

# Monthly Market Review

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## THE GREAT RESET

Election not yet settled; vaccines raising hope

It was a November to remember. The widely accepted divided-government electoral outcome – the return to normalcy with checks and balances narrative – and the much better-than-expected efficacies in Pfizer’s and Moderna’s COVID-19 vaccines lifted risk appetite around the globe. Retail investors were especially enthusiastic as shown by the surge in the American Association of Individual Investors’ bullish sentiment index. Record pace of inflow into equities drove up the S&P 500 Index by 11% for the month, yet it still paled in comparison to MSCI Europe’s 17% appreciation. Optimism for a sustained economic recovery led to outperformance by U.S. Small Cap and value stocks: the Russell 2000® Index surged 18% and the Russell 3000 Value® Index outpaced its Growth counterpart by over 300 bps.

The risk-on sentiment boosted the commodity complex from base metals to crude oil. The latter soared 26% despite rising inventories. Investors were apparently looking past near-term issues with rising COVID-19 cases and associated economic tolls. The reflation narrative brought down the U.S. Dollar Index and gold prices; the former declined 2.2% and the latter was clobbered with a 5% loss. Some pundits claimed that gold has been supplanted by bitcoin, which surged a whopping 42%. If bitcoin were indeed a replacement for the shiny yellow metal, it should have declined during times of rising economic optimism. Instead, it has become an asset comparable to the imaginary Schrödinger’s cat, which can be dead and alive simultaneously as long as the box which contains it is not opened. So far this year, bitcoin has largely been moving in tandem with equities, yet many of its proponents also argue that it possesses gold’s defensive characteristics. The reality is that bitcoin is an amorphous digital creation that, according to Warren Buffett, “you can’t do anything with it except sell it to somebody else.” However, that does not preclude it from moving higher due to its limited supply in the face of rising investor interest.

There was one conspicuous absentee at the reflation lovefest: the U.S. Treasury market. Long bond yields had declined during a risk-on month. It could be a realization that the split Congress will make government less profligate, but that should dent the reflation narrative. Some suspect that it may reflect the expectation that the Fed will soon increase its purchase of longer-dated bonds, a step closer to the so-called yield curve control. Such a move could be a catalyst to drive precious metal prices higher as it will likely lead to lower real interest rates.

## IN POLLS WE TRUST?

It was a contentious election that pitted various establishment interests against a sitting president. The incumbent, branded a radical by his opponents for his bold and expansive policies, was an effective campaigner who drew large and enthusiastic crowds, especially among farmers and laborers. His challenger, a centrist politician who preferred to keep a low profile and rarely traveled, chose to rely on surrogates among moneyed interests and the media to get his messages out.

At a big rally on October 31<sup>st</sup>, three days before the November 3<sup>rd</sup> Election Day, the president had to wait 15 minutes for his raucous supporters to calm down before starting his fiery speech. He defiantly stated, *"Never before in all our history have these forces been so united against one candidate as they stand today. They are unanimous in their hate for me - and I welcome their hatred."*

Earlier that day in 1936, FDR had received some discouraging polling data. *The Literary Digest*, one of the most respected publications in the country, published the result from the most extensive polling ever conducted as of 1936. The weekly magazine, founded in 1890, pioneered presidential election polling in 1916 and had correctly predicted the outcome of every race through 1932. In August 1936, it took on the ambitious task of mailing out questionnaires to ten million prospective voters chosen from its subscriber base, automobile registration lists, phone directories, and club membership rosters. Approximately 2.3 million postcards were returned and they indicated that Republican candidate Alf Landon would win the presidential election with 57% of the popular vote and an electoral college edge of 370 to 161. However, this prediction was contradicted by the American Institute of Public Opinion, a one-year old start-up founded by an advertising executive named George Gallup. Gallup wrote in his syndicated newspaper column that his survey of around 50,000 people indicated Roosevelt would carry 56% of the popular vote.

Three days later, FDR won a landslide - 60.8% of the popular vote and 523-to-8 in the Electoral College, the biggest margins of victory since President James Monroe's largely uncontested election in 1820. With the benefit of hindsight, Wilfred John Funk, *The Literary Digest's* editor-in-chief, realized that they committed a huge sampling error by polling mostly wealthier voters - those who could afford cars, phones, and club memberships during the Great Depression. It was a blow to the magazine's credibility and led to its shutdown in 1938.

