Bulls vs Bears… We are Siding with the Bulls, but Both Sides Could be Right

MARKETS ARE NEARLY ALWAYS RATIONAL AND LOGICAL. HOWEVER, IT USUALLY TAKES HINDSIGHT TO SEE IT. – WISE PERSON

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- **Bull vs. Bear: RiverFront leans cautiously optimistic about equities**
- **Bear: Trade policy and the election create another risk factor into end of year.**
- **Bull: Economies are becoming less fragile and policymakers have your back.**

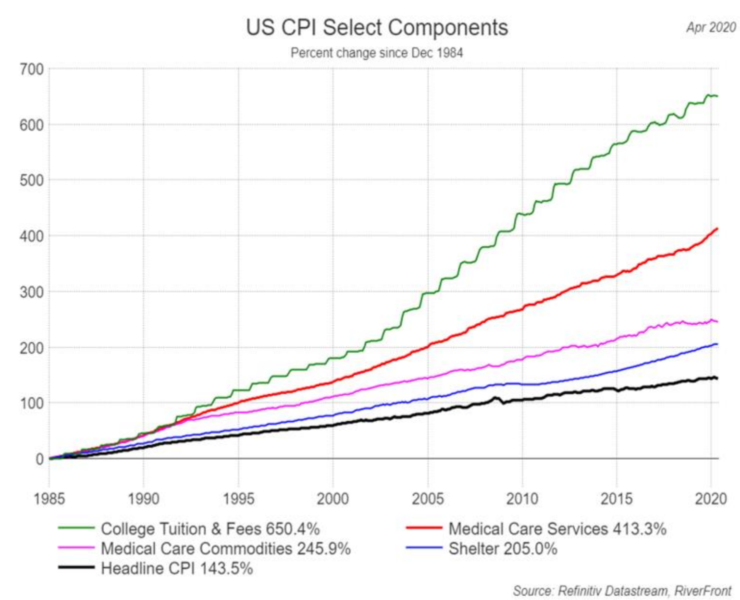
We see the investment world today being divided between two camps: those that can't understand the market rebound (the Bears) and those that think the rebound is entirely justifiable (the Bulls). Our Weekly View is dedicated to the macro-economic debate between these two sides. In reality, RiverFront's investment team lies somewhere in between these two extremes, but leans cautiously optimistic about equities after historic amounts of stimulus were provided to dampen the economic effects of COVID-19.

THE ECONOMY IS UNCERTAIN BECAUSE THE FUTURE TRAJECTORY OF COVID-19 IS UNCERTAIN.

- **Bear: The crisis may not be over and there is no historical analog to look to for guidance.**
  - **Much about COVID-19 is still unknown:** Many unknowns surround COVID-19, making it hard to predict the duration and magnitude of its economic impact. According to the Wall Street Journal, some leading medical experts suggest the US needs to be testing at least 6 million people a week in order to allow the country to safely lift restrictions – this is roughly three times the testing the US is currently doing. We also don't yet know if the virus will taper in the summer as some other pandemics have done, or whether a 'second wave' may emerge.
  - **No vaccine for the foreseeable future:** Unlike off-the-shelf antivirals, a novel vaccine will be administered to otherwise healthy people and thus requires long trials and careful scrutiny for approval. While markets rallied last week in part over news that progress has been made on a vaccine, these reports must be taken with a grain of salt given the early nature of testing. Even once a vaccine is approved, manufacturing for widespread usage will also create a lag. Even optimistic forecasts suggest no vaccine will be able to be widely distributed in 2020.
- **Bull: No matter the path of COVID-19, another full economic shut-down is unlikely. Also, some of the changes implemented to fight COVID-19 will have lasting positive impacts to the economy.**
  - **Another full economic shutdown is unnecessary and carries health risks of its own:** Antivirals and other therapeutics have shown efficacy in helping to offset symptoms and speed recovery. For instance, the FDA has cleared antiviral Remdesivir under an emergency authorization on May 1 after promising early results in a US government-run study (*source: Bloomberg*).

Additionally, it is becoming more understood that an economic shutdown carries health risks of its own such as mental health crisis and suicide (*Source: The Washington Post*).

- **Lasting positive economic changes have occurred whether COVID-19 returns or not:** Quarantine and social distancing rules have led to a quantum leap in tech adoption (video conferencing, data sharing, mobility, etc.). Historically, technology has allowed people and companies to do more with less, driving productivity. Therefore, it stands to reason that a quantum leap in tech adoption should lead to similar quantum leap in productivity, which should amplify corporate earnings in the future. This quantum leap in tech adoption may help address two age old problems plaguing the developed world:
  - **Ever-rising Cost of Education:** Education costs, particularly post-secondary, have risen far more quickly than inflation (see chart below) and as a result have represented a growing proportion of discretionary spending. With universities being forced to offer classes online and students becoming more comfortable learning from home, we anticipate distance learning to grow in popularity. Traditional universities that permanently adopt some of the 'temporary' accommodations have the opportunity to take market share and more importantly, lower the cost of education for all.
  - **Ever-rising Cost of Health care:** Like education, the growth of health care costs has dramatically outpaced inflation (see chart below). The COVID-19 response has brought at least three meaningful changes to health care that we believe will lower health care costs beyond the crisis. First, cheaper health care delivery solutions like tele-medicine and internet prescription refills have experienced greater adoption and will likely become a normal part of our health care experience long after social distancing rules end. Second, improvements to the regulatory framework that reduces the 'red tape' and accelerates the approval process are also unlikely to disappear. Finally, the quantity and variety of new entrants who have entered the health care industry will likely bring new thinking and ideas to an industry in need of both.



