Fisher Investments™ Institutional Group

MARKET PERSPECTIVES
REVIEW & OUTLOOK

THIRD QUARTER 2020

THIRD QUARTER 2020 REVIEW & OUTLOOK

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THIRD QUARTER 2020 REVIEW & OUTLOOK
EXECUTIVE SUMMARY

October 05, 2020

PORTFOLIO THEMES

- We continue to favor larger, high-quality companies, but our assessment of the market's future path will determine if we shift toward smaller cyclical firms.
- Unlike many past cycles where the bull market's leading category underperformed in the subsequent bear, large Technology equities have held up relatively well during the bear market and initial bounce off the market lows. Consequently, we are not yet convinced the recovery will be a conventional new bull led by small value.

MARKET OUTLOOK

- **Equities Appear to be in a New Bull Market:** The rally since late March looks to us to be a new bull market forming as equities look further into the future and anticipate a recovery.
- **Equities are Leading the Economic Recovery:** As a leading indicator, equities have started recovering well before Covid-19 is gone, restrictions are removed, or the economy recovers.
- **Early Bull Markets Begin with Pessimism:** Volatility is to be expected, but with pessimism about a second wave growing and positive data garnering little fanfare, we think more gains are likely.

The nascent bull market continued in Q3 as the MSCI ACWI hit new highs before encountering September turbulence—normal volatility, in our view, even this early in a bull market. Overall, global equities rose 8.1% in the quarter.[i] Nine months in, global equities are up 1.4% on the year.[ii] Remarkably, despite the bear market and all of the brutality 2020 has thrown at us on a human level, returns are largely on track toward our full-year forecast as detailed in our Q4 2019 Review. Of course, we didn't then anticipate the journey including a lightning-fast bear market and a record-speed recovery, but we did expect mildly positive returns.

Between the pandemic, a variety of natural disasters, civic upheaval, business closures, job losses and so much more, this year has been tough. Yet markets are resilient, indifferent and never caring or kind—their coldness is what enables them to rise through turbulent times like these.

Remember this as we face uncertainty over the next few months. Fears are elevated on multiple fronts, starting with the US election and the high likelihood of delayed results—not to mention recounts and court challenges from both political parties. Another Covid-19 wave also looms large, with many anticipating a return to lockdowns as restrictions begin to tighten in some areas. Pundits warn the economic recovery is already losing steam, citing high-frequency indicators including checkpoint crossings as reported by the US Transportation Security Administration, restaurant reservations and retail foot traffic, among others. On the geopolitical front, a rift between the US and China—regardless of which side wins the US election—preoccupies many investors, as does the recent realignment in the Middle East. We don't dismiss any of these risks, but markets move most on probabilities, not possibilities. As we will discuss in the full Review & Outlook, the worries that dominate investors' minds today range in validity, in our view, but they seem mostly like bricks in the bull market's wall of worry.

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i Source: FactSet, as of 10/01/2020. MSCI ACWI Index return with net dividends, 06/30/2020 – 09/30/2020.
ii Ibid. 12/31/2019 – 09/30/2020.

That includes the US election, which remains too close to call as we write. While we expect our full Review & Outlook will come to you before Election Day, we plan to follow up with dedicated post-election commentary. Absent a clear victory by either candidate, mail-in ballots, recounts and potential legal challenges mean clarity may not come on election night or even in the days that follow. In the meantime, the Review will share a framework for assessing the contest. We will explain what to ignore and why for the purposes of analysis and what to focus on (key indicative Senate races, trends in swing states, each party's detailed tactical game). Eventually, though, we will have a winner, uncertainty will fall, and normal election and inaugural-year market drivers should kick in. As we detailed last quarter, history suggests that means a milder 2020 and stronger 2021 if Joe Biden wins, with a stronger 2020 and milder 2021 if President Donald Trump prevails.

On October 1, President Trump tested positive for Covid-19, joining a growing list of world leaders that have contracted the virus, such as UK Prime Minister Boris Johnson and Brazilian President Jair Bolsonaro. While this development introduces another variable into the presidential election and increases short-term uncertainty, it is impossible to know at this time whether this will materially affect the election outcome or President Trump's ability to fulfill the duties of office. That said, the US federal government is much bigger than the president, whose direct involvement is largely not required for the day-to-day functioning of basic government activities. Further, the US Constitution provides clear guidance as it relates to a line of succession and power transfer thus reducing uncertainty.

Volatility's return last month concerned investors globally, particularly with Tech leading the way down. For some, this supported the notion of overvalued Tech and Tech-like equities being the sole driver of the market recovery, setting equities up for a big fall when they inevitably reversed course. Yet data showed otherwise. By September 4, when the volatility began, 95% of the almost 3,000 equities in the MSCI ACWI were in positive territory since March 23's low, with 77% up 20% or more.[iii] Excluding Tech and the Tech-like FANG equities (Facebook, Amazon, Netflix and Google), US equities were up 46.9% vs 42.9% for Continental Europe (ex. Tech)—a testament to the bull market's breadth.[iv] In our view, the volatility that ensued is typical of the market's behavior after surpassing the prior bull market's peak. It is normal for equities to bounce around before breaking out. It is also normal for volatility—even a correction—to strike within a bull market's first few months, once the initial V-shaped recovery has run its course.

As for the notion of markets being tired after a big rally, necessitating weak or negative returns from here, the data show otherwise. Since 1928, US equities have had 34 prior stretches of five consecutive positive months, with most following bear market or correction lows—like this rally. Returns were positive over the next 6, 12 and 18 months over 80% of the time—far greater than equities' average frequency of positivity.[v] Better yet, when the five-month rally exceeded 25%—as this recovery did—returns were positive over the next 18 months 100% of the time.[vi] That doesn't guarantee positive returns from here, but it does show fatigue is a myth.

iii Source: FactSet, as of 10/02/2020. Statement based on MSCI ACWI Index constituent price returns, 03/23/2020 – 09/04/2020.

iv Source: FactSet, as of 09/08/2020. S&P 500 total return ex. Information Technology sector and Facebook, Amazon, Netflix and Alphabet (Google's parent company) and MSCI Europe Ex. UK Index excluding the Information Technology sector, 03/23/2020 – 09/04/2020.

v Source: Global Financial Data, Inc., as of 09/10/2020. S&P 500 positive five-month streaks and subsequent price returns, 12/31/1927 – 08/31/2020.

vi Ibid.

In emerging markets, many countries are battling Covid-19 outbreaks, and none have fully recovered economically. However, we believe markets are looking beyond this-toward the long end of the 3 – 30 month range they typically weigh-to a time when society has dealt with the virus, letting economies return to some form of normalcy. In our view, markets are forward-looking and already processed the virus's near-term economic effects. We don't think they are irrationally ignoring today's bad news. Even though not all EM economies or equity markets will bounce back at the same pace, due in part to the interconnectedness of global supply chains, we think the new global expansion and bull market should pull them along.

While it is too early to generate a 2021 forecast, we remain bullish but vigilant. Bear markets typically begin either when euphoria makes expectations unattainable or when equities are unexpectedly impaired by a multi-trillion dollar negative shock. We don't think either factor exists now. We also think growth-oriented equities are likely to keep leading, as the drivers that typically support value are missing. As we will detail in the full Review, pundits' continued calls for value to lead seem to be mostly baseless. Eventually value will lead again, most likely after they have given up on it.

GLOBAL UPDATE AND MARKET OUTLOOK

October 26, 2020

Q3 MARKET RECAP

THE YOUNG BULL MARKET PERSISTS

The young bull market continued higher in Q3, hitting new all-time highs along the way with a record-fast recovery to new highs. As shown in Exhibit 1, using S&P 500 data for its long history, it only took 5.9 months for equities to reach breakeven point.

EXHIBIT 1: A RECORD-FAST RECOVERY TO NEW HIGHS

First All-Time High	Peak	Cumulative Returns	Duration (Months)
6/9/1950	8/2/1956	158%	74
9/24/1958	12/12/1961	46%	39
9/3/1963	2/9/1966	29%	29
5/4/1967	11/29/1968	15%	19
3/6/1972	1/11/1973	11%	10
7/17/1980	11/28/1980	16%	4
11/3/1982	8/25/1987	136%	57
7/26/1989	7/16/1990	9%	12
2/13/1991	3/24/2000	314%	109
5/30/2007	10/9/2007	2%	4
3/28/2013	2/19/2020	116%	83
Average		77%	40

Source: Global Financial Data, Inc. and FactSet, as of 10/05/2020. S&P 500 price index, 05/29/1946 – 08/18/2020. Price returns used in lieu of total due to data availability.

Pundits question how equities could erase the bear market while Covid-19 restrictions persist and case counts rise. Most presume the rally is fragile, propped up by "stimulus" or a mirage created by overvalued Tech companies. In our view, it is because equities are a leading indicator and normally look about 3 – 30 months ahead. During the bear market, they focused on the very short end of that range as the sudden economic contraction became clear. Once markets fathomed this, they resumed pricing the likely future further out. However we get there, by then the virus will likely be old news and society will have adapted—whether because of a vaccine, better treatments or some other means. In our view, equities are rationally registering that future, correctly anticipating society's return to normal activity and the corporate earnings recovery accompanying it.

A TIRED, TECH-LED MARKET

Bears argue the bull market is fatigued after equities' fastest round trip to new highs. In our view, this is simply faulty logic or a lack of understanding of how markets actually work, since equities don't "tire." Equities have enjoyed 34 unique 5-month positive streaks since 1928, with more than 80% coming after a correction low or bear market—like this bull market. Over the next 6, 12 and 18 months, equities are overwhelmingly positive. (Exhibit 2) Similarly, when the five-month rally exceeded 25%—like the current bull market—equities fared even better (Exhibit 3).

EXHIBIT 2: EQUITIES AFTER A FIVE-MONTH POSITIVE STREAK

	6 Months Later	12 Months Later	18 Months Later
Average Return	7.0%	11.2%	13.9%
Frequency of Positivity	84.1%	86.4%	81.8%

Source: Global Financial Data, Inc., as of 09/09/2020. S&P 500 Price Index, 12/31/1927 – 08/31/2020.

EXHIBIT 3: EQUITIES AFTER A FIVE-MONTH POSITIVE STREAK OF 25% OR MORE

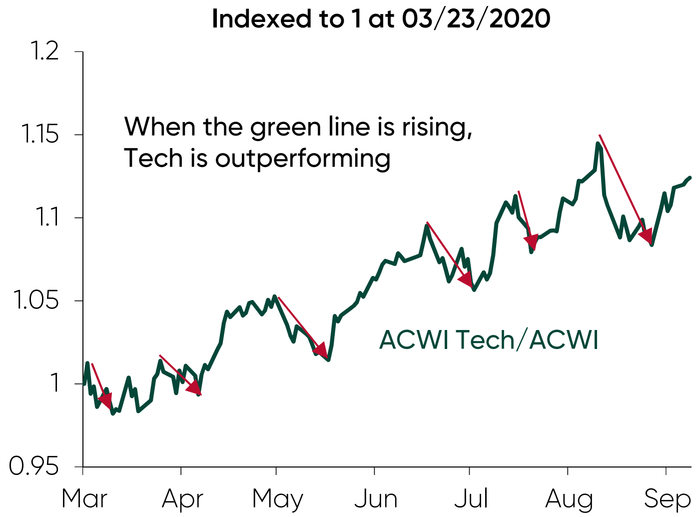
	6 Months Later	12 Months Later	18 Months Later
Average Return	10.6%	12.6%	20.8%
Frequency of Positivity	100.0%	85.7%	100.0%

Source: Global Financial Data, Inc., as of 09/09/2020. S&P 500 Price Index, 12/31/1927 – 08/31/2020.

As always, past returns don't predict, but history shows long rallies don't necessitate long declines, although short-term volatility is always possible. Some pessimists say overvalued Tech companies are driving this bull market and their inevitable implosion will derail it. Mid-September's volatility is merely a preview, supposedly, of trouble ahead. However, as stated in the Executive Summary, the new bull market is much more than a Tech rally. With the majority of ACWI, US and Continental Europe (ex. Tech) equities in positive territory, it is behaving just like past ones, with big, global broad-based gains—a fact few appreciate.

The sector's September dip isn't a sign of trouble for Tech, in our view. Brief sector countertrends are common. This young bull market has already seen several brief pullbacks, yet Tech leads overall. (Exhibit 4) The same thing happened in the Tech-led bull market that ended in February. Brief countertrends are normal.