George Gallup's prescient call on the 1936 election made the Gallup Poll the gold standard in the industry. He continued to refine his polling methods and his company expanded rapidly at home and abroad. George Gallup even made it to the cover of the May 3, 1948 issue of *TIME*

Equity Markets Indices <sup>1</sup>	10/30/20 Price	11/30/20 Price	MTD Change	YTD Change
MSCI All Country World	551	618	12.2%	9.4%
S&P 500	3270	3622	10.8%	12.1%
MSCI EAFE	1780	2054	15.4%	0.8%
Russell 2000 <sup>®2</sup>	1538	1820	18.3%	9.1%
NASDAQ	10912	12199	11.8%	36.0%
TOPIX	1579	1755	11.1%	1.9%
KOSPI	2267	2591	14.3%	17.9%
Emerging Markets	1103	1205	9.2%	8.1%

### Fixed Income

2-Year US Treasury Note	0.16%	0.15%	-1	-142
10-Year US Treasury Note	0.88%	0.84%	-3	-108
BBG Barc US Agg Corp Sprd	1.25%	1.04%	-21	11
BBG Barc US Corp HY Sprd	5.09%	4.12%	-97	76

### Currencies

Chinese Renminbi (CNY/\$)	6.69	6.58	-1.7%	-5.5%
Brazilian Real (Real)	5.75	5.36	-6.7%	33.0%
British Pound (\$/GBP)	1.29	1.33	-2.8%	-0.5%
Euro (\$/Euro)	1.16	1.19	-2.3%	-6.0%
Japanese Yen (Yen/\$)	104.66	104.31	-0.3%	-4.0%
Korean Won (KRW/\$)	1135.15	1106.40	-2.5%	-4.3%
U.S. Dollar Index (DXY)	94.04	91.87	-2.3%	-4.7%

### Commodities

Gold	1879	1777	-5.4%	17.1%
Oil	35.8	45.3	26.7%	-25.7%
Natural Gas, Henry Hub	3.35	2.88	-14.1%	31.7%
Copper (cents/lb)	305	342	12.2%	22.3%
CRB Index	145	160	10.6%	-13.8%
Baltic Dry Index	1283	1227	-4.4%	12.6%

Source: Bloomberg

Magazine, which dubbed him "the Babe Ruth of the polling profession." The article crowed that, since the 1936 election, Gallup's average margin of error spanning 196 elections was within 4%.

*TIME's* crowning of Gallup turned out to be ill-timed. Exactly six months later, President Truman shocked the world with his come-from-behind victory over Thomas E. Dewey. Truman won the popular vote 49.6% to 45.1%, a reversal of Gallup's prediction that Dewey would win by 50% to 44%. The irony of the situation was aptly summed up in an article titled "The Great Fiasco" in the November 15, 1948 issue of *TIME*: *"From the grave of the Literary Digest, whose back was broken by its 1936 straw vote, came a sepulchral horse-laugh last week."*

## THE ERA OF DISTRUST

84 years after the Truman-Dewey polling disaster, the industry was once again humiliated even though pollsters knew they had to tweak their methodologies to account for the so-called shy Trump voters. Remember predictions of a Blue Tsunami or Biden's 17-point lead in Wisconsin? Democrats wound up losing at least 8 seats in the House, and Biden managed to squeeze out a mere 0.7% edge in the Badger State. Polls had also predicted a neck and neck senate race in South Carolina and a near-certain defeat for Susan Collins in Maine. Lindsey Graham wound up defeating Jamie Harrison by 10 points and Collins bested Sara Gideon by 9 points.

In an era when experts are often viewed with suspicion and even contempt, these wildly inaccurate polls only deepened many people's distrust of the establishment. Cynics claimed that misleading polls could have been used to affect fund raising and voter turnout. They pointed out that Harrison probably would not have become the first-ever Senate candidate to raise more than \$100 million if not for the erroneous polling data that overstated his chance of winning. Similarly, Gideon was able to capitalize on promising poll numbers to outraise Collins \$68.6 million to \$26.5 million.

