



“Ahhh, this porridge is just right’ Goldilocks said happily and she ate it all up”.



As we have conjectured over recent commentaries, the equity markets rallied strongly in response to the increased, albeit incomplete, political certainty that the election provided. In fact, the Standard & Poor’s 500 Index enjoyed its biggest post-election rally since 1932.

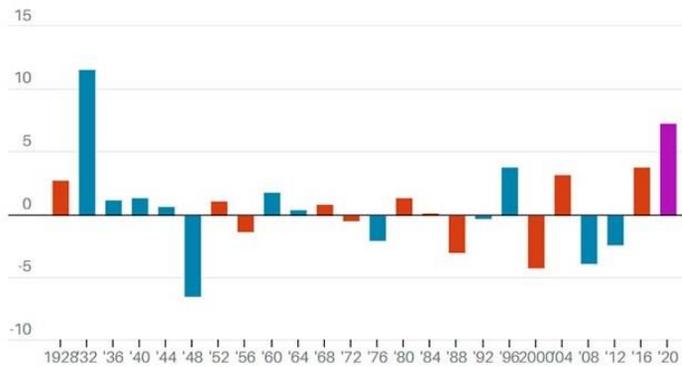
If anything, it is perhaps surprising just how powerful the market rebound was, when you consider the significant levels of uncertainty that still remain, due to the upcoming run-off elections in Georgia, and their implications for control of the U.S. Senate, President Trump’s continued refusal to concede the election (as we had also predicted in previous commentaries), and the unsubstantiated but widely circulated conspiracy theories related to massive election fraud and secret cabals of political operatives which are, at minimum, damaging the credibility of American democracy and further dividing an already deeply-divided country.

For evidence that this last statement is in no way hyperbole, consider that a just-released poll by Monmouth University revealed that 70% of Republican respondents believe that President-elect Biden won “due to voter fraud”, and that 4% of Republican respondents still believe that President Trump will ultimately prevail in his quest for a second term.

We have no doubt that the partial replacement of election uncertainty with increased political certainty, along with the market’s almost immediate dismissal of election fraud and conspiracy claims as non-credible, were very bullish catalysts. However, we also believe that this may turn out to be one of those rare times when the ultimate outcome of the political process is likely to be as bullish for the equity markets as was the removal of the election uncertainty itself (a factor which has historically been more than sufficient to catalyze powerful market rallies in its own right). You can see below this tendency for markets to rally strongly, largely without regard to the outcome, in the period between the election and Inauguration Day.

Voting for Gains

The S&P 500 had its best election week since the Great Depression.



Source: Dow Jones Market Data

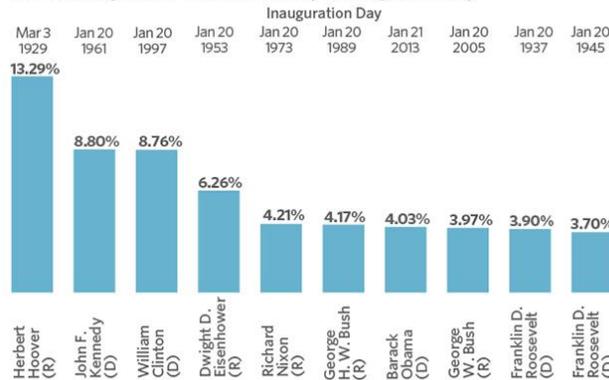
Ultimately, we attribute the magnitude of the post-election rally to not only the improved clarity that the election provided, but also the “goldilocks” result that it apparently produced.

There are many reasons why Wall Street manifested a distinct preference for Biden over Trump, as was evidenced by the fact that financial service firms and Wall Street executives

donated almost six times as much to the Biden campaign as they donated to Trump. Biden was viewed as being better equipped to get the pandemic under control, likely to be less unilateral and less reactive in regards to trade policy and foreign policy, and a “steadier hand at the ship of state”.

