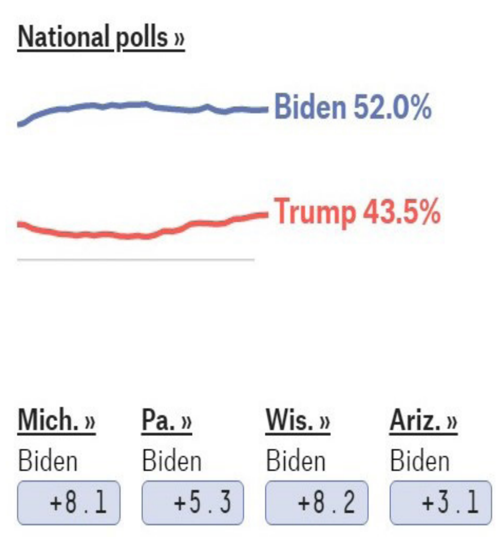
Investment Market	Q3 2020	2020
U.S. Large Cap Stocks	8.9%	5.6%
U.S. Mid Cap Stocks	7.5%	-2.4%
U.S. Small Cap Stocks	4.9%	-8.7%
International Developed Stocks	4.8%	-7.1%
Emerging Market Stocks	9.6%	-1.2%
Barclays US Aggregate Bond	0.6%	6.8%
Barclays Global Aggregate Bond	4.1%	4.8%

Sources: Eaton Vance, as of 9/30/2020

MARKET REVIEW AND OUTLOOK

The Tension of Politics

After nearly 2 years of campaigning, posturing, and mudslinging, we are pleased to report that the Presidential election cycle will draw to a close on November 3rd. At least we think it will. With mail in voting being offered across the country and 21 states allowing early voting, the likelihood of a clear cut result on the morning of November 4th seems unlikely. While Joe Biden currently leads in national and battleground state polls, there is a hesitancy on the part of mainstream media to jump to conclusions given how they were caught off guard in 2016.



Source: FiveThirtyEight, as of 11/2/2020

As you can imagine, we have clients that comprise every corner of the political spectrum and we hear no shortage of opinions on what political policies would best suit our country. We highlight this to caution those who believe that positive investment outcomes can only be supported by their party of choice. In fact the outcome of the Presidential election has very little intermediate to long-term bearing on market performance. A compelling example from recent memory is that the S&P 500 has returned over 30% in two calendar years over the last decade: in 2013 after President Obama was elected to his second term and in 2019, the third year of President Trump's first term.

Those who lean to the right may believe that this election is different. Democrats are promoting big government, and the primary showcased a wide variety of plans to raise taxes on businesses and high earning individuals. A headline from the Wall Street Journal read in March that "Bernie Sanders' Tax Plan Would Be Biggest Expansion Since World War II." Sanders plan proposed raising the top income tax bracket to 52% from its current level of 37%.

And yet, Joe Biden is at the top of the ticket this fall and while Biden has shifted further to the left than at earlier points in his career, there are two important items to place in priority with his agenda.

MARKET REVIEW AND OUTLOOK

1) A potential Biden administration would first tackle the response to COVID, both from a health and economic perspective. This plan would likely include a continuation of additional unemployment insurance, another round of stimulus checks, and aid to states and municipalities. These details are all a part of the current stimulus bill that is in a holding pattern in Congress, and will not pass before the election due to political gamesmanship in both parties. From an economic and market perspective, additional money into the hands of consumers is especially welcome, particularly in the middle of a pandemic. One reason the economy bounced so significantly after the downturn in March is due to how quickly money got into the system through stimulus checks, boosting unemployment insurance, and the Payroll Protection Program (PPP). Another round of stimulus, in the form of immediate cash would do more to buoy economic sentiment than the *potential* for higher taxes from a possible Democratic sweep would do to hurt economic sentiment.

2) Biden's proposed tax plan would incorporate the following agenda items:

- Move the highest income tax bracket from 37% to 39.6%.
- Reverse the corporate tax rate back to 28%.
- Increase social security payroll taxes on the highest income bracket to 12.4%.
- Tax long-term capital gains at 39.6% for those making over $1 million.

For those in the highest income tax brackets, make no mistake, your taxes would go up under his plan. However, we think there are two important things to point out as it relates to both the timing of these two agenda items and the anticipated effect they will have.

First, prioritizing the COVID response is the best option for an incoming administration as it injects money into the economy quickly. A stimulus and tax bill are not going to be joined at the hip due to conflicting interests. Because there are already stimulus negotiations on the table and a distinct need for money to get into the economy, that bill will take precedence.