While pollsters were clearly the big losers in this election cycle, an even bigger casualty, unfortunately, may be America's electoral system. It seems that many Americans' trust in the integrity of our elections depend on whether their side wins. For what it's worth, surveys indicated that 91% of Democrats viewed the presidential election as free and fair in 2020, but only 43% of them had a similar view in 2016 after Hillary Clinton's loss. Another poll showed that 79% of Trump voters believed the 2020 election was stolen from him. The mainstream media blames Trump's penchant for conspiracy theories and his refusal to concede the election for this climate of distrust. However, instead of proactively debunking the substance of the allegations raised by Rudy Giuliani, the President's attorney, liberal pundits sought to discredit him as a comical figure with melting hair dye. In the meantime, Big Tech has been busy censoring claims of voter fraud and voting system irregularities. These moves might have further cemented the belief among parts of Trump's base that the establishment has been undermining the President for four years. They pushed back by circulating statistical anomalies in voting data to support the voter fraud memes. Ironically, Big Tech's zeal to muzzle some of these voices has driven conservatives to flock to their new echo chamber, the censorship-free social media app Parler, where conspiratorial views can be shared with no push back from the opposing side.

The unfortunate gap in perception between the right and the left might be fueled in part by the seeming absence of

an honest broker, a role that used to be played by the independent press. The country also lacks a charismatic leader who can unite us in words and deeds - can we name one national politician respected by both the left and the right?

## THE UNFATHOMABLE

The prevailing market consensus is that Trump is now a lame duck and that President-elect Biden will soon restore trust in the government and America's global leadership. However, I worry that it will take much time for a divided nation to be healed.

Assuming the GOP manages to keep control of the Senate by winning at least one of the two runoff races in Georgia, we are likely to face two years of paralysis and gridlock into the 2022 mid-term election. There will be no honeymoon period for President Biden as he will be caught between the progressive wing of his party looking for payoffs and a tight-fisted GOP opposition. He will be battling Senate Majority Leader McConnell over the size of the urgently needed stimulus bill from the get-go. Trump will play kingmaker from Mar-a-Lago and leverage his loyal and angry base to pressure congressional Republicans. On the global stage, Biden will likely be tested by the usual suspects like Iran, China and Russia, and Republicans will likely frame any concession that Biden makes as a sign of selling out our country. The Senate may also push hearings and investigations on alleged election frauds as well as Hunter Biden's past business dealings. While financial markets usually prefer political gridlock, it may prove not so constructive during times of crisis.

Policy initiatives would be quite different if Democrats manage to pull off two upset victories in the Georgia runoff races to gain control of the Senate. This is viewed as a low odds event, but the betting market still gives it a roughly 25% chance. Much will depend on voter turnout, especially among many disenfranchised Trump supporters. A belated Democratic sweep will likely result in a big fiscal stimulus program in early 2021, only to be followed by the pain of higher taxes and more onerous regulation. The progressives will also try to get as much accomplished as possible before the mid-term election, which has historically been tough on the incumbent president's political party.

Lastly, let's not hastily write off President Trump, who will continue to exert much influence over the Republican Party. While markets have already dismissed his effort to contest the election, the betting market Predictit still gives him a 10% chance of winning. The President lost Arizona, Georgia, and Wisconsin by narrow margins of 0.3%, 0.2%, and 0.7%, respectively. His team is attempting to flip these results with audits to disqualify questionable mail-in ballots. There are also pending lawsuits across multiple

states with the objective of having state legislatures nullify the popular votes. While pundits kept on citing the high number of losses suffered by Trump's legal team, he only needs to win a few decisions at the SCOTUS to prevail. However, time is quickly running out for Trump's legal maneuverings. The two key dates to watch are December 8<sup>th</sup>, when states are required to resolve any disputes and have elections certified, and December 14<sup>th</sup>, when state electors cast their Electoral College votes. If Trump manages to prevent Biden from reaching the required 270 votes, there will be a contingent election in Congress, where each state's delegation votes *en bloc*, or one vote per state. Trump would likely win that contest with the GOP controlling more states than Democrats. Should this sequence of improbable events play out in Trump's favor, there will likely be protests, riots and four years of even more extreme politicking. It is an improbable and unfathomable outcome to many. However, having experienced a year of global pandemic, unprecedented lockdowns, and a bizarre election, the improbable may be more commonplace than we think.

