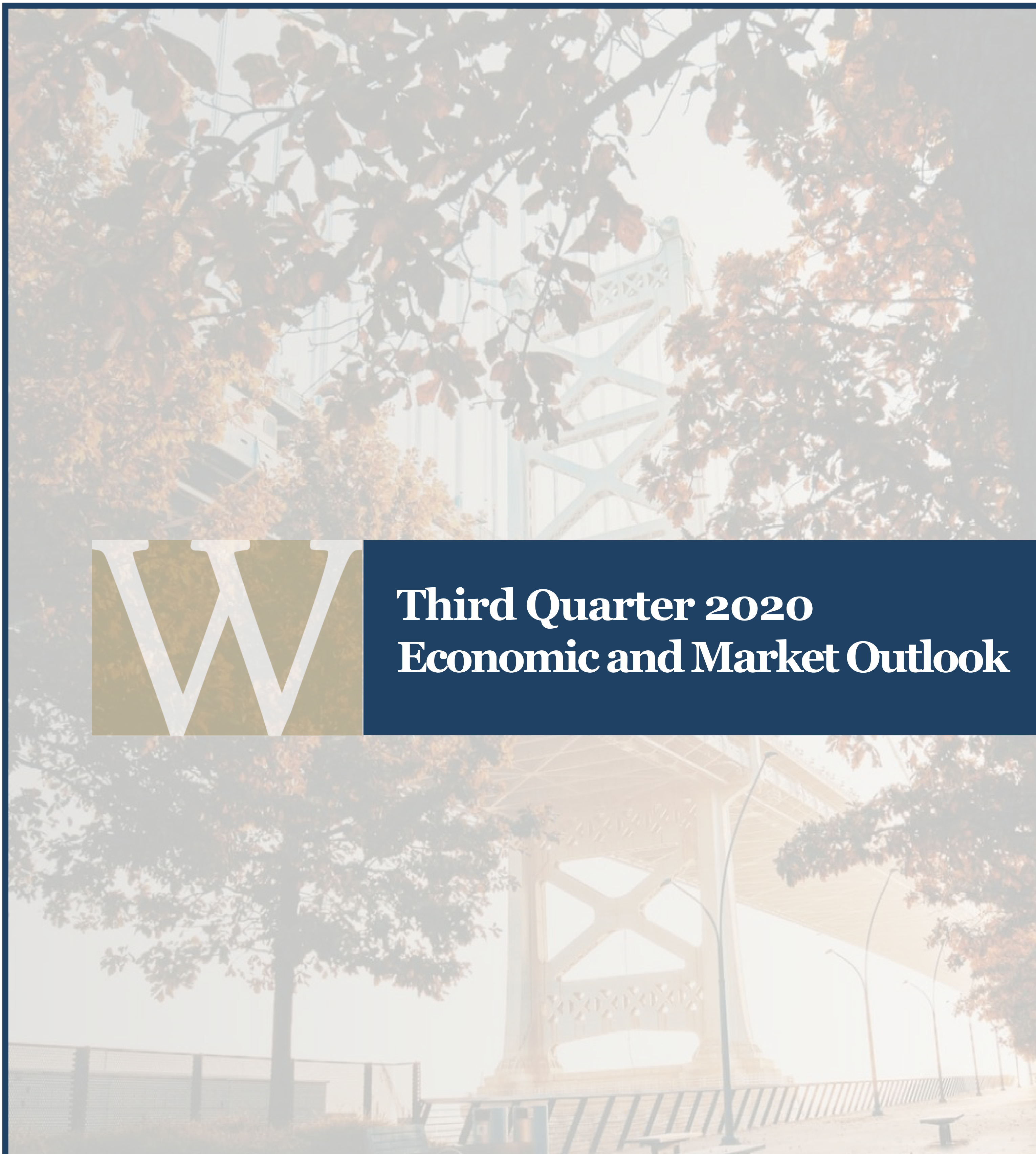

Third Quarter 2020 Economic and Market Outlook

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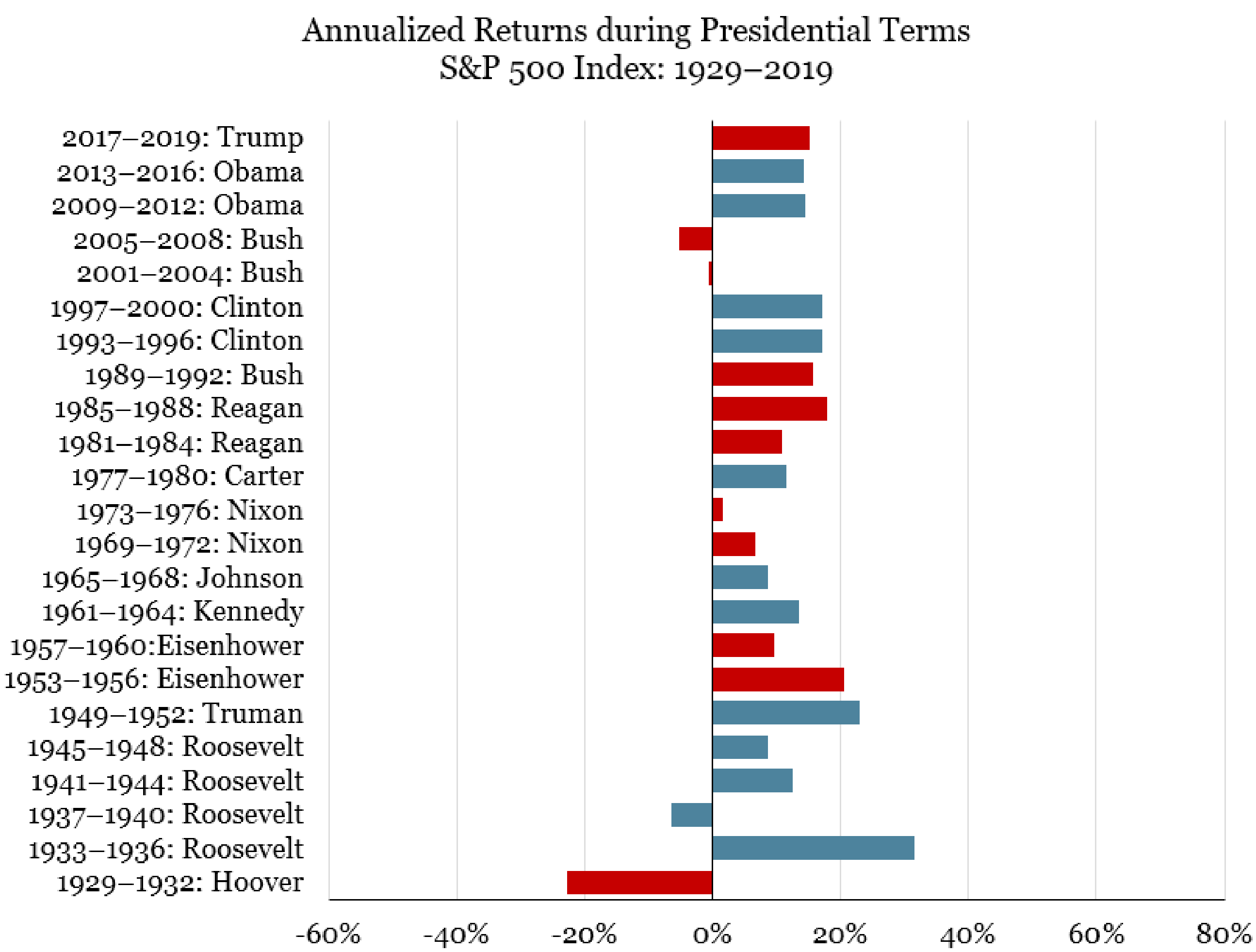
Economic conditions continue to improve, despite virus case count increases, high unemployment, uncertainty surrounding additional government stimulus and the upcoming presidential election. Although a second wave of virus cases has started in the U.S. and around the world, we continue to see a slow but uneven economic recovery. Industrial production, consumer spending and other indicators of economic activity have been picking up for months as businesses have opened with restrictions. In China, where the outbreak first occurred, consumer spending is nearly back to pre-pandemic levels, which is a good sign for the rest of the world.