Post-election gainers

Percent change of S&P from Election Day to Inauguration Day



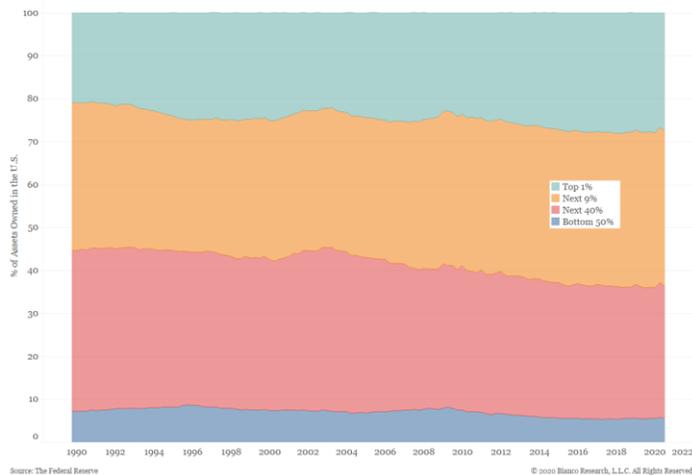
Source: Dow Jones

As was just noted by Larry Fink, CEO of Blackrock (the world’s largest asset management firm), "I do believe strongly that the market is in desire of more stability, of less volatility. They're looking for a voice that moderates, not

a voice that incites. I truly believe President-elect Biden can be that voice of reason." He went on to say that investors are "encouraged by having a leader now that is more inclusive, a leader that could probably bring a little more global harmony."

At the same time, there are a number of President Trump’s policies that are very popular with both Wall Street and investors in general, and a common concern about a potential Biden presidency was that he would immediately reverse so many of these policies. This includes reregulating much of the economy, increasing taxes on corporations and the wealthy, increasing capital gains tax rates, and pursuing policies designed to more equitably distribute wealth from the “haves” to the “have-nots”.

Distribution of Assets in the U.S.



Source: The Federal Reserve

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However, if things ultimately turn out as expected, with a relatively smooth transition of the presidency, and the Republicans winning at least one of the two seats in the Georgia runoffs for U.S. Senate (scheduled for January 5th), thus creating the checks and balances inherent in divided government, then the markets are likely to profit from the aforementioned “goldilocks” solution, where they should benefit from a steadier, more predictable and less reactionary set of federal government policies, but without the risk (at least, over the next two years) of significant changes to tax and/or regulatory policies.

That said, while Wall Street has traditionally cheered divided government, as it keeps the politicians in Washington, D.C. from “screwing things up”, we are less sure that gridlock is a “good” thing this time, when there is such a significant need for both sides of the aisle to work together to overcome the pandemic.

If anything, partisan brinkmanship is already causing significant problems both due to President Trump’s unwillingness to provide the Biden transition team with the information and resources necessary to facilitate a smooth transition of power, and the inability (i.e. unwillingness) of the respective sides to pass an additional coronavirus relief bill, which we

believe is absolutely crucial, if we hope to prevent the new surge in COVID case counts, and the resulting restrictions and lockdowns, from causing a significant economic slowdown, if not an outright contraction.

Which party will control the Senate after 2022 election?

Contract	Latest Yes Price	Best Offer
 Republican	64¢ NC	64¢
 Democratic	38¢ NC	37¢

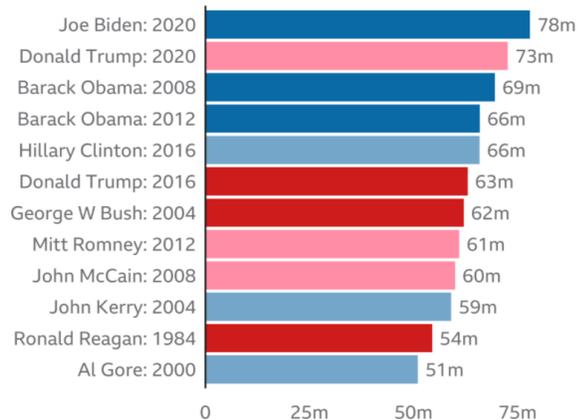
We believe that the impending run-off elections in Georgia are of critical importance on several levels, particularly when you consider what seems to be the prevailing Republican opinion that the Party will need the President’s help to assure victory there (despite the fact that the prediction markets are already assigning a 63% likelihood of the Republicans winning at least one of the two seats).