EXHIBIT 4: TECH'S BRIEF PULLBACKS DIDN'T PREVENT OUTPERFORMANCE



Source: FactSet, as of 10/06/2020. MSCI ACWI Information Technology and MSCI ACWI Index returns with net dividends, 03/23/2020 – 09/30/2020. Indexed to 1 on 03/23/2020.

STYLE LEADERSHIP DOMINATES YOUNG BULL MARKET

Q3 2020's sector leaders and laggards largely echoed full-year trends: Tech, Tech-like Communication Services and Consumer Discretionary (the two sectors containing the FANG equities) retained their dominance. Financials remained more challenged with headwinds such as record low global interest rates and muted inflation expectations (Exhibit 5).

EXHIBIT 5: MSCI ACWI INDEX SECTOR RETURNS AT A GLANCE

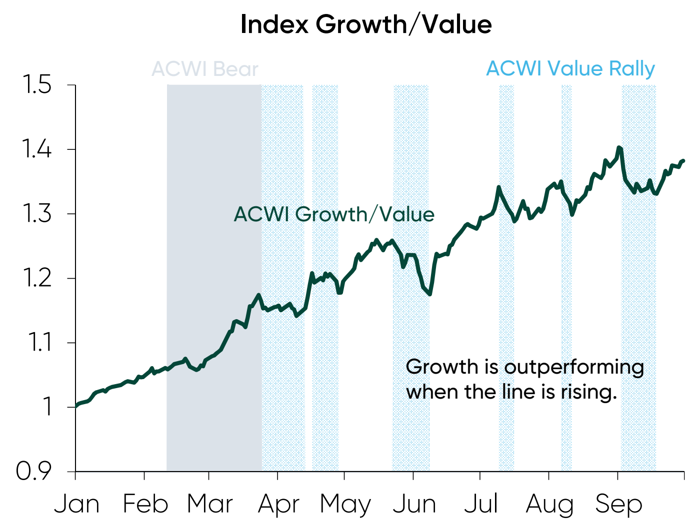
	Q3	Since 3/23	YTD
Information Technology	13%	67%	26%
Consumer Discretionary	18%	70%	19%
Communication Services	7%	41%	8%
Health Care	5%	42%	7%
Materials	12%	63%	2%
Consumer Staples	7%	31%	1%
Industrials	11%	54%	-4%
Utilities	11%	54%	-4%
Real Estate	2%	35%	-14%
Financials	1%	32%	-22%
Energy	-13%	30%	-42%

Source: FactSet, as of 10/05/2020. MSCI ACWI Index sector returns, 06/30/2020 – 09/30/2020, 03/23/2020 – 09/30/2020 and 12/31/2019 – 09/30/2020.

Sectors have a large impact on style leadership. Not coincidentally, the leaders are heavy on growth equities, while the laggards are value-heavy.

While growth equities have led all year—and in the 2009 – 2020 bull market's later years—pundits continually call for value to lead. Whenever value temporarily asserts leadership, as it did in September, it supposedly heralds a big shift. Yet this hasn't happened. As Exhibit 6 shows, value has had several short rallies this year, yet growth has dominated overall. In our view, this speaks to the importance of not being deceived by short-term countertrends.

EXHIBIT 6: SHORT VALUE COUNTERTRENDS DIDN'T DERAIL GROWTH'S OVERALL LEADERSHIP



Source: FactSet, as of 09/30/2020. MSCI ACWI Growth and Value Indexes, 12/31/2019 – 09/30/2020. Indexed to 1 at 12/31/2019.

Now pundits argue value hasn't taken over leadership yet because recovery hasn't truly arrived—once all businesses reopen, they claim, value will rally as the economy starts growing more rapidly. We see why this argument would gain traction, as value normally outperforms in a recovery. However, the factors that usually support value during recoveries aren't in place, and we see little evidence that will change even when the pandemic is behind us.

As detailed last quarter, while this is indeed a new bull market, equities are behaving as if it were a late-stage bull market. We think this is because the preceding bear market was rather correction-like. Bear markets usually start slowly, grind lower over several months and end in panic. This bear market was a short, panicky plunge from start to finish. It ended before economic data confirmed contraction, and as a result, investors did not have time to flee from small value equities (a category that usually does not have the ability to withstand a deep recession). Typically, categories of equities that fall most in the later stages of bear should perform best in the early stages of a bull. However, the truncated duration of this bear has limited the sense of relief that fuels small value's outsized bounce in new bull markets. We think this is why growth led in the 2009 – 2020 bull market's later stages, during the bear market and in the new bull market to date.

AS DETAILED LAST QUARTER, WHILE THIS IS INDEED A NEW BULL MARKET, EQUITIES ARE BEHAVING AS IF IT WERE A LATE-STAGE BULL MARKET.

Credit conditions don't support value, either. Value companies typically rely on bank funding, rather than corporate bond issuance. Therefore, value's early bull market catalyst usually comes from a steepening yield curve. This typically happens because long-term interest rates rise as investors become less risk-averse and reverse their bear market flight to bonds while Central banks usually also cuts short rates.

Banks borrow at short rates, lend at long rates and profit off the spread, which represents their net interest margins. So as short rates fall and long rates rise, banks become more eager to lend as potential profits rise. This gives lower-quality companies easier credit access, boosting value equities.

None of that is happening now. The yield curve is somewhat flat, discouraging lending. The Fed and other central banks have pinned short rates near zero and continue their misguided quantitative easing (QE) bond purchases, reducing long-term interest rates. This shrinks banks' net interest margins, erasing the incentive to lend to all but the most creditworthy companies. That largely excludes value equities. Not being able to raise money—especially while many retail stores and services face Covid-19-related capacity constraints—works against value, in our view.

This also hurts banks, as flat yield curves sap their profits—an additional reason Financials have underperformed. They aren't the only value-heavy sector with unique headwinds. Airlines still suffer from the pandemic's impact on travel. Smaller, value-oriented Energy companies focused on shale oil drilling are struggling under high debt and weak oil prices, which make that debt difficult to service or even refinance while the yield curve is flat. While this hurts Energy broadly, this is not much of an issue for the large companies in the sector which have heathier balance sheet overall. It may also be worth noting Energy's small absolute size in the broad market. At the start of the 2009 – 2020 bull market, Energy was 12.8% of the MSCI World by market cap.[vii] By that bull market's conclusion, it was down to 4.4%. Now, as of October 8, it is at 2.5%.

Nothing leads or lags forever, and value's time will come eventually. However, in our view, that is likeliest to happen after the next bear market lets interest rates and sentiment run their normal courses, establishing the fundamental conditions for value's typical early-cycle boom.

vii Source: FactSet, as of 10/08/2020. MSCI World Energy sector share of total index market capitalization.

US POLITICS ARE A TAILWIND

Election years are normally good for equities, averaging 11.1% returns and positive 82.6% of the time since 1925—and back-end loaded.[viii] This election year returns might seem abnormal in contrast, with the high-speed bear market. Yet, three-fourths of the way through the year, the S&P 500 isn't hugely out of step with the average election year.

Equities' average return in election year first halves (before 2020) is 1.1%.[ix] This year's return is -4.0%.[x] Typically, returns improve in the second half. This year is no exception, with equities up 8.5% since June 30.[xi] That normal back-end loaded run seems underway.

While it is too early to formulate a 2021 forecast, we can make a preliminary assessment of political drivers. A phenomenon we call the Perverse Inverse tends to dictate returns in election and inaugural years. It all ties to investors' biased perceptions of Republicans as pro-business and Democrats as less market-friendly. In years when Republicans win, high hopes generally drive above-average election-year returns, while Democratic victories lead to muted returns as fears of anti-business policy mount. However, in the inaugural year, neither side accomplishes as much as investors hope or fear—even when one party controls the legislature and presidency.

The United States' tripartite system obstructs big policy shifts, via debate in Congress and potential legal challenge. Even when party control is uniform, different factions may have different priorities—especially among those up for re-election in the looming midterms. That necessitates negotiation and vote trading. As a result, presidents never do all they say they will. President Trump had promised a robust border wall and the Affordable Care Act's repeal. Neither are complete, despite having a Republican Congress in his first two years. It was the same under President Barack Obama in 2009 and 2010. Despite having solid Democratic control of the legislature, his two major legislative achievements—financial and healthcare reform—were both significantly watered down. The "Bush tax cuts" weren't fully repealed. The adjustment his administration did make to them didn't come until late 2012—after his re-election.

Whatever happens in November, we will get either a newly elected Democrat or re-elected Republican—both of which follow the general trend, with nearly identical returns over the full two-year stretch. Therefore, should President Trump win, that implies a stronger 2020 and milder 2021 as hopes for pro-business legislation prove false. If former Vice President Joe Biden wins, that points to a tamer 2020 return and strong 2021 as fears of radical change wane.

GEOPOLITICS

In the Middle East, the US helped broker deals between Israel and Gulf Arab states, including the United Arab Emirates (UAE) and Bahrain. Some experts worry the realignment may stir regional turbulence. That is possible, but it isn't a new threat. In the Middle East, local violence is unfortunately normal. Regional conflicts would have to escalate globally to threaten equities—and there is little sign of that currently.

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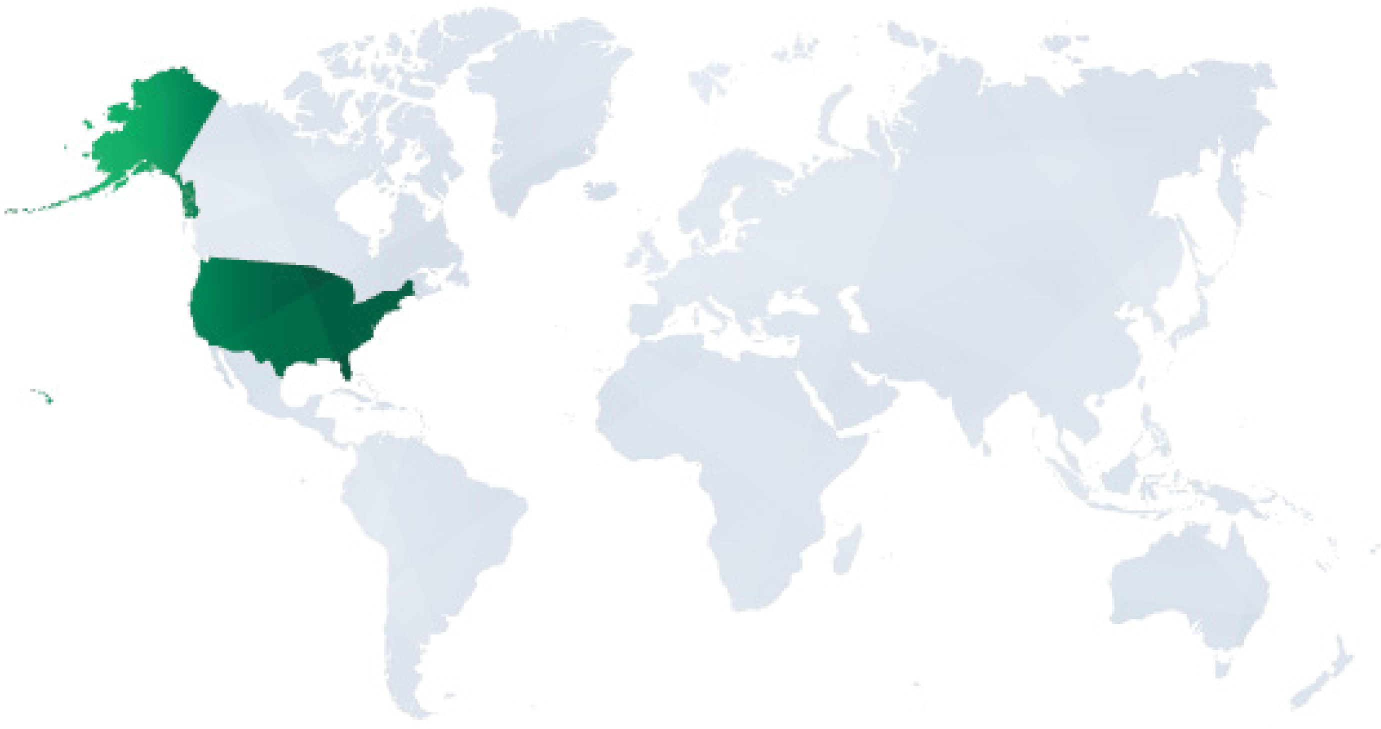
viii Source: Global Financial Data, Inc. and FactSet, as of 01/07/2020. S&P 500 average total return and historical frequency of positive annual returns in presidential election years since 1928.

ix Source: FactSet, as of 07/29/2020. S&P 500 price return in election year first halves from 1932 – 2020. Price return used due to daily data availability.

x Source: FactSet, as of 10/05/2020. S&P 500 price return, 12/31/2019 – 06/30/2020.

xi Ibid. 06/30/2020 – 09/30/2020.