For most of 2020, the business models addressed the sudden shift in consumer behavior, met the demand for new mobile technology or those that showed promising treatments for COVID-19, were in favor. Those that generated revenue related to commercial real estate, travel and leisure were hardest hit given the various COVID restrictions. Equity market strength this year remains concentrated in growth stocks, although valuations are getting stretched; the recent sell-off in September suggests that market leadership could be changing.

However, near-term risks to the market include the upcoming U.S. presidential election and the potential for a drawn out period of uncertainty as votes are tabulated. Equity markets tend not to like the uncertainty that impending U.S. presidential elections introduce and will react to polls as Election Day approaches. While the current polls suggest that Democrats may win the White House and may have a chance to pick up seats in Congress, the uncertain nature of this year and the fact that polls did not predict the outcome four years ago means that positioning for a certain election result before November 3, 2020 would be premature.

Figure 1: Markets Have Been Positive during both Democratic and Republican Terms Historically

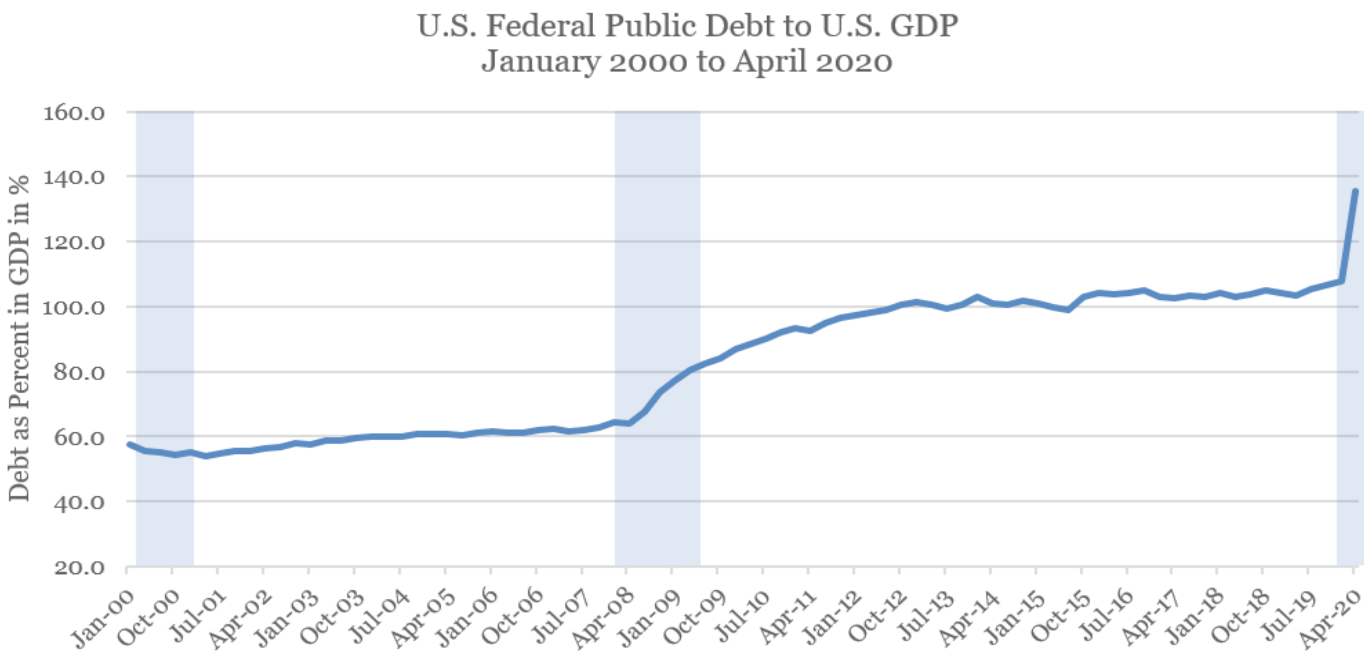


Source: Dimensional Fund Advisors

