WELLINGTON SHIELDS & CO. LLC
Quarterly Market Strategy Report

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Be Alert to October Surprises

There is a growing consensus that Democrats will win the White House, possibly increase their majority in the House and could even tilt the balance in the Senate. And economists are now indicating the Biden-Harris platform may not hurt the economy as much as originally expected. However, history has shown that consensus views, and economist's forecasts, are more often wrong than right. In short, it may be wise to stay alert for October surprises.

In terms of the Biden-Harris platform, former Vice President Joe Biden has stated he will repeal the Trump tax cuts which means taxes will go up for all individuals and businesses. To say that taxes will not increase for anyone making less than $400,000 a year is simply self-contradictory. Moreover, targeting tax increases on incomes of $400,000 or more could hurt millions of small business owners who need positive cash flow to expand. The only effective way to raise taxes on the wealthy and not hurt the average worker would be to eliminate tax breaks focused on the wealthy such as the carried interest loophole. More importantly, to raise taxes while the economy is still struggling to gain its footing from a mandatory shutdown seems reckless.

Some say the positive impact of the proposed Biden-Harris fiscal stimulus will offset the negatives from tax hikes. However, the Biden-Harris stimulus plan is tilted toward infrastructure spending on green and sustainable energy sources. This is an admirable goal, and it should be done, but it will take a long time. Federal infrastructure spending tends to be slow and inefficient. President Obama's $830 billion American Recovery and Reinvestment Act of 2009 was the largest stimulus-spending package in all of American history, and it promised "shovel ready" construction projects to spark job creation and lift the economy. Unfortunately, only 15% of the money was used for roads, bridges, and other infrastructure projects and it took more than three years to have much of any Impact. * In sum, we would be skeptical that the Biden-Harris stimulus plan will work as promised. The most effective way to stimulate the economy is to give money directly to consumers and businesses either through tax cuts or direct checks. And it should be done quickly. As Federal Reserve Chairman Powell indicated -- more stimulus is needed since households need cash to pay rent and support their families.

* https://www.wsj.com/articles/obamas-bad-stimulus-example-11584745388

The financial media appears perplexed by what they see as a disconnect between the soaring stock market and a weak economy; yet this disconnect may not be as big as perceived. As stock market averages are knocking on their all-time highs in October, there are also signs of a solid rebound. This can be found in the strong gains in disposable income, construction spending, auto sales, manufacturing, consumer, and business confidence. The household sector's double-digit savings rate also points to more potential spending ahead. Perhaps the media is looking at shutdowns and virus trends while the stock market is looking to the future.

If there is a disconnect in the financial environment it is found in valuations. Equity prices are rising without a commensurate increase in earnings. As a result, PE multiples have jumped to record levels. If earnings do not rebound strongly from the big declines seen in the first and second quarters of 2020, the stock market will be trading well-above fair value. This is the crux of the stock market's risk today.

PREDICTING ELECTIONS

October is an interesting month in many ways. A good equity performance in October during a presidential election year has been a good omen for the incumbent party. October is less than half over, but it is showing an above average gain to date. Furthermore, the equity market's performance in the three months leading into the election has been a remarkable precursor of the election. A loss in either the S&P 500, the DJIA, or both, in the three months leading into the election has predicted a loss for the party currently in the White House. A gain has preceded a success. There have been few exceptions to this rule. In 1932, the equity market rallied strongly even though President Hoover (Republican), on the cusp of the Great Recession, lost the election to Franklin Delano Roosevelt (Democrat). The market also declined in the three months prior to the successful re-election of Dwight David Eisenhower (Republican) in 1956, following the Korean War. And the stock market did not predict the change in political power in 1968 when Republicans (Nixon) succeeded Johnson (Democrat). However, President Johnson failed to win his party's nomination at the 1968 Democratic Convention and was replaced by Hubert Humphrey. But aside from these anomalies, a positive performance from the end of July to the end of October has indicated that the party in power would retain the White House.

Equity Performance Three Months Prior to Election

Election Year	Election Winner	SPX	DJIA	Party Upset
1932	FDR	14.1%	14.1%	*
1936	FDR	8.6%	7.5%	
1940	FDR	7.7%	6.7%	
1944	FDR	0.6%	0.3%	
1948	Truman	4.4%	4.0%	
1952	DDE	-3.5%	-3.7%	*
1956	DDE	-7.7%	-7.3%	
1960	JFK	-3.8%	-5.9%	*
1964	JFK	2.0%	3.8%	
1968	Nixon	5.8%	7.9%	*
1972	Nixon	3.9%	3.3%	
1976	Carter	-0.5%	-2.0%	*
1980	Reagan	4.8%	-1.2%	*
1984	Reagan	10.2%	8.3%	
1988	GHW Bush	2.6%	0.9%	
1992	Clinton	-1.3%	-4.9%	*
1996	Clinton	10.2%	9.1%	
2000	GW Bush	-0.1%	4.3%	*
2004	GW Bush	2.6%	-1.1%	
2008	Obama	-23.6%	-18.0%	*
2012	Obama	2.4%	0.7%	
2016	Trump	-2.2%	-1.6%	*
2020	?	6.5%	7.8%	

Source: Refinitive; Dudack Research Group

OUTLOOK

Although high PE multiples imply investors should be cautious and maintain a solid focus on value in the short term, we find many reasons to be bullish long term. Not only are the trends favorable in most economic data but in the breadth of the market as well. The number of daily new highs has steadily increased in October and the advance decline line reached an all-time high. The Dow Jones Transportation Average made a series of new highs in mid-October and the Russell 2000 index has become the outperforming market benchmark. These are all signs of a broadening advance. Supportive monetary policy, solid economic releases, and the potential of new fiscal stimulus sometime in the next three months, also implies equities should do well in the longer term.

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