UNITED STATES
COMMENTARY



COMING SOON - 2020 US ELECTION CLARITY

With US Election Day nearing, the angst is palpable. The already heated campaign has only gotten more so with Covid-19 (including President Trump's positive virus test), the Supreme Court, civic unrest and much more. Campaign rhetoric can be polarizing however election clarity is coming soon and we expect it to be a bullish relief for markets. Typically, markets hate rising uncertainty, but they like falling uncertainty—and uncertainty should fall very soon.

This highly unusual campaign remains unpredictable, in our view. That won't stop many pundits from trying to forecast, with many having their favored indicator, poll or other allegedly sage tool. From a market perspective, we think it is wisest to tune it all out. We favor no politician nor any political party, and there is ample history of equities doing well and poorly under Democrats and Republicans. To argue otherwise is to dismiss 94 years of equity market history and say "it's different this time"—which Sir John Templeton famously dubbed investing's four most dangerous words. Who wins is less important than simply getting a winner—a resolution. If that doesn't come on election night, it will soon thereafter.

In the following, we will share the factors we think you should ignore—and those that hint at who wins. But to reiterate: Getting clarity is what matters most of all for equities, not who wins.

THE PERVERSE INVERSE

While clarity matters most for equities, the Perverse Inverse phenomenon affects returns' timing, with pro-business hopes buoying election year returns when a Republican wins and anti-business fears weighing on them when a Democrat wins.

However, in the inaugural year, this flips. Politicians typically moderate in office and presidents never, ever get nearly as much enacted as they promise during their campaign. It is very hard to get major items through Congress with some even enduring classic court challenges. Every bill that does eventually make it through Congress, earns the president's signature and survives court challenge weakens the congressional will for the next one. Presidents get at most one or two big bills through Congress in their first four years with even less in a second term.

For investors, with Democratic presidents this moderation relieves fears—a positive and bullish surprise. In Republicans' cases, it disappoints. Therefore, Democratic inaugural years have historically been great for equities while Republicans have been tepid. Yet returns over the election and inaugural year combined don't differ materially either way—especially when we have a re-elected Republican or newly elected Democrat (Exhibit 7).

EXHIBIT 7: THE PERVERSE INVERSE—INCLUDING THIS YEAR'S POSSIBLE OUTCOMES

	Election Year	Inaugural Year	First Two Years
All Republicans	15.2%	2.6%	18.0%
All Democrats	7.4%	16.2%	23.4%
Re-Elected Republican	10.6%	2.7%	13.1%
Newly Elected Democrat	-2.8%	21.8%	15.9%

Source: Global Financial Data, Inc., as of 10/04/2020. S&P 500 total returns, 12/31/1925 – 12/31/2019.

Naysayers might dismiss this history, claiming Joe Biden is a Trojan horse for socialism. President Trump opponents say his re-election would similarly sow chaotic uncertainty, as he governs via Twitter, roils international relationships and disdains the legislative process. Those sentiments power the Perverse Inverse. If investors broadly fear an election will bring socialistic policy and it doesn't come, the relief unconsciously lifts equities. Partisan bias blinds many to the notion that the reasons they say this time is different are likely to mirror the reasons others said earlier elections were "different."

AIR BIDEN VERSUS GROUND TRUMP

Like so much in 2020, this election is different from any we have seen. The two major parties have remarkably different strategies. Republicans have built the deepest ground game ever. The party claims to have over 1.5 million trained volunteers in swing states, so that even if their candidates are less popular, Republicans can still win by getting their voters out better than the Democrats do.

By contrast, the Democrats made a conscious decision to have almost no ground game. Joe Biden frequently argues the Trump administration hasn't been cautious enough on Covid-19. Whatever your view, arguing for more caution means you logically can't send forth an army of door-knockers. Democrats are unlikely to hold big rallies or drive would-be voters to the polls. Hence, the Democrats have deployed what is called an "air game" aimed at increasing turnout via the early submission of mail-in ballots coupled with the biggest advertising campaign ever.

Part of the Democratic strategy is to deploy cash on advertising in swing states—as President Trump's campaign pulls back. Joe Biden's principal campaign has raised significantly more money than Trump's at this point—and the support of many and varied political action committees gives it an even bigger edge.[xii] Furthermore, the GOP's extensive ground game is very expensive. So despite having more time to raise funds, President Trump's campaign ended August with less money than Joe Biden's—and that was before a huge Democratic fundraising run after Supreme Court Justice Ruth Bader Ginsburg's death and the first debate.[xiii]

xii "Money Tracker: How Much Trump and Biden Have Raised in the 2020 Election," Sean McMinn, Alyson Hurt and Ruth Talbot, NPR, 09/20/2020.

xiii Source: Federal Election Commission, as of 10/04/2020.

Hence, the Democrats are spending big on television and internet advertising. While we don't think it is likely that these ads will change many voters' minds, it is a concerted effort to get the vote out—and early. The Democrats know that if Joe Biden has an Electoral College lead on November 3, it will likely grow as mail-in ballots hit. If they can get their vote out effectively and early, those tallies may prove decisive—eliminating uncertainty early on.

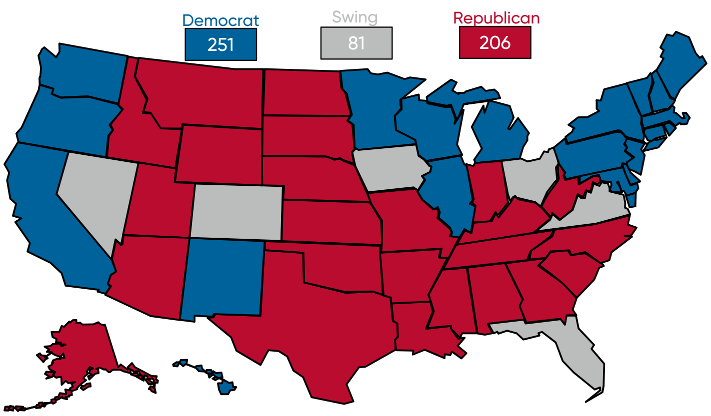
TOP-DOWN VERSUS BOTTOM-UP

So the election hinges on whether Joe Biden's air game or President Trump's ground game wins. This plays into the top-down versus bottom-up analysis we first deployed in 2016—and shared again last quarter.

Most election analysis is "top down," assigning each state to the party that took it in last five presidential elections. "Swing" states are those that elected presidents from each party at least twice in this span. Top-down analysis favors Joe Biden (as it favored Hillary Clinton four years ago) (Exhibit 8).

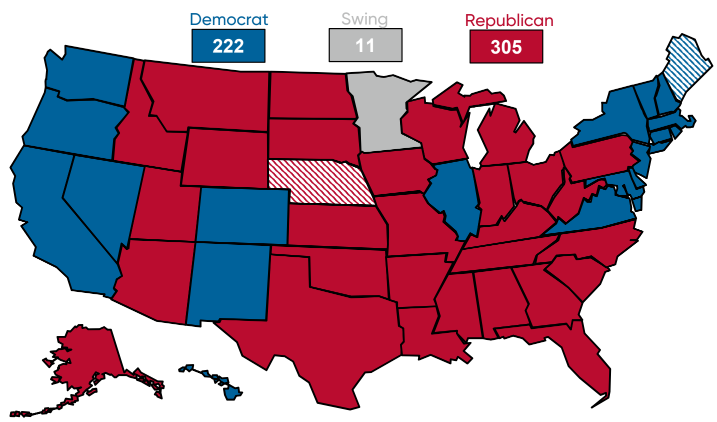
Bottom-up analysis uses party control of state legislatures to capture subtle shifts in voters' preferences between presidential races. In 2016, a bottom-up analysis showed President Trump's edge—which ultimately held in the vote. Bottom-up analysis still favors President Trump. That doesn't tell you who will win, but it shows both candidates have viable paths to victory (Exhibit 9).

EXHIBIT 8: TOP-DOWN ELECTORAL MAP



Source: The Wall Street Journal, US National Archives and Fisher Investments Research, as of 07/28/2020.

EXHIBIT 9: BOTTOM-UP ELECTORAL MAP



Source: National Council of State Legislatures, US National Archives and Fisher Investments Research, as of 07/28/2020. Nebraska has a non-partisan, unicameral state legislature but leans Republican. Washington, D.C. is counted as Democratic based on the city council's breakdown. Swing state defined as a state without uniform party control of the legislature. Maine and Nebraska split their electoral vote.

CLARITY WILL COME, BUT WE MAY HAVE TO WAIT

Election night probably won't bring the cathartic clarity it usually does. Barring a landslide—particularly a material Joe Biden lead in electoral votes—we probably won't know the winner on November 3. It may take days to sort out, as states tally the vote, possibly recount and deal with legal challenges. Yet we should have a clear conclusion by early to mid-December at the latest.

While some states will process mail-in ballots early, others legally can't until Election Day. Although some swing states require receipt of mail-in ballots by election night (Arizona, Florida, Georgia, Maine, Nebraska and Wisconsin), seven simply require postmarks by that date. Michigan, critical in 2016, will accept ballots through November 17. Final, certified vote tallies are due even later, with the nomination of electors due by December 8's safe harbor deadline (the last day on which states can select electors with assurance Congress will accept them). Those electors will then cast their votes—determining the president—on December 14. Exhibit 10 shows the timeline of key national events and events in 12 swing states.

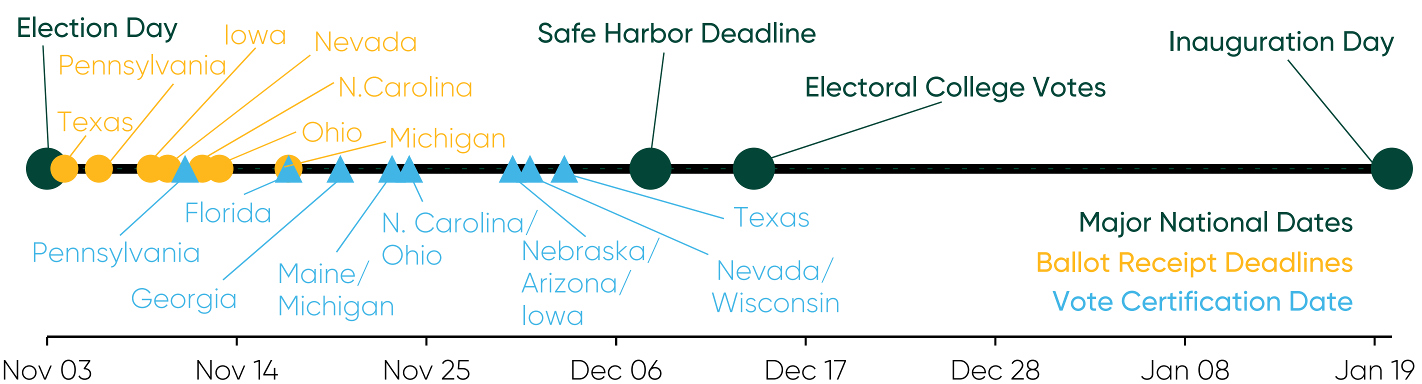
THE NOISE TO IGNORE

The following are factors we think investors should ignore to help with election clarity.

NATIONAL POLLS

Four years ago, pundits argued Hillary Clinton's 6.7 to 7.1 point mid-October lead rendered her victory a foregone conclusion.[xiv] It wasn't, as national polls can't account for state-level results—which determine the electoral tally. Many are seemingly making the same mistake this time, arguing Joe Biden's 9.7 point average poll lead means the race is over.[xv] While that could be right, it could also easily prove incorrect again. Only a few states really matter for the Electoral College and last-minute shifts in these aren't uncommon.

EXHIBIT 10: ELECTION TIMELINE



Source: Vote.org, National Council of State Legislatures, Secretaries of State, NPR, The Washington Post and Fisher Investments Research, as of 10/09/2020. Wisconsin's Election Day ballot receipt deadline is undergoing legal challenges as we type.

xiv Source: RealClearPolitics, as of 10/05/2020.

xv Ibid, as of 10/09/2020. Average poll margin for Biden on 10/09/2020.

STATE POLLS

Similar logic holds at the swing-state level. While such polls target the Electoral College, many understated President Trump's swing-state support in 2016 (Exhibit 11). Perhaps the current polls have corrected the errors made in the past or they may have overcorrected in trying to reflect the less visible President Trump voters. They might now better reflect actual voters' intentions, but there isn't any way to know.