## THE GREAT RESET

In spite of the difficult winter ahead with rising COVID-19 cases, hospitalizations, and deaths, the market's confidence in the post-pandemic recovery has been boosted by better-than-expected developments on the vaccine front. However, with unemployment remaining elevated and many small businesses teetering on the edge of bankruptcy, the actual pace of recovery will not be a straight line; much will depend on government policies on vaccination and economic assistance.

On the vaccination front, experts have yet to agree on what percent of a population needs to be vaccinated to create herd immunity against COVID-19. Several countries are debating whether COVID-19 vaccination should be made compulsory, and some are mulling the use of Carte Jaune (Yellow Card), an international certificate of vaccination issued by the World Health Organization, as proof of vaccination for international travel. In time, most of us will get vaccinated, but don't be surprised by a slow uptake. Many still worry about the vaccine's potential side effects and would prefer to wait and see how others fare. Some of today's anti-maskers will also likely become tomorrow's anti-vaxxers to sow seeds of confusion and resistance. These are potential issues that investors who have recently bid up travel and hospitality stocks need to be mindful of.

Regarding the post-pandemic reconstruction effort, progressives, led by the so-called Davos elites (of the World Economic Forum fame), are advocating an urgent "Great Reset" of capitalism to ensure equality and sustainability. They also call for harnessing the Fourth Industrial Revolution (i.e., Big Tech) to address health and social challenges. Their vision for the future could be

gleaned from a 2016 article penned by a young Danish politician with the title "*Welcome to 2030. I Own Nothing, Have No Privacy, and Life Has Never Been Better.*" This title was so controversial that its posting on the World Economic Forum website was changed to a bland "*Here's how life could change in my city by the year 2030.*"

The pace of the Great Reset will in part depend on the final outcome of the U.S. election as it will determine whether Trump's "America First" doctrine will be relegated to the dustbin of history. Still, some resets will be unavoidable since COVID-19 has exacerbated some longstanding issues such as the world's debt dependency and the widening gap between the haves and the have-nots. There will be elevated levels of bankruptcy and debt restructuring. Governments may further increase their leverage to bail out the economy and placate electorates that demand more generous social contracts. Riccardo Fraccaro, Italy's Secretary of the Council of Ministers and a close aide of Prime Minister Giuseppe Conte, even floated a trial balloon on sovereign debt restructuring by suggesting that the European Central Bank consider "canceling sovereign bonds bought during the pandemic or perpetually extending their maturity." Businesses will also need to respond to lasting behavioral changes caused by the pandemic. In sum, there is no going back to the pre-COVID-19 world, and markets will need to adjust.

There is, however, one institution that will not push the reset button any time soon - the Federal Reserve. It will likely continue its loose monetary policies and may even look for an excuse - any political or economic turmoil - to increase the size of QE given the record high levels of U.S. debt-to-GDP and still bloated fiscal deficits. Investors will continue to view the Fed's dovishness as a potential security blanket, and the Fed's role as an enabler of moral hazard could persist until sustainably higher inflation eventually makes a comeback.

Lastly, as we approach the end of this turbulent year, let me wish you a safe and healthy holiday season. There may be moments of darkness and despair in the winter ahead, but a season of light and rebirth is not far behind. COVID-19 has put a spotlight on issues that we usually don't think much of: the fragility of life, vulnerabilities in a civil society, and inequality among people. It's distressing to learn that, during the month of October 2020, Japan had more people dying of suicide, which went up 40% from a year ago, than its cumulative year-to-date deaths from COVID-19. I am grateful to be able to work from the comfort and safety of home during the pandemic, which makes me more empathetic toward those who face health risks at work and the unfortunate who have lost their jobs. Let's hope Americans can put aside partisan differences in rebuilding a better post-pandemic world. There is more that unites us than divides us.



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