Both parties are going to pour all of their resources into these two run-offs, as the outcome will determine whether President-elect Biden will be able to pursue his full agenda, or if the Republicans will still be able to control everything from the federal budget to the appointment of major government positions, including Supreme Court judges, members of the Federal Reserve, and even the very members of Biden’s cabinet.

As for President Trump, who did receive the second largest number of votes for president in U.S. history, it is likely that he will retain an enormous amount of influence in the Republican Party for years to come, and perhaps even lead a populist faction within the party, much like the progressive left faction of the Democratic Party. Longtime Republican strategist, Mike DuHaime, just noted Trump’s pervasive and powerful influence, stating that many Republicans “who do know better are sitting silent right now out of fear that Donald Trump may or may not support them in 2022 or 2024.”

Biden wins most votes in US electoral history

Total number of votes cast for Democrat and Republican presidential candidates. Darker colour indicates victory



Source: MIT, Edison via Reuters

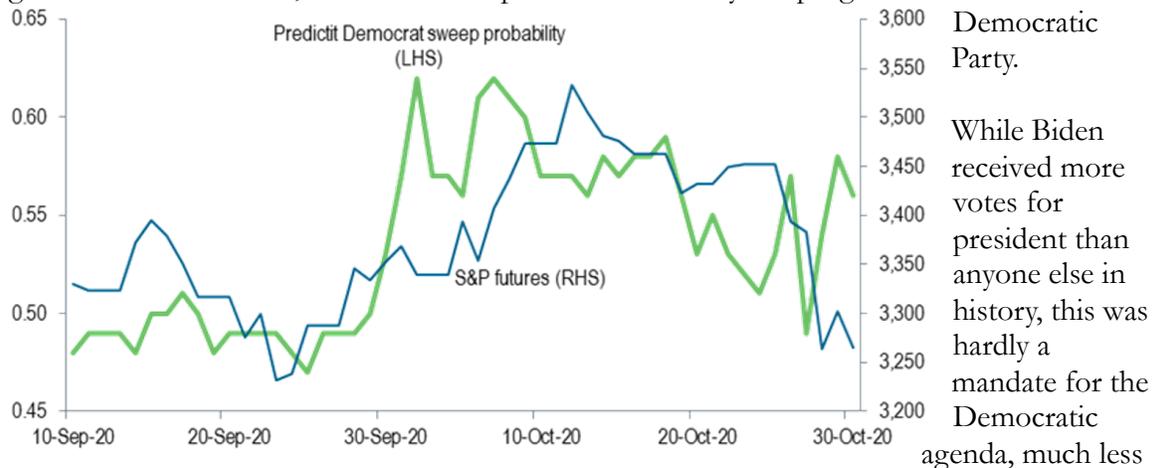


Republican strategist George Will echoed this perspective, noting that “They [Republican politicians] are walking on eggshells and minding their language, whereas if some of them did not have this [Georgia run-off] election, they would tell the president to please pack up and depart.” Further complicating matters are Trump’s substantial efforts to maintain control of the Republican National Committee even after he leaves office.

This would certainly help to explain why most Republicans continue to refrain from criticizing the President for his outlandish claims of election fraud and his refusal to cooperate with the incoming Biden administration.

Despite all of the political rancor, we are somewhat hopeful that the willingness of the respective parties to work together will improve after the conclusion of these January 5th runoff, for the simple reason that President-elect Biden and Senate Majority Leader McConnell are long-term friends, with a long history (dating back to 1985) of working together in a productive and relatively non-partisan way. In fact, in 2015 Majority Leader McConnell was the only Senate Republican to attend the funeral for Biden’s son Beau, and has recently referred to Biden as his “old friend” and “trusted partner”.

We recently benefitted from a unique opportunity to consult with a former U.S. Ambassador to Germany and, among the insights that he passed on is that Biden is an accomplished negotiator, who is well respected on both sides of the aisle and that, when he served as Vice-President under President Obama, it was always Biden who was tasked to negotiate with the various factions in Congress. He also reaffirmed our expectation that a President Biden will govern from the center, and will not be pulled to the left by the progressive elements of the



agenda, much less the progressive left agenda. Exit polls showed that 21% of Biden voters were “anti-Trump”, but not “pro-Democrat”, and Democrats not only lost much of their lead in the House, but also saw the overall composition of the House shift towards the center.