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POLITICS HAVE BECOME INCREASINGLY UNCERTAIN

- **Bear: Trade policy and the election create another risk factor into end of year.**
  - **US/China trade war to resurface:** Tensions between the US and China have appeared to resurface in the wake of COVID-19. Last week, China announced they'd be moving ahead with national security laws in Hong Kong, effectively bypassing democratic local legislature. Thus far, China does not appear be on pace to honor Phase 1 imports commitments, and the Trump administration threatened to raise tariffs early this month. Recall that concerns over the trade war were a cause of acute market stress back in late 2018.
  - **Risk of a Democratic Sweep has Increased:** The stock market tends to like political 'gridlock,' with neither US political party holding dominion over both the legislative and executive branches. However, the odds of a November Democratic sweep of both houses of Congress as well as the presidency have

increased recently; polling website FiveThirtyEight's congressional ballot tracker now has an 8-point lead for the Democrats (as of 5/20/20). In addition, as we discussed in our 2020 Outlook, a declining economic outlook is historically not good news for an incumbent President.

- **Bull: Tougher trade policy may be a good thing and there are some things both parties agree on.**
  - **Tough trade policy may accelerate reshoring:** Reshoring, which is the opposite of offshoring, has been accelerating in recent years. The trend began with the rising cost of foreign workers and the side-effects of offshoring becoming clearer, such as intellectual property theft. Changing trade policies and the new and growing risk of border shutdowns should accelerate that trend, in our view. We believe reshoring is a good thing, since it creates higher-paying manufacturing jobs and seems to be disproportionally focused on America's interior where jobs are most needed.
  - **Presidential race has become more business friendly and there appears to be bi-partisan support for bailouts:** Presidential politics have become more business friendly since the outbreak of COVID-19. Senator Elizabeth Warren and Senator Bernie Sanders have dropped out of the race, leaving Former Vice President Joe Biden, more a centrist who appears to be more well-received by the business community.

INTERNATIONAL ECONOMIES ARE EVEN MORE UNCERTAIN

- **Bear: Economies outside of US were struggling even before COVID-19:**
  - **Europe is a mess:** While the US entered the crisis in solid economic shape, the same could not be said for the European Union, which represents the largest economy and trading bloc in the world (*source: European Commission*). Some key European economies, such as Italy, were already close to recession in early 2020. This economic weakness has kept many interest rates below zero, damaging profitability at Euro banks. It is also complicating the already fragile politics between northern and southern eurozone countries.
  - **Asia and emerging market growth slowing:** Japan and China were both slowing economically ahead of COVID-19, and both are now seeing dramatic drop-offs in output. In addition, many commodity-levered economies such as Australia, Canada, Latin America, Russia, and parts of Africa may be hurt by the persistent weakness in commodity prices brought about by COVID-19.
- **Bull: Economies are becoming less fragile and policymakers have your back.**
  - **Economies are more resilient:** The coordinated global response and the pace of innovation has left us awestruck by how adept we have become to problem solving. A networked world, ubiquitous data, genomics, biomechanics, massive computing power, and advances in artificial intelligence to name a few, have allowed us to understand and solve problems far more quickly than in the past. While economies will never be bullet-proof, the ability to quickly heal after a crisis may be the next best thing.
  - **Bad news may be good news for policy:** Monetary and fiscal stimulus have become well-used tools throughout the world and are likely to be used in greater quantity and frequency the worse the news gets. This hardens the argument that there is a 'put' for risk assets. Policymakers now appear to be less comfortable with economic and market cycles and are more likely to toss out the 'life ring' in a crisis. If our assumption is correct, risk-takers can feel more confident that risk assets may offer asymmetrical returns in the future (backstopped downside and unlimited upside).

Bottom Line: *As you have read this piece, it is easy to see that valid points exist on both sides of the argument. Our portfolio management team is more bullish than bearish but recognize that the environment is dynamic and could shift quickly. Additionally, there is a view that both sides could be right, which seems to be the message of the market. For example, the argument of the bulls seems to be supported by growth stocks, particularly in* *healthcare and technology, as investors appear comfortable to embrace the 'glass half full' perspective. On the other hand, the underperformance of small-caps, financials and cyclicals, seem to suggest that any economic recovery will be slow and possibly a long way off.*

Our portfolios are currently slightly overweight equities and we have recently added to our equity positions. Within equities we are overweight growth stocks and continue to favor US stocks over international and emerging markets. We recognize that the economic effects of COVID-19 require nimbleness in our thinking and an adherence to our tactical and risk management processes.