Second, a jump in taxes could adversely effect many of our clients but the important element here is timing. Taxes are not going up on January 1st 2021. If anything, it seems that tax policy will be deliberated over in the next two calendar years and set in motion either in 2022 and more likely in 2023, which would occur after the next round of Congressional elections in 2022. With Biden's potential tax plan already being circulated, that gives accountants plenty of time to craft a strategy to mitigate the hit that would be experienced from future rising tax rates.

Even though tax policy changes and closing the wealth gap have been long-discussed by the Democratic party, there is a high likelihood these proposals will be diluted in the next year or two due to another Congressional election cycle coming up in 2022. It is difficult to campaign on widespread tax hikes and the tone could likely be softened as we get closer to mid-term elections.

MARKET REVIEW AND OUTLOOK

The Resilience of Markets in Spite of Politics

One of the most frequent questions we get is whether or not we should get more conservative into the election. While every election cycle carries a great deal of uncertainty, this cycle seems to be even more fraught with tension given the backdrop of the pandemic and social unrest. While we have encouraged those putting new money to work to stagger their buy-ins, for those with a long-term objective, it can be detrimental to base an investment strategy on the political party currently controlling the White House.

The following illustration from Charles Schwab provides a stark example of the pitfalls of investing along party lines. Starting in January of 1900 (yes, politics were contentious back then as well), if one invested $10,000 in the market and held onto their stock positions only when a Republican was in office, they would have $98,000 currently. If one invested only during Democrat regimes, they would have $429,000. If you invested during both, and let the market compound returns regardless of who was in office, the result would be an investment portfolio of $4,223,000. In essence, playing politics cost a long-term investor over 4 million dollars. As a point of geo-political reference, the last 100 years includes world wars, rising taxes, social unrest, and yes, two global pandemics (the Spanish Flu in 1918 and the current battle with Coronavirus). Perhaps your time line is significantly shorter and does warrant more nuance with how conservatively you are positioned, but the message remains the same for long-term investors - it doesn't pay to play politics with your investment strategy.

Staying Invested vs. Investing in Single Party

Source: Charles Schwab, Bloomberg, as of 10/2/2020. For illustrative purposes only. The above chart shows what a hypothetical portfolio value would be if a hypothetical investor invested $10,000 in a portfolio that tracks the Dow Jones Industrial Average on 1/1/1900 under three different scenarios: a Republican presidential administration; a Democratic presidential administration; or staying invested in the market throughout the entire period noted. Chart does not reflect effects of fees, expenses or taxes.

MARKET REVIEW AND OUTLOOK

The U.S. Economy - Shutdown and Thriving

The tension continues between the stock market and the economy, with the Dow Jones Industrial Average near all-time highs and the unemployment rate at 7 year highs. For many, it is hard to reconcile restaurants and brick and mortar retail locations being shuttered while stocks continue to perform very well. If there is such a significant degree of pain on Main Street, will that be reflected on Wall Street at some point in the future?

The answer depends on a few outcomes. First and foremost, the vast majority of job losses have been concentrated in the leisure and hospitality sector, which is comprised primarily of hotels and restaurants. While there are many employed in this sector, it is a relatively small driver of GDP - just 4.2% of 2019 GDP in the U.S. - compared to other industries such as finance (21%), professional/business services (13%), government spending (12%), and manufacturing (11%).

To further illustrate this divide, and apply it to the stock market, it is instructive to look at two large, established American companies - Hilton and Microsoft - and compare their recent earnings and their respective weights within the market. In the second quarter of this year, Hilton generated revenue of $132 million and a net *loss* of ($432) million, compared to net income of $362 million last year. Put differently, their revenue in the second quarter *dropped* 70% from last year. Microsoft, on the other hand, generated $38 billion in revenue in the second quarter, up 9% from last year, and earned $11.2 billion in income. While Hilton struggled to maintain any semblance of revenues in the middle of the pandemic, Microsoft experienced steady growth thanks to their ability to shift white collar jobs from the physical office to the virtual world. If you've gotten a meeting request from us over the last 6 months, it has been from the Microsoft Teams app; a piece of the Office software suite that we did not use prior to 2020.

As it relates to the market, Microsoft is a 5.7% weight in the S&P 500 while Hilton barely registers, at a 0.08% weight. This divide helps illustrate how professional services industries, like technology, which have seen little disruption from COVID, have become a much greater part of the economy and have provided a stablizing force despite so much turmoil in specific segments of the economy.