Further, Democrats are unlikely (depending on the Georgia run-offs) to see a unified government (the anticipated “blue sweep”), which is a bit of an anomaly, if you consider recent history, where Bill Clinton, George W. Bush, Barack Obama, and Donald Trump all started their first term in control of all three branches of legislative government.

Indeed, we believe that one of the reasons why the equity markets reacted so favorably to the election results is that they are being viewed by many as a repudiation of socialism and the progressive left of the Democratic Party. If anything, it confirmed that America is still, on average, a center-right country and, as was noted by National Republican Congressional Committee spokesperson Michael McAdams, the election proved that the “socialist agenda of the progressive left is completely out of touch with middle-class voters”.

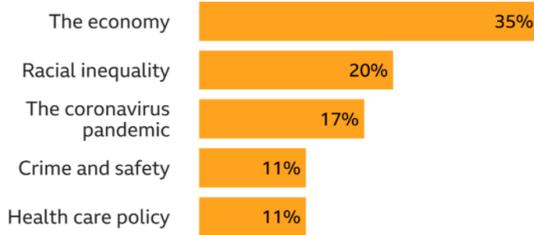
This perspective was reinforced in a long, post-election phone call (a sort of Democratic Party post-mortem on the elections) designed to understand just what went wrong, where a caucus of House members reportedly “yelled, swore, and traded blame” with each other, and Virginia Representative Abigail Spanberger proclaimed “We need to not ever use the word ‘socialist’ or ‘socialism’ ever again. We lost good members because of that.”

As was noted by Republican strategist George Will shortly after the election, “It seems to me the really depressed people today are the AOC (Representative Alexandria Ocasio-Cortez) progressive caucus-types who saw their future turn to ashes on election night”. Further, according to several news outlets, Ocasio-Cortez has stated that the criticism from members

of her own party is causing her to consider a new career.

National exit poll: Issues

Which one of these five issues mattered most in deciding how you voted for president?



Sample size: 3,755 respondents. All figures have a margin of error
Source: Edison Research/NEP via Reuters, 22.30 EST (03.30 GMT)

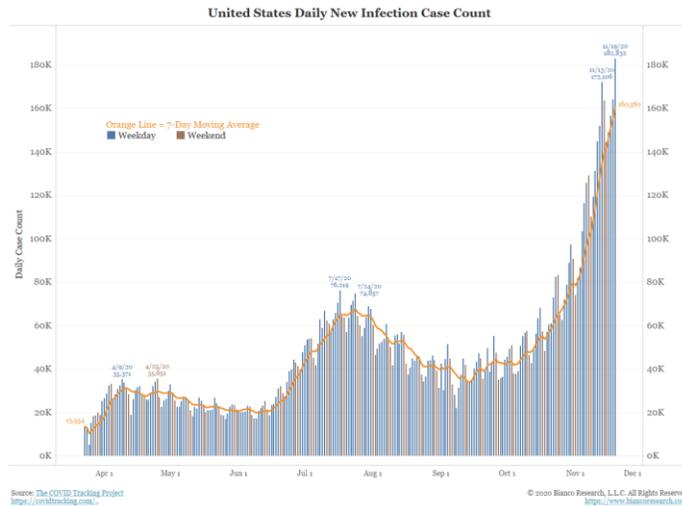


Further, when you compare how well Biden performed on a state-by-state basis versus left-leaning candidates in the same state, you can make a strong argument that Biden, because he is a moderate, was likely the only of the Democratic candidates that could have won this election, and that it was the successful efforts of the Republican Party to associate the Democrats with

socialism and efforts to defund the police that prevented the “blue wave” Democratic sweep that the polls and prediction markets were anticipating.