So why do we hear so much about polls? We suspect it is because election years are key for the media, who benefit from increased attention and the resulting ad spending.

They use polls like a scoreboard, a big attention-getter. Admitting these polls' accuracy is unclear would invalidate the scoreboard, costing ratings. They occasionally critique a poll or two, but not the practice overall.

PREDICTION MARKETS

Many poll skeptics have historically used prediction markets—websites letting you wager on who will win, with the fluctuating odds allegedly indicating who is leading the race. The logic: Polls are feelings while prediction markets use actual money.

There is a lot of sense in this, but there are huge drawbacks. These markets have relatively few participants, particularly since the Obama administration deemed most non-academic prediction markets illegal gambling. There is also no scientific sampling of participants, which drives potential bias. The Brexit vote in 2016 is a classic example. Prediction markets heavily favored "Remain," as most participants clustered in the city of London—staunchly pro-EU territory. They failed to capture "Leave" support elsewhere in England. 2016's presidential race also showed these markets' limitations. Betting markets gave Hillary Clinton an 82% likelihood of winning on Election Day 2016.

EXHIBIT 11: STATE LEVEL POLLS IN 2020 AND 2016

	2020	2016	Actual 2016 Result	Date of Polls Included in Average
Arizona	Biden +3.1	Trump +2.5	Trump +3.5	9/11 - 9/30
Florida	Biden +2.0	Clinton +2.4	Trump +1.2	9/15 -10/1
Georgia	Biden +0.3	Trump +4.6	Trump +5.1	9/11 - 9/30
Iowa	Biden +0.5	Trump +4.8	Trump +9.5	9/14 - 9/26
Maine (CD2)	Biden +4.0	Trump +8.5	Trump +10.3	9/10 - 9/23
Michigan	Biden +5.2	Clinton +5.3	Trump +0.2	9/10 - 9/22
Nebraska (CD2)	Biden +6.5	Trump +9.0	Trump +2.0	9/18 and 9/28
Nevada	Biden +5.3	Trump +0.2	Clinton +2.4	9/8 - 9/25
North Carolina	Biden +0.5	Trump +0.3	Trump +3.7	9/11 - 9/25
Ohio	Biden +2.5	Trump +1.8	Trump +8.1	9/1 - 10/2
Pennsylvania	Biden +6.5	Clinton +2.4	Trump +0.7	9/18 - 10/2
Texas	Trump +3.2	Trump +5.2	Trump +9.0	8/28 - 9/25
Wisconsin	Biden +5.5	Clinton +4.7	Trump +0.7	9/10 - 9/26

Source: RealClearPolitics, as of 10/04/2020. Maine and Nebraska award Electoral College votes to the state-wide winner and the winner of each Congressional district. The two cited here are Congressional districts considered swing regions.

TELEVISION NEWS ANALYSTS

If investors want to understand what is likely to happen between now and the end of vote counting, tune out the pundits on MSNBC, CNN and FOX News analysis and predictions. They amount to ideological chatter aimed at their own bases. It is programming designed to hook like-minded viewers.

OTHER FACTORS

Similarly, if investors wish to discern the winner, tune down your bias as it can make it difficult to view developments dispassionately—necessary to seeing developments clearly.

Many people also focus on vice presidential nominees and debates—and Justice Ruth Bader Ginsburg's death added Supreme Court drama. However, vice presidents rarely sway races. Headlines argue this time is different, citing Joe Biden's age and President Trump's Covid-19 diagnosis. That allegedly made the vice presidential debate more significant than it otherwise would have been. While we can see the logic, voters' party preference is exceedingly unlikely to hinge on vice presidential candidates, as their talking points are merely an extension of the presidential platforms. As for the court, the open seat could influence the race, but it is entirely unclear how. Both parties claim it benefits their side, which can't be true.

What is clearly true is that more voters than normal have made up their minds by now, simply because we know these two nominees better than we usually know both candidates. No one knows for sure how many undecided voters actually remain—or how many voters could change their mind from one party to the other. That further makes predicting the winner now pointless.

Lastly, President Trump's diagnosis and subsequent behavior stole many headlines—and stoked significant speculation about the potential impact on voters. Yet for every plausible-seeming theory that it would hurt his chances, there is a plausible-seeming theory it will help them. Ultimately, we suspect this won't sway many voters from their pre-existing views.

WHAT TO WATCH

SWING STATES

More states appear to be in play now than four months ago thanks to the Democrats' air game, including Arizona, Georgia and Texas. These have gone Republican in each of the last five presidential elections, and retaining them is critical for President Trump. He has no conceivable path to victory without Texas—the 38 electoral votes are too hard to replace.

The main factor to watch in these and other swing states are Senate races. As we mentioned last quarter, few voters split their ballots. If the presidential candidate campaigns well, that can provide a major boost to downstream races in the Senate and House. The reverse is also true, but the effect is much smaller. Hence, we can look to Senate races in tight states as an indication of which way the state will likely swing in the presidential campaign.

> "... WE CAN LOOK TO SENATE RACES IN TIGHT STATES AS AN INDICATION OF WHICH WAY THE STATE WILL LIKELY SWING IN THE PRESIDENTIAL CAMPAIGN."

Many of these races are closer than almost anyone expected—a factor likely favoring the Democrats. In Texas, Republican incumbent Senator John Cornyn and Democratic challenger MJ Hegar are in a tight race. In Arizona, the GOP lost a Senate seat in 2018's race to replace the retiring Jeff Flake when Democrat Krysten Sinema defeated Republican Martha McSally. This year, McSally—who filled John McCain's seat after his death—faces a close special election race against Mark Kelly. Both of Georgia's Senate seats are up this year and are worth watching.

The state of Montana is interesting because so much is at stake—the state's sole House seat, one Senate seat and the governorship. The state supported President Trump by a wide margin in 2016, but it also re-elected Democratic Governor Steve Bullock.

Governor Bullock is now challenging incumbent GOP Senator Steve Daines, and the race is too close to call. The House and governor's races are similarly tight. How these contests go hints at President Trump's chances to take the state's (admittedly few) electoral votes. But in many ways, Montana is symbolic, in an exaggerated sense, of national trends. It isn't a bellwether state, but it does point to a directional trend.

Elsewhere, North Carolina's hotly contested race between GOP Senator Thom Tillis and Democrat Cal Cunningham was upended in early October when Senator Tillis announced he had Covid-19 and immediately thereafter Mr. Cunningham, a married man, was forced to admit he had sent multiple romantic messages to a married female Democratic operative. Anything could happen in that race. Yet the Senate race there will impact the presidential election in the state somewhat, too. In Michigan, Democratic Senator Gary Peters is in a close race with GOP challenger John James—which suggests the state is in play for President Trump, contrary to state-level polling. If James wins, that bodes well for and helps President Trump.

NON-SWING STATE KEY SENATE RACES

If you see some of the races that are close now, like Senate Majority Leader Mitch McConnell's race against Amy McGrath in Kentucky, become very tight, President Trump is in trouble. If South Carolina GOP Senator Lindsey Graham loses—in a race that has gotten very close—President Trump likely can't win.

THE OVERALL SENATE

Overall, about 13 Senate seats are too close to call now. Democrats hope to get 60 seats, but they would need a near-sweep. Republicans think there is a 50/50 likelihood of holding the Senate.

ON ELECTION NIGHT

When watching the results on election night, there are a few factors worth watching for. For one, President Trump needs to lead by a sizable margin that night. If he doesn't, then he has little chance, considering most mail-in votes will likely be Democratic. If Joe Biden leads—much less leads big—the presidency is almost assuredly his.

US DEBT AND DEFICITS

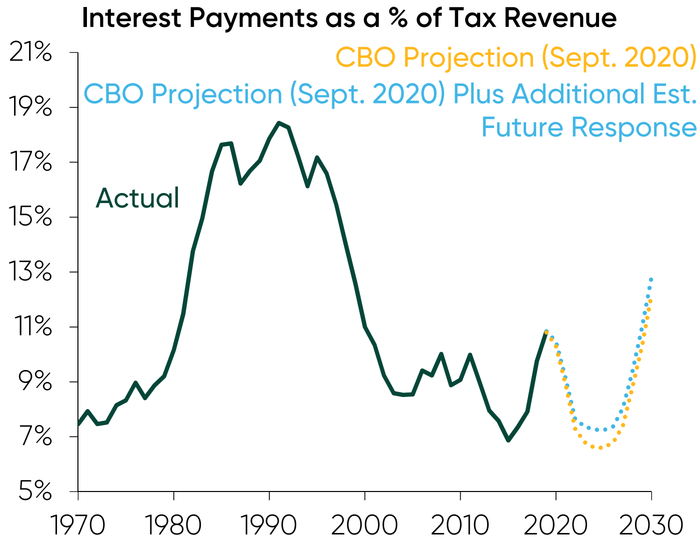
To fund Covid-19-related economic assistance, the US federal debt has skyrocketed. The nonpartisan Congressional Budget Office (CBO) projects the budget deficit will triple to $3.3 trillion this fiscal year, bringing net public debt to 98% of GDP by yearend and 107% in 2023—the highest since World War II's aftermath.[xvi]

While this new spending is indeed historically big, not all of it represents permanent budget entries—many, like the extra unemployment assistance, are Covid-19-related one-offs. Others are loans. As for the near-term debt increase, total debt matters far less than a country's ability to pay interest and principal on maturing debt. On this front, debt looks far less onerous.

xvi "An Update to the Budget Outlook: 2020 to 2030," Staff, CBO, September 2, 2020. Date accessed: October 6, 2020.

In fiscal 2019, interest payments were 10.8% of tax revenues.[xvii] The CBO estimates this will rise to roughly 13% by 2030—even including their estimate of additional policy response costs. (Exhibit 12) Take all long-term projections with several grains of salt, but for perspective, interest payments ranged from 15% – 18% during most of the 1980s – 1990s—terrific times for the US economy and equities.[xviii]

EXHIBIT 12: US FEDERAL INTEREST PAYMENTS AS A PERCENTAGE OF TAX REVENUE



Source: FactSet and Congressional Budget Office, as of 10/06/2020. Federal net interest outlays and total revenues, 12/31/1970 – 12/31/2030. Data from 12/31/1970 – 12/31/2019 are actual results, and the figures from 12/30/2020 – 12/31/2030 are the CBO's projections.

The CBO's forecast could prove too pessimistic. Treasury yields are historically low, helping the Treasury refinance maturing debt at lower rates. Consider the example in mid-August 2010 where the Treasury sold $25.4 billion in 10-year notes at a 2.63% interest rate.[xix] A decade later, the Treasury effectively refinanced those notes at a far lower 0.63%.[xx]

In our view, this higher debt load is plenty affordable—the US isn't likely to turn into Greece in the next 3 – 30 months. As we have written repeatedly over the years, this is the timeframe we think markets price.

IS GOVERNMENT STIMULUS SINGULARLY SUPPORTING THE RECOVERY?

One common concern we have seen for months from investors is that government spending alone is propping up the economy, and without more, the recovery is doomed. However, reality already debunked this via the expiration of several CARES Act benefits. Extra federal unemployment assistance expired on July 31, and an August Executive Order only partially replaced it. Yet retail sales still grew in August and September—rising above pre-pandemic levels. Broader consumer spending held firm, too. We think ongoing growth proves government assistance wasn't necessary for a recovery, although it undoubtedly helped millions of people who are out-of-work.

There is no reason to expect that without further assistance or new, actual stimulus, the normal craftiness of people trying to overcome obstacles can't propel a recovery. Many folks entered this period with healthy household balance sheets—an unusual recession in this regard. Some will struggle if businesses can't reopen or capacity limitations aren't lifted. That hurts those impacted, and we are empathetic. However, the economy has already proven more resilient than appreciated.

RUNAWAY INFLATION

After the Fed unleashed trillions of dollars in lending and liquidity this April, people feared the massive money supply increase guaranteed runaway inflation. As Milton Friedman summed up, inflation is always and everywhere a monetary phenomenon—so focusing on money supply is sensible. While we agree there is potential for higher inflation in the years to come—a possible future risk—we don't see it as reason to be bearish today.

xvii Source: US Office of Management and Budget, as of 10/05/2020.