Markets tend to focus on economic policies such as tax, regulation, trade and government spending. The current administration cut taxes in 2017 and would likely keep both corporate tax rates and personal tax rates where they are. The Democratic Tax Plan increases corporate taxes to 28% from 21% and increases the marginal tax rate for those earning over $400,000/year. Both Republicans and Democrats position that there would be a positive and needed economic impact as part of their plan, impacting businesses and constituencies differently.

The COVID-19 Pandemic and its impact on the economy will be important factors in determining the result of the U.S. Election, although long-term concerns regarding growing budget deficits will likely be less so despite the recent increases. In fact, the latest figures suggest that the U.S. Budget Deficit grew to $3.1 trillion as of September 30, 2020 as government spending to support businesses and households during the lockdowns caused government borrowing to soar while corporate and personal tax revenue fell. *In fact, according to the Office of Management and Budget, the Federal Public Debt at approximately $21 trillion is now larger than U.S. GDP as illustrated in Figure 2.*

Figure 2: Debt as a Percentage of U.S. GDP Has Been Rising Even Before Most Recent Recession



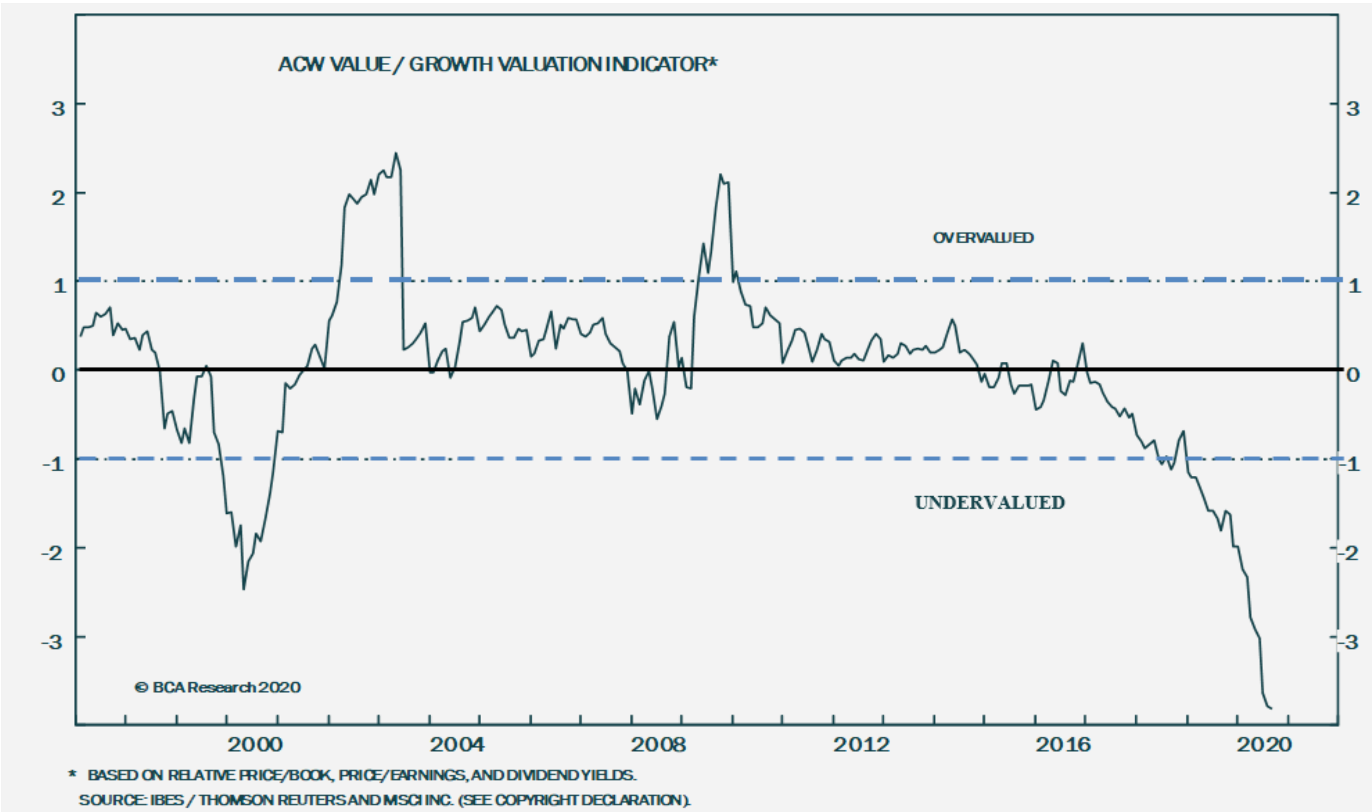
Source: Federal Reserve Bank of St. Louis and U.S. Office of Management and Budget, Federal Debt: Total Public Debt as Percent of Gross Domestic Product [GFDEGDQ188S], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GFDEGDQ188S, October 18, 2020.