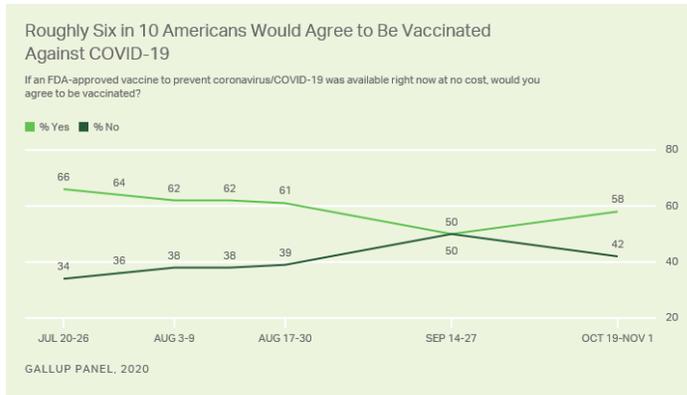
In addition to the anticipated “goldilocks” election results, the outlook for both Main Street and Wall Street has just benefitted dramatically from news on the medical front, where the vaccines from both Moderna and Pfizer showed a much better than anticipated effectiveness rate of essentially 95%, which is dramatically more effective than the average flu shot and equal to the efficacy of the smallpox vaccine, which was sufficient to eradicate that virus. Moreover, there is new research from the La Jolla Institute of Immunology suggesting that immunity from the coronavirus could last for years, which would be hugely important in efforts to eradicate the virus.

Dr. Fauci, who estimates that most Americans will be able to receive a vaccine by the end of April, summarized the vaccine news as “the cavalry is coming”, and early indications are that these, and likely other vaccines and therapeutics still to be announced, truly are a game-changer, and the ticket to the return of normalcy.



The problem is that late April (or June, which is the CDC estimate for when a vaccine will be available to everyone who wants it) is going to seem very far away while in the midst of a mismanaged and out-of-control pandemic, and the massive logistical and supply-related issues associated not only with giving two sets of injections to each of 300+ million people (in the U.S. alone), but also convincing a very skeptical public that getting vaccinated is safe, effective, and absolutely necessary. That’s not even to mention getting everyone to wear masks and to social distance in public, which will likely remain important for some time to come. To quote Dr. Fauci, “December, January and early February are going to be terribly painful months.”

Early on, there was considerable concern amongst the public that, as a result of political pressure, vaccines and therapeutics were being expedited through the approval process without proper safety testing, as now appears to have been the case with recently-approved remdesivir. A recent Gallup survey revealed that 80% of those who said that they will elect not to be vaccinated cite a fear of side-effects as the reason why.

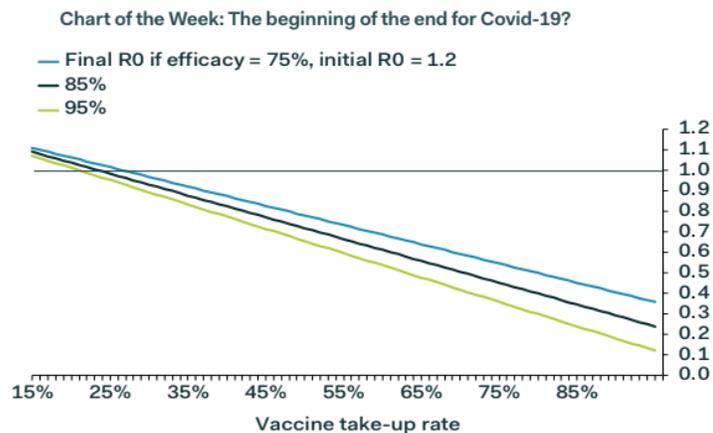


Greatly complicating matters is that much of the country, including reports of those on their

deathbeds, still view the virus as “fake news”. As per Dr. Fauci’s recent comments at The Hastings Center, “Despite a quarter million deaths, despite more than 11 million infections, despite 150,000 new infections a day, they don’t believe it’s real. That is a real problem.”

Fortunately, the public’s perception of vaccine safety is slowly starting to change, as fairly broad adoption of the vaccines will be essential to a return to normality. Time itself should help to address the vaccine-related safety concerns as, according to the FDA, over the last 40 years, between 90 and 95% of serious negative reactions to a new vaccine going through clinical trials have occurred within the first 40 days after injection.

The Chief Scientific Advisor for “Operation Warp Speed”, Dr. Moncef Slaoui (a.k.a. the “vaccine czar”), said on November 22nd that a 95% effectiveness rate combined with a 70% adoption rate should be sufficient to produce herd immunity in the U.S. by sometime in the early summer, and that the first Americans could get vaccinated by the middle of December. It does indeed look like the cavalry is within sight.