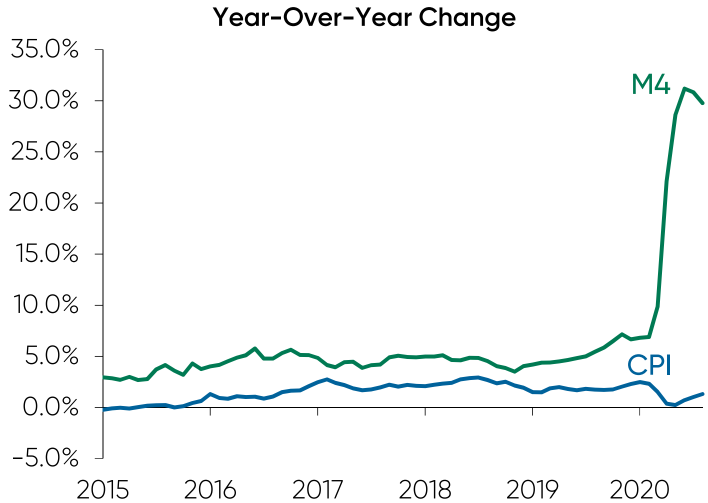
xviii Ibid.

xix Source: TreasuryDirect.gov, as of 10/05/2020.

xx Ibid.

It is extraordinary that the huge increase in money supply hasn't brought inflation. (Exhibit 13) In our view, the primary reason is that the velocity of money is down where new money isn't changing hands quickly. It may be that the huge increase in M4 (the broadest measure of money supply) doesn't translate to velocity because many of its components are slow moving.

EXHIBIT 13: US CONSUMER PRICE INDEX (CPI) AND M4 MONEY SUPPLY SINCE 2015



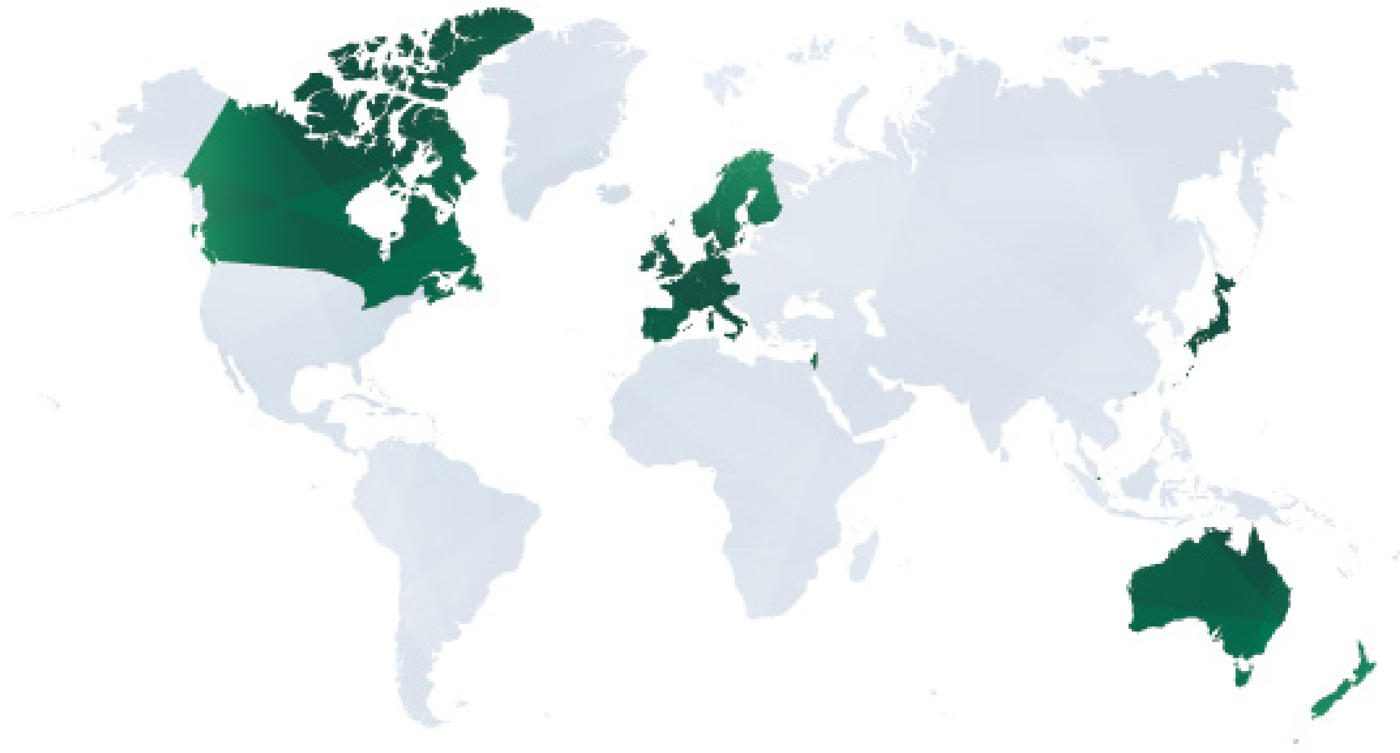
Source: St. Louis Federal Reserve and Center for Financial Stability, as of 10/05/2020. US CPI – All Items in US City Average and M4 Money Supply, percentage change y/y, January 2015 – August 2020.

Perhaps velocity is coming at a lag and inflation will eventually pick up—but it likely won't happen suddenly. It is more likely to start gradually—more like a U-shape than a V or even W.

We think that will likely be the case if and when inflation spikes this time. Currently, households and businesses are hoarding cash in hopes of better times ahead, which stalls velocity. Rampant inflation can't happen if people are cash hoarders. As times improve and spending heats up, inflation starts picking up gently—and these periods are always good for equities. Trouble generally doesn't arrive for markets until inflation has been high for a while, prompting central banks to take aggressive action—increasing the risk of monetary policy mistakes. For example, the big money supply increase that began in the late 1960s stoked the 1970s' hot inflation—which accelerated as the Fed kept fueling money supply growth.

That said, potentially hot inflation isn't necessarily a sign to take defensive action. Even if you are right about inflation, you have ample time to prepare. Furthermore, inflation beginning to heat up isn't necessarily bad for equities. The major issue for equities is when it takes off and central banks fight it hard, which can lead to recession.

GLOBAL DEVELOPED EX-US COMMENTARY



THE RETURN OF SWEEPING LOCKDOWNS

Another risk most investors are worried about is a future Covid-19 wave bringing sweeping lockdowns again, panicking markets. This is perhaps today's most realistic risk, in our view, and a difficult one to assess, since lockdowns are political decisions—unpredictable. Hence, we closely monitor developments.

Vaccine progress continues, and eventually, we will get one. However, the timeframe is unknowable. One of the four presently in advanced trials could win the race, or it could be another. It could arrive in a few months, or later. Upon approval, it won't reach everyone at once. The order will likely be top government officials, healthcare workers, vulnerable people, government workers, teachers and lastly everyone else. That is a long time for regular people to gain immunity. Polling says only about half of people in the developed world will take a vaccine when it is available, which is roughly what happens with normal flu vaccines annually.

How will regional and local governments, as well as international leaders, handle flare-ups in the meantime? What lessons have they learned so far, and how will they apply them, if at all? At the time of this writing, Covid-19 flares in Europe have not brought back previous sweeping national lockdowns. But some new restrictions have arisen at the regional and local levels. UK Prime Minister Boris Johnson added restrictions for all of England—not as draconian as before—but indicated a second lockdown is on the table if need be. In Spain, Madrid is now closed to non-essential travel. Several French cities recently restricted dining and entertainment.

No one can say for sure how this will pan out, though some politicians seem to enjoy having new power—and likely won't surrender it easily. This may be election posturing, but it could also linger.

Another virus wave could be bigger than the first because people are tired of restrictions and may not comply as readily. If that triggers additional government action, the response would probably panic markets. However, we must judge these developments as they evolve and we monitor them closely.

EUROPEAN MARKETS LOOK BEYOND CURRENCY VOLATILITY

Since reaching a low on March 20, the euro is up 10.5% against the dollar.[xxi] Many policymakers and financial commentators have taken notice. The European Central Bank (ECB) President, Christine Lagarde, has said the ECB is "carefully monitoring" the extent to which the euro's appreciation puts downward pressure on prices.[xxii] Other policymakers echo her point. Still others worry about the strong euro's effect on exports. However, while the euro's recent rise relative to the dollar may seem sizeable, it isn't out of step with recent history—and even if it were to rise further, it isn't likely to slow down exports or GDP growth.

ECB officials mostly worry that the strong euro will weigh on import prices, which theoretically imports deflationary forces and tightens monetary conditions despite the ECB's efforts otherwise. They worry this renders the central bank powerless to aid the recovery or prevent deflation unless it amends policy to help the euro depreciate. As a result, this could cause other nations to follow suit—potentially kicking off a long-feared currency war.

On the more tangible side of things, other pundits fear it will make eurozone exports more expensive, decreasing demand for eurozone goods abroad and, by extension, exporters' GDP—presuming exporters will raise prices in the end market in order to protect profits. However, the alternative is equally unpalatable to investors: Companies' keeping end prices steady and settling for letting currency translation take a bite out of earnings.

Whenever the euro strengthens, pundits presume it will be particularly bad for Germany, the eurozone's manufacturing and export champion. However, it isn't the only export-heavy nation in the currency bloc. In the Netherlands, for example, pre-Covid-19, exports of goods and services represented 82.5% of annual GDP.[xxiii] Overall, eurozone exports comprise 45.8% of the bloc's GDP, noticeably above the world's 30.6% share.[xxiv]

However, while the euro's rise might seem large in isolation, analyzing the issue with context is key. The euro was down earlier this year because of the "flight to quality" that is common during bear markets—so much of its current rise is just its rebound from March low. This often happens during bear markets because investors seek the perceived safety of US Treasury bonds. In order to do so, they sell other currencies and buy dollars.

xxi Source: FactSet, as of 10/13/2020. US dollars per euro, spot rate, percentage increase, 03/20/2020 – 10/12/2020.

xxii "ECB's Lagarde Takes Benign View on Growth, Euro Strength," Balazs Koranyi, Francesco Canepa, Reuters, September 9, 2020.

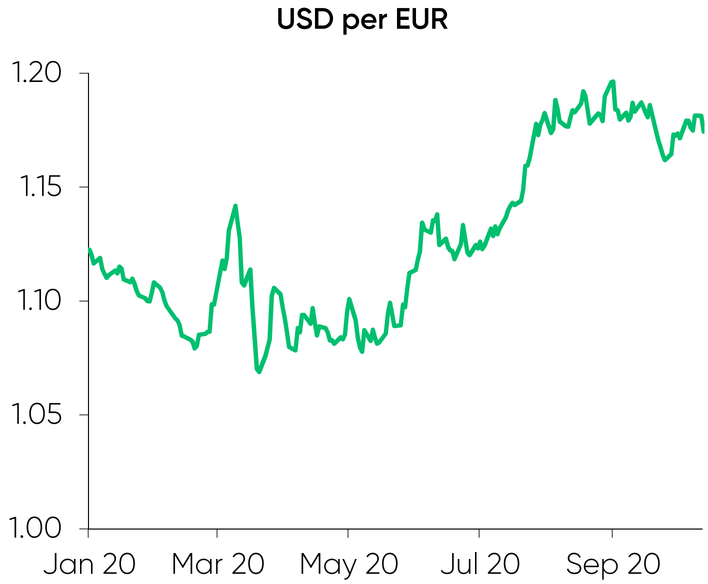
xxiii Source: World Bank, as of 10/14/2020. Exports of goods and services as a percentage of GDP, 2019.

xxiv Ibid.

This is exactly what happened earlier this year. Between March 9 and March 20, the euro declined -6.4% against the dollar, as panic ensued and investors sought the perceived safety of US Treasurys, forcing them to sell euros and buy dollars.[xxv] However, as equities began recovering, that trade reversed, and the euro rebounded. (Exhibit 14)

Yet the euro's rise didn't impede recovery. As the euro rose against the dollar, so did eurozone equities—against a backdrop of slowly improving eurozone retail sales and purchasing managers' indexes, among other economic data.[xxvi] Notably, eurozone exports rose for the fourth consecutive month in August, despite the strong euro.[xxvii]

EXHIBIT 14: USD PER EUR IN 2020



Source: FactSet, as of 10/14/2020. US dollars per euro, spot rate, 01/01/2020 – 10/13/2020.