One of the main arguments for why this trend may continue in the U.S., regardless of which administration ultimately is elected in November, is that the cost of servicing the debt has fallen dramatically over the past decade. The 10-Year Treasury bond, which is a proxy for the interest rate that the U.S. government has to pay, has fallen to all-time lows, and is negative after inflation. Expectations that government spending, whether it is for current programs (healthcare and social security) or plans for new spending on infrastructure, will continue to increase.

Market volatility remains elevated, but stable as we enter the home stretch of the U.S. Election and investors tend to be looking beyond the immediate uncertainty to a point at which the global economy recovers. News of progress on a number of vaccine candidates have given some hope to the potential that we can resume our normal lives. As this becomes the case, the likelihood is that the companies that have been most negatively impacted by the current environment will recover as well. According to Bank Credit Analyst Research (BCA), *a shift from the "Pandemic Trade" to the "Recovery Trade" will likely occur over the coming months, which should benefit financial services, energy and industrial companies as well as international markets which tend to be more cyclical in nature. The dominance of growth stocks, and technology in particular, should give way to a broadening of the market, particularly if investors start to focus on extreme valuations again when making investment decisions.*

<u>There are several potential catalysts for a shift in market leadership within the equity market</u>. The first is the potential for a safe and effective vaccine, as discussed, which begin to realize the prospects for many industries almost immediately. There are also signs that concentrated high stock market valuations are nearing a resistance where a reversal may occur. In Figure 3, we show the historical valuation statistics for global stocks.

Figure 3: Global Value Stocks are Historically Cheap Relative to Global Growth Stocks



Source: Bank Credit Analyst (BCA), www.bcaresearch.com Weekly Report, "Pivot to Value" as of September 18, 2020.

In looking at traditional measures of stock valuations, such as Price/Book, Price/Earnings and Dividend Yields, Bank Credit Analyst conducted an historical study to show how the gap between value stocks and growth stocks has widened since 2016. *As Figure 3 suggests, global value stocks have never been as cheap relative to their growth counterparts as they are today and this includes the dot-com era of the late 1990s*.

Interestingly, from early 2000 to 2008, value stocks rebounded from their period of undervaluation as technology stocks retreated and global growth accelerated again after 2001. While the catalysts are not likely to be the same today as they were in 2000, we believe the low level of interest rates, the relative strength of the U.S. Dollar and inflation are factors that could shift investor focus to value stocks.

Regardless of the U.S. Election outcome, markets are pricing in more fiscal stimulus. A vaccine would clearly propel the economic landscape and may change market leadership as the most sensitive sectors start to rebound. *Our portfolio strategy continues to emphasize effective and opportunistic diversification, supported by valuations and sound fundamentals.*

Contact Us

If you would like to learn more, please visit us at www.wescott.com, or contact us at 215.979.1600. We would love to hear from you.

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