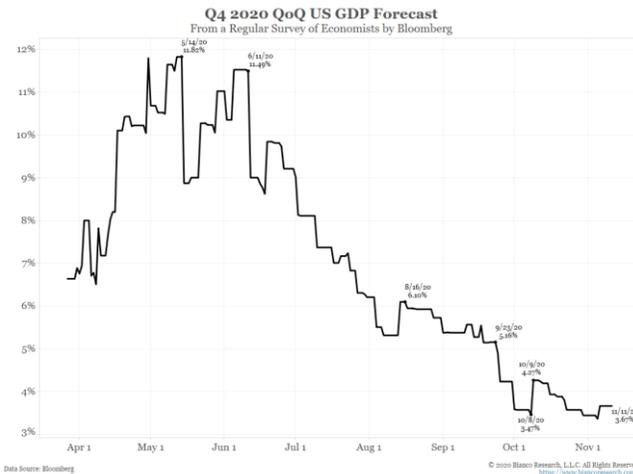


However, between now and the cavalry’s arrival, the domestic economy is likely to get hit very hard by this rapidly-spreading pandemic, thus leaving the country in desperate need of a massive fiscal stimulus program to carry the economy through the winter and fall months.

In fact, the economy has been waiting for a new stimulus package since August 1st, and there hasn’t been much urgency on the part of the federal government to get anything done because of pre-election partisanship and the facts that the COVID case count had receded in the third quarter, while the economy was showing decent and seemingly sustainable signs of recovery. These improving trends, although temporary, allowed Senate Majority Leader McConnell an opportunity to remind everyone that Republicans used to believe in fiscal responsibility, and countered the \$3.4 trillion “Heroes Act” being supported by congressional Democrats and the Biden administration, with a \$500 billion stimulus package.

Given the size of this divide and today's unprecedentedly bad levels of political rancor, we are concerned that the government may not agree to a sufficient stimulus package until they absolutely need to, and that normally means not until the levels of economic pain have become intolerable. Look back to the Global Financial Crisis and the \$700 billion T.A.R.P.

(Troubled Asset Relief Program) vote as precedent.

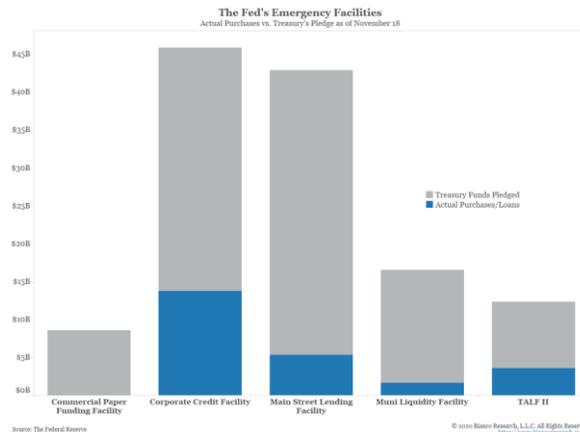


We hope that we are wrong, but we are concerned that the most likely outcome is for this absolutely essential economic support to be delayed until after Inauguration Day, or at least until after the Georgia run-offs, as both sides may be hesitant to give the other a political victory before the run-off date.

During this month's update to our advisors, we noted our concern that such an outcome could catalyze a double-dip recession, as the surging pandemic case count catalyzes rolling regional lock-downs and changes in consumer behavior. Over recent days, we have been joined in that concern by JP Morgan and Bloomberg Economics, both of whom are now predicting an economic contraction in the first quarter of 2021, and Dallas Federal Reserve President Robert Kaplan, who just noted that the economy could be at risk of slipping back into recession.

According to JP Morgan, "While the economy powered through the July wave, at that time the reopening of the economy provided a powerful tailwind to growth. ... The economy no longer has that tailwind; instead it now faces the headwind of increasing restrictions on activity."