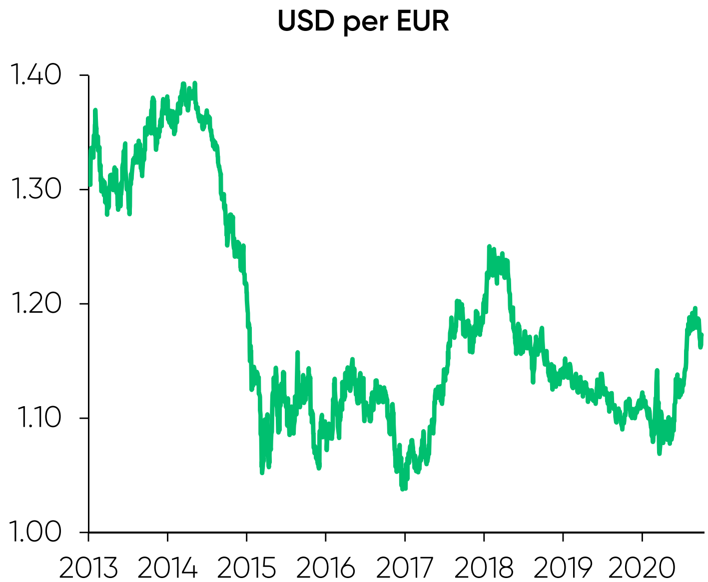
xxv Source: FactSet, as of 10/12/2020. US dollars per euro, spot rate, percentage increase, 03/09/2020 – 03/20/2020.

xxvi Source: FactSet, as 10/16/2020. Statement based on review of retail sales and PMI data, May 2020 – September 2020.

xxvii Source: FactSet, as of 10/16/2020. Eurozone export growth, May 2020 – August 2020.

Moreover, even with the increase, the current $1.17 exchange rate isn't exceptionally high compared with recent history.[xxviii] Consider the year 2017 where the euro rose 13.8% against the dollar - climbing from $1.05 to $1.20 (slightly above today's rate).[xxix] During that time, the eurozone exports rose 7.1% y/y.[xxx] Meanwhile, eurozone GDP grew 2.6% y/y and eurozone equities rose 28.1%, beating the world.[xxxi] In 2013, amid the eurozone's regional recession, the euro hit its low of $1.28—far higher than current rates—on March 27[xxxii] (Exhibit 15). From then through yearend, it appreciated by 7.8% against the dollar. However, this also didn't stop the economic recovery from beginning in Q2 2013, as exports rose. Meanwhile eurozone equities climbed 28.9% that year, beating the world's 26.7%.[xxxiii]

EXHIBIT 15: USD PER EUR, 2013 – 2020



Source: FactSet, as of 10/14/2020. US dollars per euro, spot rate, 01/01/2013 – 10/13/2020.

Regardless, we don't think eurozone equities will lead the global markets this year as they are too value oriented. Value companies tend to be smaller, carry more debt and depend more on economic growth—a quality that makes them more vulnerable in recessions. They also tend to return profits to shareholders via dividends and share buybacks. Growth equities, on the other hand, generally have higher valuations. They also tend to reinvest excess profits into the business. Further, they typically cluster in areas that see long-lasting demand trends that don't correlate as much with the overall economy. In our view, the market's current drivers favor growth-oriented companies more, particularly the biggest Tech and Tech-like equities. The eurozone has relatively low Tech exposure, which is one reason why eurozone valuations have lagged the US for most of the last 20 years.

Some fear the euro will rise further from here, which will then pose issue for exports and GDP. However, in our view, this fear is based on an outdated, mercantilist view of trade inconsistent with the globalized economy. Today, very few products are made exclusively in one country. Rather, companies import parts, raw materials and machinery, which they then use to produce their products. A strong euro means these imported inputs are cheaper for eurozone companies.

However, this doesn't mean a strong euro is an automatic positive for European companies. Many eurozone firms generate significant revenue outside the currency bloc. For example, the Dutch semiconductor-equipment maker, ASML has 5,000+ suppliers ranging from the US to Taiwan.[xxxiv] A strong euro reduces the cost of its imported supplies, but its chief customers are leading chipmakers in the US and Asia.[xxxv] BMW, the German auto-manufacturer, is another example.

xxviii Source: FactSet, as of 10/19/2020. US dollars per euro, 09/30/2020.

xxix Source: FactSet, as 10/16/2020. US dollars per euro, spot rate, 01/02/2017 – 02/28/2018.

xxx Source: FactSet, as of 10/16/2020. US dollars per euro, spot rate and eurozone exports percentage increase, 12/31/2016 – 12/31/2017.

xxxi Source: FactSet, as of 10/16/2020. Eurozone GDP growth, MSCI EMU and MSCI World Index returns with net dividends, 12/31/2016 – 12/31/2017.

xxxii Ibid.

xxxiii Source: FactSet, as of 10/16/2020. MSCI EMU returns and MSCI World Index returns with net dividends, 12/31/2012 – 12/31/2013.

xxxiv "How ASML Became Chipmaking's Biggest Monopoly," The Economist, February 29, 2020.

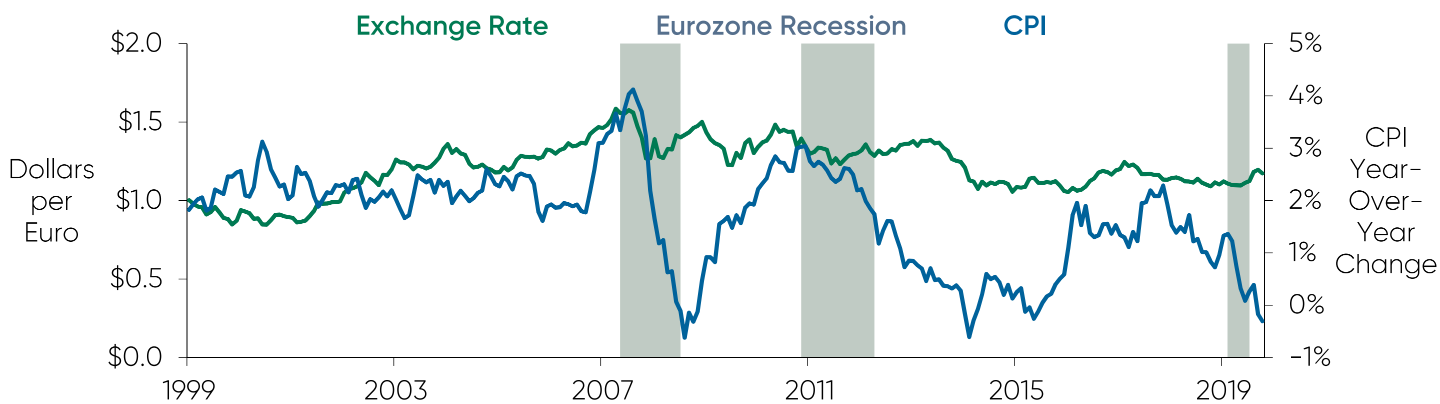
xxxv Ibid.

It works with 12,000 suppliers across 70 nations.[xxxvi] It second-biggest supplier is Canadian, while most of its electric-car batteries hail from Sweden.[xxxvii] The strong euro might reduce these costs, but it may also weigh on revenue in China and the US—BMW's two biggest geographic sources of revenue, accounting for 38% of sales.[xxxviii] Hence, the impact of a strong or weak currency is far smaller than many presume. This is doubly true considering most companies hedge for currency swings.

As for fears a strong euro will dampen import prices and depress inflation, we don't think this is a real risk. For one, history doesn't show a preset relationship between exchange rates and inflation. Consider Exhibit 16, which shows the year-over-year percentage change in the eurozone's harmonized consumer price index and the exchange rate. From 2002 to 2006, the euro strengthened steadily to levels far exceeding today's. During that time, inflation remained in a 100 basis point range.

Overall, there is little evidence exchange rates exert much influence over prices. But even if they did, it is worth remembering that inflation and deflation data are at best coincident, often skewed by short-term factors and usually the product of several trends. There is little to no evidence they reliably predict economic direction. In our view, there is a lot less to currency exchange rates' impact on the economy than most investors seem to think.

EXHIBIT 16: NO DISCERNIBLE RELATIONSHIP BETWEEN EXCHANGE RATES AND CPI



Source: FactSet, as of 10/19/2020. Dollars per euro and eurozone harmonized CPI, 12/31/1999 – 09/30/2020. Recession dating as per Centre for Economic Policy Research official dates. Note: 2020 recession hasn't been officially declared over yet.

xxxvi Source: BMW Group, as of 10/14/2020.

xxxvii Source: FactSet, as of 10/14/2020.

xxxviii Source: FactSet, as of 10/19/2020.

BREXIT TRADE DEALS

Prime Minister Boris Johnson roiled international politicians and commentators as well as members of his own party in September. The issue at hand is the legislation he unveiled outlining the UK's customs and state aid rules (particularly as they pertain to Northern Ireland) in the event the UK's post-Brexit transition period expires at yearend without an EU trade deal to replace it. Prime Minister Johnson's government described it as a "legal safety net" with a high likelihood of never taking effect. Yet many observers claimed it violated the exit agreement struck with the EU, breaking international law and rekindling the risk of a no-deal Brexit and economic isolation for the UK. In reality, it has already begun disproving this thesis, and as further events unfold, we think equities should continue gaining clarity and realize even a no-deal Brexit shouldn't bring disaster.

The legislation in question is called the Internal Market Bill. It contains the legal framework (including customs rules) for trade with the EU and between the islands of Great Britain and Northern Ireland if Brexit happens without a trade deal in place. The aim is to inject more clarity for businesses and investors. Yet some of its provisions differed from the Withdrawal Agreement finalized with the EU last year, prompting one cabinet secretary to state the customs rules would "break international law in a very specific and limited way." This prompted an international backlash and, given the EU's stated disagreement with Johnson's decision, rekindled fears of the two sides going their separate ways with no trade deal.

The principal dispute was over customs on goods crossing the Irish Sea. When the UK and EU signed the Withdrawal Agreement, many saw its protocol on Northern Ireland as unrealistic. It kept the border between Ireland and Northern Ireland open and frictionless, in keeping with requirements under 1998's Good Friday Accords. It also accepted customs checks for goods traveling between Great Britain (e.g., England, Wales and Scotland) and Northern Ireland, and affirmed Northern Ireland's unfettered access to the rest of the UK. This sounded like a win for all sides, but as policymakers hashed out the details, it became clear that it was an impossible trinity, with a high likelihood of Northern Ireland becoming economically isolated from the rest of the country. After all, how can Northern Ireland really have unfettered trade access to Great Britain if companies have to file export declarations every time they cross the sea? In our view, the provisions in the Internal Market Bill were effectively amendments to the agreement to ensure there isn't a de facto border down the Irish Sea. In a press conference discussing the new legislation, Johnson, claimed the new bill seeks to insure against "extreme interpretations" of the Withdrawal Agreement and isn't false advertising.

> ".. AS FURTHER EVENTS UNFOLD, WE THINK EQUITIES SHOULD CONTINUE GAINING CLARITY AND REALIZE EVEN A NO-DEAL BREXIT SHOULDN'T BRING DISASTER."

In the weeks that followed, as Parliament debated the bill, several members of Johnson's Conservative Party threatened to ruin the legislation. However, in a bid to head off a rebellion, the government introduced an amendment that would give Parliament a vote on whether to exercise the provisions that ran counter to the Withdrawal Agreement if and when the time came. For instance, while the bill still gives the UK government power to amend or waive export declaration requirements for shipments from Great Britain to Northern Ireland, Parliament would have to approve the specific action when and if the government decided to take it. This procedure, known as a parliamentary lock, aimed to safeguard against the EU and international community's concerns. It also satisfied most of the Conservative rebels, helping the legislation pass the House of Commons at September's end.

EU leaders, however, continue to verbally reject the amended bill and warn they could impose sanctions on the UK for breaching the Withdrawal Agreement should it take effect. At the same time, negotiations over a trade deal continue, raising the question of whether the tough stance on both sides is merely a negotiating tactic.

As of mid-October, despite the bluster, the two sides aren't far apart, with the biggest disagreement remaining over fishing rights, and the incentives for both sides to reach a deal remain high. Since Brexit began, both sides have drawn, erased and redrawn red lines, and it seems reasonable to expect this to continue over the next few weeks.