Jobs still haven't caught up to pre-crisis levels yet

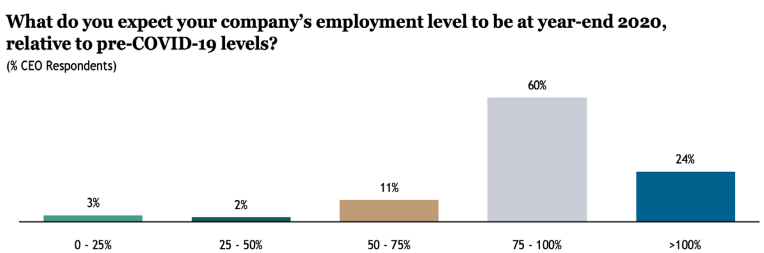
Net change in total employment over various time frames, by sector

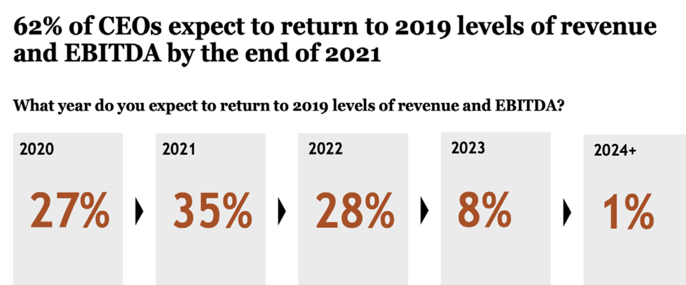
	NET CHANGE IN EMPLOYMENT OVER LAST...		
INDUSTRY SECTOR	1 MONTH	3 MONTHS	6 MONTHS
Construction	+20,000	+639,000	-398,000
Education and health services	+215,000	+1,170,000	-1,559,000
Leisure and hospitality	+592,000	+3,978,000	-4,281,000
Professional and business services	+170,000	+648,000	-1,621,000
Retail trade	+258,300	+1,471,100	-910,300
Transportation and warehousing	+37,900	+99,800	-470,300

SOURCE: BUREAU OF LABOR STATISTICS

MARKET REVIEW AND OUTLOOK

To be fair, the comparison between Microsoft and Hilton shows two extreme ends of the spectrum. What about broad gauges of economic health and corporate guidance? Blackstone conducts regular surveys of CEOs within their portfolio companies, the most recent of which polled 94 executives spanning the globe, in a wide variety of industries. Not surprisingly, the majority expected revenue to fall in 2020, with a median estimate of a *minus* (10%) growth rate. However, the majority of respondents expected a fairly quick rebound from the pandemic. Over 24% of respondents expected employment to be greater at year end than pre-COVID levels. 60% expected employment to be within 75-100% of pre-COVID levels.





In terms of earnings, 62% of CEOs expected 2019 levels of revenue and EBITDA to return by the end of 2021. There were notes of concern from the survey. Some included the uncertainty over another virus wave in the winter and continued supply chain disruptions; however, most CEOs predicted that the U.S. would come out a winner (vs. China) due to onshoring and reconfiguration of the supply chain back to domestic operations.

Corporate resilience has underpinned much of the current economic recovery from the lows experienced in March. We expect that sentiment, at some point, should be buoyed by positive news with respect to vaccine development, more effective therapeutic treatment of existing COVID cases, and the potential for more fiscal stimulus in the next year.

MARKET REVIEW AND OUTLOOK

Closing Thoughts

Heading into the final quarter of a year that was tumultous on many levels, we find ourselves reflecting on a few persistent thoughts. First, in spite of tremendous amounts of stress that the year has brought, we are grateful that we have been physically healthy. Many were not as fortunate and we do not take that for granted. We are also thankful that we have not only continued uninterrupted in business, but have also grown closer with our clients.

It seems pretty safe to say that uncertainty will persist in the final months of the year, especially as it relates to the election outcome and the presence of Coronavirus. Though it may be easy to disaster plan for a political outcome that you may not favor, we encourage our investors to be resolute in applying a long-term lens to their financial strategy. This will help counterbalance the stress of short-term volatility

As the we head into the holiday season, we wish you and your families a safe and healthy end to the year. We welcome the opportunity to speak with you at any time regarding your financial situation and planning for better years to come.

MARKET REVIEW AND OUTLOOK

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All data as of 9/30/20 via Eaton Vance, Morningstar, FiveThirtyEight, Charles Schwab, Bloomberg, and Blackstone.