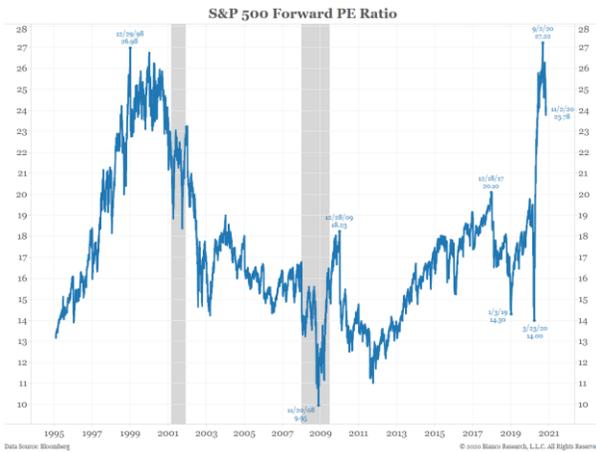
A double dip recession would be particularly concerning, with the Fed already having used almost all of the tools at its disposal, with interest rates already essentially at 0%, and the Treasury Department just gutting the Fed's ability lend to businesses and to add liquidity to the economy and debt markets in a second downturn, by forcing them to return to the Treasury Department \$455 billion of emergency funds. These funds were designed to allow the Fed to provide emergency loans to state and local governments and the Main Street Lending Program, which provides emergency funding to small and medium-sized businesses, in addition to providing liquidity to the corporate bond market.



In addition to the strikingly public objections to this move by Fed Chairman Powell, Senator Ron Wyden, who is the ranking Democrat on the Senate Finance Committee, noted that "Secretary Mnuchin is removing critical support from a weak economy against the Federal Reserve's wishes. This is economic sabotage" and that "Secretary Mnuchin is salting the earth in an attempt to inflict political pain on President-elect Biden."

Carl Weinberg, chief economist at High Frequency Economics, equated it to “stripping lifeboats from the Titanic”. At minimum, as was noted by CNBC, it “will dramatically

reduce the central bank’s ability to backstop the financial system”, which makes a new fiscal stimulus package just that much more important.



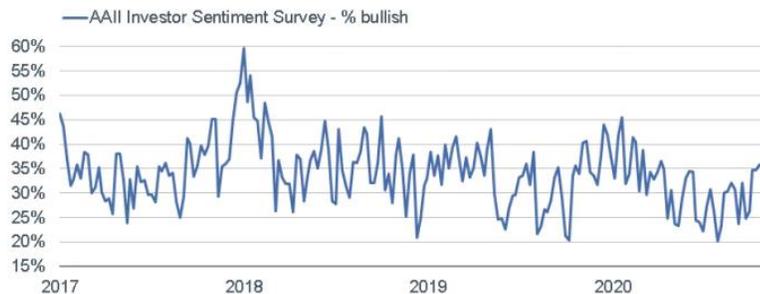
We suspect that the size and timing of a new coronavirus stimulus package will be the single most important determinant of how Main Street fairs over the next two quarters, but are less confident that Wall Street assigns it the same level of importance, due to the historical tendency for stocks to be priced on expectations for six to nine months into the future, which

happens to be the timeframe when the worst of the pandemic should be well behind us.

In regards to when we should hopefully be able to put the worst of the political antics behind us, there are two dates, besides the January 5th run-offs, that should usher in periods of greater political certainty. The first is December 8th, which is the deadline for resolving all election disputes, including recounts and related court contests. The second is December 14th, when members of the electoral College meet to finalize the election results.

Despite some (likely temporary) signs of slowing in the spread of COVID, Biden’s prediction of a “dark winter” is probably spot-on. That said, we suspect that expectations for an acceleration of this health crisis and a deceleration in the economy are probably already largely priced into most securities markets, which suggests that prices should not move dramatically unless fundamentals turn out to be either notably better or notably worse than expected. That is the good news, that a very ugly next few months is likely already priced into markets.

Spike in AAI Bullishness



Source: Charles Schwab, Bloomberg, as of 11/11/2020.

In contrast, the post pandemic period should look much better from an economic and earnings perspective, which is something that almost everyone would agree with, and that’s the bad news, as it suggests that a dramatic 2021 recovery in both corporate earnings and economic growth is already reflected in current prices, which is why current valuations are so extraordinarily high, because future expectations are so much better than current reality. Unfortunately, securities prices normally don’t react to the same news twice (i.e. both when anticipated and when realized), and surveys of investor and institutional manager sentiment suggest that much of next year’s great news is already being priced in. In other words, expect Main Street to benefit much more than Wall Street from the realization of a post pandemic world. Wall Street will likely price in normalization well in advance of its actual arrival.

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