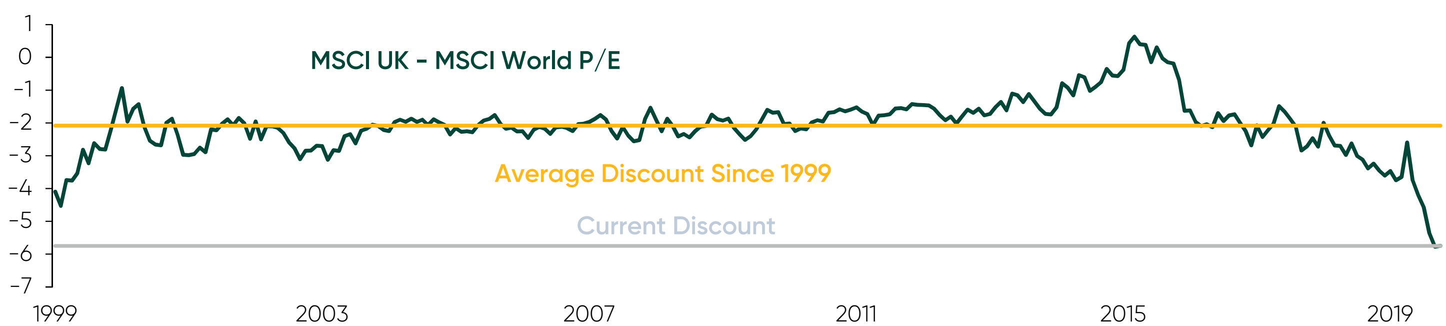
International politicians' warnings that the UK's move would ruin its ability to sign trade agreements all seem far-fetched. Mere days after observers claimed no country would sign a free-trade agreement with the UK after it violated its word on the Withdrawal Agreement, Japan and the UK finalized and signed their free-trade agreement. Vietnam and Canada subsequently confirmed their intent to continue negotiating their own agreements with the UK. Perhaps most significantly, Japan and the UK both confirmed their deal was a prelude to the UK potentially joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the largest trade area (as measured by participants' GDP) outside of the EU. In our view, this cuts against claims that the rest of the world would view the UK as unreliable and shows Brexit is not a protectionist move.

As 2021 begins, the UK should remain one of the world's most open nations.

Trade with the EU should also continue apace regardless of what politicians do or don't agree to in the coming weeks. As discussed last quarter, the tariff schedule for a World Trade Organization Brexit—which would apply to the EU in the event of no trade deal—represents a broad reduction from the EU's current tariff scheme. UK ports operators have updated procedures and staffing as needed to handle customs checks on goods crossing the English Channel and repeatedly dismiss warnings of days-long truck queues as politicized sensationalism with no real-world grounding.

Regardless of what happens, markets have been dealing with no-deal Brexit fears for over four years now. As shown on Exhibit 17, MSCI UK forward price to earnings typically trade at a discount to the MSCI World, though the spread is currently at a 20-year low, suggesting some negative sentiment surrounding a no-deal Brexit may already be priced in. Similarly, the pound has yet to recover its pre-referendum rate (Exhibit 18).

EXHIBIT 17: MSCI UK & MSCI WORLD PRICE TO EARNINGS RATIO



Source: FactSet, as of 09/30/2020. Data shows the difference between the MSCI UK and MSCI World next twelve months price-to-earnings ratio.

EXHIBIT 18: POUND EXCHANGE RATE

Source: FactSet, as of 09/30/2020. Data shows the pound sterling effective exchange rate with notable Brexit events.

Headlines have imagined every possible scenario up to armed conflict. There have been warnings of blockades and a sudden stop in trade. Similarly, there are fears of a protectionist, isolated UK along with forecasts for deep recession, hyperinflation and a debt crisis in a post-Brexit UK. Nonetheless, the reality that emerges is likely to be different from all of these worst-case scenarios, especially as it becomes clear both sides are intent on keeping trade flowing. While uncertainty may remain a headwind for UK equities as the deadline approaches, the risk of Brexit driving a market or economic disaster after 2020 ends seems exceedingly low.

JAPAN: NEW PRIME MINISTER, SAME OLD POLICIES

On August 21, Japan's Shinzō Abe, resigned as prime minister due to the same health issues that truncated his first 2006 – 2007 premiership, ending Japan's longest uninterrupted stint in office at eight-plus years. To serve out Prime Minister Abe's final year as the ruling Liberal Democratic Party's (LDP) president, the party selected Yoshihide Suga, and Parliament swiftly confirmed him as the new prime minister. It is unclear how long he will serve at this point. The LDP's next leadership election is in September 2021, with the next general election due a month later. However, speculation is rife that Prime Minister Suga will call a snap election. In the meantime, considering Mr. Suga was Shinzō Abe's Chief Cabinet Secretary, we expect him to largely maintain the status quo politically. Outside of heightened uncertainty surrounding the potential for a snap election, we don't see much impact for Japan's markets.

As Shinzō Abe's former policy coordinator, Prime Minister Suga likely extends policy continuity. Time will tell, but most political analysts expect him to hew closely to "Abenomics" as he was one of its chief architects. That generally means pursuing fiscal stimulus, encouraging the Bank of Japan (BoJ) to maintain its quantitative easing policies and pursuing economic reforms. Shinzō Abe's record on the latter was mixed, and it is hard to envision Prime Minister Suga making markedly more progress in the current environment.

Covid-19 is likely to take up much of his immediate attention, particularly in trying to pass a third supplementary budget for fiscal year 2020. That ends next March, so parliamentary submission of a plan is likely needed by January. He is also already preparing for his first budget starting April. Initial figures put it over ¥105 trillion, eclipsing this year's record.[xxxix]

> "OUTSIDE OF HEIGHTENED UNCERTAINTY SURROUNDING THE POTENTIAL FOR A SNAP ELECTION, WE DON'T SEE MUCH IMPACT FOR JAPAN'S MARKETS."

Other than that, it appears Prime Minister Suga is pushing for deregulation, digitalization and other bureaucratic reforms to improve government efficiency. For example, one early initiative he is promoting to improve Japan's competiveness as a financial hub calls for waiving arduous inheritance taxes for foreign professionals and increasing English-language support to lure global talent. Another involves digital transformation in the wake of pandemic shutdowns exposing Japan's overreliance on physical paperwork. These reforms are only in their planning stages, which may still amount to nothing, much like more major overhauls Prime Minister Abe spoke of implementing previously. Mr. Suga has also staked significant political capital on holding the delayed 2020 Tokyo Olympics next July and August, despite its unpopularity. How much this effort eats into other things he may want to accomplish remains to be seen.

At the same time, Prime Minister Suga likely doesn't share one of Shinzō Abe's major distractions: the dedicated effort to amend Article Nine of the Japanese Constitution, which renounces the sovereign right to war. The motion ran aground against popular opposition, drained Prime Minister Abe's political capital and, in our view, thus prevented deeper structural economic reform. While it remains a formal LDP plank, it is an uphill battle Mr. Suga is unlikely to take up as vigorously as Prime Minister Abe, for whom it was a lifelong ambition.

xxxix "Japan Budget Requests Hit Record of $997 Billion, Fuelled by Pandemic Spending," Tetsushi Kajimoto, Reuters, 10/07/2020.

As for potential early elections, pundits thought Prime Minister Suga might try to capitalize on his 70%-plus approval rating and fractured opposition to call for snap elections, cementing his popularity ahead of the LDP's next leadership contest. Prime Minister Suga says he won't call early elections "for the time being"—in consultation with LDP coalition partner Komeito leader Natsuo Yamaguchi.[xl] Prime Minister Suga and Mr. Yamaguchi say their top priorities are fighting Covid-19 and supporting the economy.

Yet speculation over a potential snap vote is still mounting, and it would not surprise us if he changes his mind and called one in the not-so-distant future. Cabinet ministers have hinted he could call one in early 2021. The opposition's relative disarray might prove too enticing. The Democratic Party of Japan—the LDP's main opposition through 2016—dissolved that March. It reformed mainly intact last month as one split-off group—the Democratic Party for the People—merged into the Constitutional Democratic Party of Japan. However, its popularity remains only a shadow of its brief 2009 – 2012 stretch in power. When opposition forces rejoined, they polled in the single digits.[xli]

Overall, absent large-scale structural reform—which doesn't look likely for the foreseeable future—we think domestic headwinds remain. Yoshihide Suga's ascendancy to the prime minister's post does little to change that, meaning Japan likely continues to be reliant on overseas demand.

xl "Japan's Suga Rules out Snap Election 'for Time Being,'" Yuki Fujita, Nikkei Asian Review, 10/03/2020.

xli "65% Have Low Expectations for Post-Merger Opposition Party in Japan: Poll," Staff, The Mainichi, 09/09/2020.

EMERGING MARKETS **COMMENTARY**

CHINA'S ECONOMIC RECOVERY

China is doing well economically, which is typically good for equities. Retail sales notched their first year-over-year rise since the pandemic in August, and industrial production has already surpassed pre-pandemic levels.[xlii] Retail sales and industrial production also rose in Q3. The faster growth rate stirred concerns of a "two-track recovery" in which factory production surges while consumption and services remain tepid. The unspoken fear is that government stimulus, which flows mostly to heavy industry and construction, is the only thing boosting the economy, while consumers and services are struggling. Indeed, China continues to face challenges with the lack of international tourism likely weighing heavily on consumption.

Yet the fact retail sales are now in positive territory speaks volumes, in our view. Moreover, increased heavy industry activity should help pull the rest of the country along. China's official non-manufacturing purchasing managers' index (PMI) has recorded six consecutive months above 50, the dividing line between expansion and contraction.[xliii] Investor fears of stagnant services are a sign of still-rampant pessimism in the market. However, in our view, growth in the world's second-biggest economy helps demand worldwide.

xlii Source: FactSet, as of 10/06/2020.

xliii Ibid.

US-CHINA RELATIONS LIKELY CALM AFTER PRESIDENTIAL CAMPAIGN

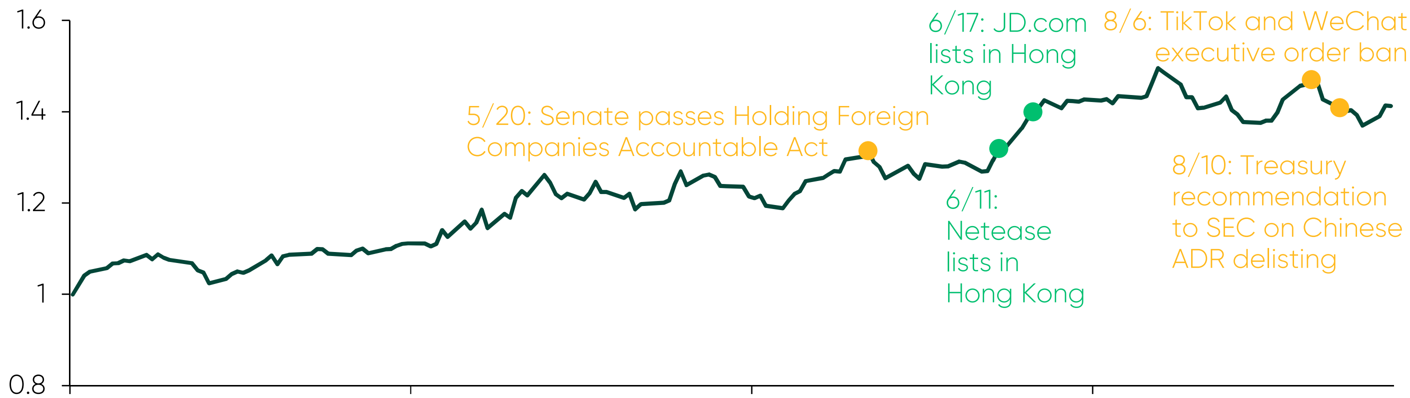
In the US presidential election, both the Democratic and Republican side are taking a stance on China with the incumbent in particular taking more symbolic action. In August, President Trump issued Executive Orders banning two major Chinese tech firms' products—ByteDance's video app TikTok and Tencent's messaging platform WeChat—in the US. The administration argued the apps' weak user privacy threatened national security. Though federal courts temporarily blocked the bans, the move stoked ongoing tensions. As headlines speculated about a potential TikTok buyer, others worried about the longer-term ramifications—e.g., Chinese companies currently trading in the US being forced to delist. Yet delistings don't automatically wipe out equity prices, as they don't erase the company from existence. Affected companies could list elsewhere, including Hong Kong. Shareholders could convert at a small cost. Either way, the tough stance against China normally calms down after the election where both sides likely reconcile.

CHINA TENSIONS IMPACT ON US ENDOWMENTS

The US State Department's letter to university endowments encouraging divestment of Chinese companies is another instance of increasing tensions between the US and China. The letter specifically called attention to endowments exposure to Chinese equities listed on US exchanges (such as Alibaba, JD.com, etc.) and warned that on August 10th, Treasury Secretary Mnuchin indicated the SEC will pursue recommendation to delist these stocks by the end of 2021 (Exhibit 19).

Similar to prior escalations, the economic and equity fundamental impact is likely minimal. Delisting US listed Chinese firms will not happen overnight – the end of 2021 being the most aggressive target – and companies are already taking action by listing on the Hong Kong exchange (JD.com & NetEase having done so in June). Most institutional investors have access to these markets and can swap the US listed shares for Hong Kong listed shares.

EXHIBIT 19: CHINESE INTERNET VS. MSCI EMERGING MARKETS WITH KEY EVENTS



Source: FactSet, as of August 19th 2020. Shows KraneShares CSI China Internet ETF performance against iShares MSCI Emerging Markets ETF performance, indexed to 1 on December 31st 2019. KraneShares ETF seeks to measure performance of investable universe of publicly traded China-based companies who primary business or businesses are in the Internet and Internet-related sector, and is used as a proxy for the space. A rising line indicates outperformance of internet and internet-sector related Chinese firms.

Additionally, it would not be difficult for US retail investors to gain access to these firms via unsponsored ADRs, much like they already do for Tencent. While some university endowments might choose or feel pressured to divest from China, we believe this will likely be a slow moving process given the structure of endowments. Further, omitting exposure to the second largest global economy is a decision which will surely lead to much hesitancy, and one could argue that omitting exposure could present a larger fiduciary risk than to include the country in a global portfolio.

CHINA-INDIA STANDOFF

Tensions along India and China's shared border in the Himalayas continued as each government accused the other's troops of new provocations, including making territorial incursions and firing warning shots across the border. India has also ramped up road construction by the border to match China's more developed transportation infrastructure on the other side. On September 21, diplomats from both countries issued a joint statement promising to improve communication and stop sending more troops to the border. Whether they will follow through remains to be seen. However, barring extreme escalation, we don't think this will prove a large negative for either country's equities. In our view, Indian equities' outperformance in September-as well as since conflicts started in May shows geopolitical tensions don't necessarily impact returns in affected countries.[xliv] Nonetheless, we don't expect India's outperformance to persist given long-running negatives like weak progress on key economic reforms and high non-performing debt levels at large state-run banks.

RUSSIAN POLITICS

Russian equities, already struggling with headwinds from an economy crippled by low commodity prices, faced even more challenges this quarter.

First, the Russians voted to overhaul the constitution, which further undermines the rule of law and sets the stage for President Vladimir Putin to remain in power for the foreseeable future.

Then the poisoning of opposition politician and Putin critic Alexei Navalny and the Kremlin's suspected involvement triggered an international row. These controversies likely contributed to the MSCI Russia's -4.7% Q3 return, lower than the MSCI Emerging Markets' 9.6%.[xlv] Year to date, the divergence is even more pronounced: Russian equities are down -28.0% to the MSCI Emerging Markets' -1.2%.[xlvi] Though these scandalous stories are not a surprise to markets, which have long been aware of Putin's strongman behavior, they highlight how politics are an endemic headwind to the country's markets and the desperate need for political reform.

> "THOUGH THESE SCANDALOUS STORIES ARE NOT A SURPRISE TO MARKETS, ... THEY HIGHLIGHT HOW POLITICS ARE AN ENDEMIC HEADWIND TO THE COUNTRY'S MARKETS AND THE DESPERATE NEED FOR POLITICAL REFORM."

President Putin first proposed constitutional reforms in January, initially seeking to limit the power of a successor and empowering the State Council (which he heads). Since Russia's constitution limits the president from serving more than two consecutive terms, political experts interpreted Putin's maneuvering as a way for him to continue guiding policy after his term ends in 2024. However, in March, both the Russian parliament and constitutional court endorsed a constitutional amendment that would reset Putin's term count from two to zero—paving the way for him to run for president again.

xliv Ibid. MSCI India Index with net dividends, in USD, 08/31/2020 – 09/30/2020 and 05/05/2020 – 09/30/2020.

xlv Source: FactSet, as of 10/16/2020. MSCI Russia Index and MSCI Emerging Markets Index returns with net dividends, 06/30/2020 – 09/30/2020.

xlvi bid. MSCI Russia Index and MSCI Emerging Markets Index returns with net dividends, 12/31/2020 – 09/30/2020.

In a national referendum—moved from April to late-June due to Covid-19—77.9% of Russian voters approved a package of around 200 constitutional amendments.[xlvii]

In addition to changing presidential term limits, the reforms included boosting the State Council's role, giving the president more power over the courts and providing Covid-19 economic relief. Opposition politicians and international observers decried the vote as a sham, and some noted copies of the new constitution were already in bookstores before voting was officially over. As blatant as Putin's bypass around the Russian constitution was, these tactics aren't surprising. He has found a way to hold onto national power, alternating as president and prime minister, since 1999. There is little reason to think this quasi-dictator has any plans to relinquish power.

A major component of Putin's political strategy is ruthlessly quelling dissent. In August, opposition politician Alexei Navalny fell ill on a flight to Moscow due to a suspected poisoning and spent 24 days in intensive care in a German hospital. Mr. Navalny has long been a critic of Putin and Russia's political elite. Besides supporting independent politicians in local elections, he leads an anti-corruption group targeting Putin's United Russia Party. Mr. Navalny also opposed the constitutional reforms and argued Russians should boycott the referendum vote in protest. After awakening from a coma, Mr. Navalny promised to return to Russia to continue his political work—and accused Putin of authorizing the poisoning. Though the Kremlin denies any involvement, the controversy sparked international outrage. In mid-October, the EU agreed to impose sanctions against Russian officials linked to poisoning.

As we monitor the ongoing situation, these issues are a reminder of the rule of law's feebleness in Russia. Government institutions like the legislature and courts lack true independence. Instead, Putin and his allies dictate policy. This likely isn't a huge shock for markets, which are well aware of Putin's dictatorial tendencies. However, these tumultuous developments highlight the fact Russia is in desperate need of reform—though little appears to be on the way for the foreseeable future.

These political controversies occasionally contribute to headwinds for Russian equities when turbulent developments emerge, like in Q3, but they are mostly just part of the backdrop behind Russian markets.

POLICY CLOUDS SOUTH AFRICA'S INVESTMENT LANDSCAPE

Unlike the rest of the world, South Africa entered its Covid-19 lockdown already in recession, as chronic power outages, mining malaise and ongoing domestic policy missteps plagued the economy. While lockdown accelerated its yearlong contraction and ending the Covid-19 restrictions on activity should reveal a reopening boost, the previous underlying issues present a dim future for the country, in our view.

There is no doubt that Covid-19 lockdowns hit South Africa's economy hard. In Q2, when lockdowns were at their most extreme, GDP slid -16.5% q/q.[xlviii] Mining, manufacturing and construction—almost 20% of total output—led the downturn, contracting about -30% q/q.[xlix] Wholesale trade, retail trade and transportation (collectively another 30% of GDP) fell nearly a quarter.[l]

xlvii "Putin strongly backed in controversial Russian reform vote," Staff, BBC, July 2, 2020.

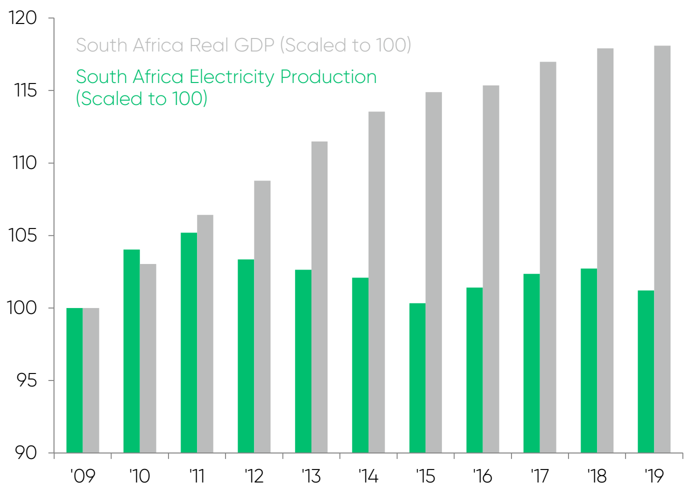
xlviii Source: FactSet, as of 10/16/2020. South Africa GDP, Q2 2020.

xlix Ibid. South Africa GDP by industry, Q2 2020.

l Ibid.

However, Q2's drop was the fourth straight contraction and GDP had already fallen in 7 of the 10 quarters since 2017.[li] Severe rolling blackouts have crippled South African mining and industrial production for years. Corruption and mismanagement by state power monopoly Eskom under former President Jacob Zuma led to a series of breakdowns at coal plants responsible for generating 70% of the country's electricity[lii] (Exhibit 20). This year has seen the most power outages on record, even with demand diminished due to lockdowns.[liii] Partial reopening from lockdowns will likely boost Q3 GDP, but without major pro-market structural reform from current President Cyril Ramaphosa's administration, headwinds likely linger.

EXHIBIT 20: LACK OF RELIABLE ELECTRICITY PRODUCTION REMAINS A DETERRENT TO INVESTMENT



Source: FactSet, data available through 12/31/2019. Last updated 10/08/2020.

However, policy seems to be moving in the opposite direction, with uncertainty over property rights rising. Even as President Ramaphosa faces the daunting challenge of reforming state-owned monopolies to root out corruption and tackle infrastructure problems crippling the country, overshadowing these efforts is his land expropriation legislation push. In 2017, the ruling African National Congress (ANC) proposed confiscating land, which South Africans of European descent own predominantly even post-Apartheid. The proposal outlines confiscation and redistribution plans similar to what Zimbabwe and Namibia did in the 20th century.

The following year, Parliament agreed to amend the Constitution's section 25(3) dealing with property rights and formed a committee to draft legislation doing so, which it published in 2019 and updated on October 11. The newly tabled bill states "just and equitable" compensation "will be determined by the courts," which in some cases may be nothing.[liv]

As the bill also notes in its opening passage, "the Minister of Public Works and Infrastructure intends to introduce the 'Expropriation Bill, 2020' in the National Assembly shortly."[lv]

While the government has yet to schedule a vote, it claims it has the necessary support to pass the measure. The ANC controls 58% of Parliament—insufficient to reach the two-thirds of seats necessary to amend the Constitution alone. However, South Africa's third-largest party, the populist Economic Freedom Fighters (EFF)—which holds 11% of the seats—also backs it, giving them the votes needed to enact the amendment. While we don't know whether they will go through with it, we doubt this bill would settle uncertainty.

The government claims this legislation won't destabilize the economy or unnerve investors. In our view, extended uncertainty over property rights is a key risk. If South Africa's households and businesses become embroiled in property ownership disputes and legal battles over them, it would likely drag down consumption and investment, clouding the economic outlook. As it stands, unclear property rights and the highly publicized push for land reform have prompted squatter occupations, leading to competing claims from different groups.[lvi]

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li Ibid. South Africa GDP, Q1 2018 – Q2 2020.

lii Source: US Energy Information Administration, as of 10/16/2020.

liii "South Africa's Economic Woes: 'It Takes Us Back 13 Years,'" Joseph Cotterill, Financial Times, 09/12/2020.

liv "South Africa Lays out Conditions to Seize Land, Says Investors Will Be Reassured," Staff, Reuters, 10/11/2020.

lv "Government Has Updated South Africa's Land Expropriation Bill – Here's What You Need to Know," Staff, BusinessTech, 10/12/2020.

lvi "As Occupations Gather Pace, South African Landowners Fear for Their Property," Kim Harrisberg, Reuters, 09/06/2020.

Banks also warn about large-scale expropriation without compensation sparking business retrenchment, impairing the roughly $100 billion in mortgages they hold.[lvii] It could also affect trade relations, violating agreements to maintain preferential access to the US and other markets.

Meanwhile in August, the EFF proposed nationalizing the country's privately owned central bank, the South Africa Reserve Bank (SARB). It seems the EFF's measure has two objectives. First, it is ideologically driven, as the EFF believes banks should be state-owned (as well as including land and mines). Second, the EFF appears to be pressing for the proposal in order to gain political advantage. The ANC holds a similar SARB nationalization plank, but it remains on the back burner due to factional infighting. Trying to force the issue now could drive a wedge in the ANC and strengthen the EFF's position in this and other matters.

Functionally though, nationalizing the SARB would likely have little impact. Currently, shareholders have no say in monetary policy decisions, and the president appoints its leadership, which wouldn't change under new ownership. Regardless, the ANC shelved the bill in September, saying the money for a buyout would be better used in a fiscal package targeting economic recovery. However, even if they do eventually press forward, we doubt this issue has substantive economic meaning.

Although, the fact that the government gets entangled in symbolic and economically meaningless debates like this as opposed to enacting real reforms and opening the economy are at the heart of the issues in South Africa. In our view, either a change in policy direction is needed or sentiment must sour much more in order for South African equities to be more attractive for investors.

lvii "Why Land Seizure Is Back in the News in South Africa," Mike Cohen, Bloomberg, 02/26/2020.

Should you have any questions about any of the information in the Third Quarter 2020 Review and Outlook, please contact us at (800) 851-8845 or FisherInstitutional@fi.com.