Risk Commentary (November 2020)
Are They Wrong (Again)?

The pollsters have posted Mr. Biden's lead over Mr. Trump at 5+%, mirroring Ms. Clinton's lead over Mr. Trump in 2016. However, the polls were wrong in 2016 as they neglected to take measure of the silent Trump supporters. If anything, the pressure for hiding support for Republicans, particularly Trump, has increased over the past four years begging the question of whether the pollsters have made the appropriate adjustments. While predicting the future is always dicey, our view is that the Presidential and Senatorial race are going to be close but that young voters and the massive early voting are likely to make the path difficult for Trump.

Regarding the impact of the elections, if Mr. Trump wins, we can probably expect more of the same. Alternatively, if Mr. Biden wins, there is likely to be material changes. For starters, it is highly likely that Mr. Biden will be shunted aside over time and relegated to ceremonial duties, with the real policy decisions being made by Senator Schumer, Congresswoman Pelosi and to a lesser extent Senator Harris and perhaps some progressive advisors. There is little doubt that momentum and gravitas in the Democratic Party has shifted leftward and the new administration is likely to try to keep various promises. For investors, the changes are likely to be far-reaching and profound. Under a Biden presidency, the House is likely to remain Democratic controlled while for the Senate, Republicans appears set to lose some seats such that Republican control will be slim at best. Hence, if elected, the Biden administration is likely to have considerable power over the next couple of years to make material changes. Below is a partial listing of potential changes:

Corporate Taxes – a rollback of the Trump tax reforms
Personal Taxes – a substantial rise, for all, particularly those making over $200K
Petroleum/ Natural Gas – increased regulation, likely a de facto ban on fracking
Student Loans – many forgiven over time
Healthcare Insurance – broader coverage, more government support
Automobiles – an increased push for electric vehicles
Banking/ Finance – tighter regulation and more support for CRA
State and local governments - more federal support

Rarely in recent history have presidential elections been as polarizing as that of the past two, begging the question of the underlying cause. Our view is that there is a cultural divide which is manifesting itself in friction in presidential politics. Since it is almost always about the money, let us start there. Simplistically, on the one hand the Progressives, who happen to be the most dynamic portion of the party currently, are pushing for wealth distribution and a "fairer" society. Progressives have become convinced of the strength of their views such that any who do not share those beliefs are either unthinking or bigoted or both. As demonstrated on a regular basis, the Progressives have gained the support of most "voices" in the country: academia, big business, the entertainment industry, media, students, sports, and probably a good portion of those who run government. Alternatively, the Republicans traditionally have had and are counting on the support of everyone else. This divide in outlook and philosophy of the two parties is unlikely to change regardless of who wins the election. Back to the current contest,

while many bemoan the foibles of Trump, perhaps another way of looking at the current state is a more wholistic view, that is, a person needed a personality like Trump's to overcome the multitude of hurdles placed in front of candidates before (and after) the election. Regarding the election, if Biden wins, perhaps the true test of his administration will be whether it is close to Bernie Sanders/ AOC's vision or more in keeping with Bill Clinton's vision. Typically, to garner more support, a candidate moves closer to the center after securing the nomination, which did not happen in Biden's case. Perhaps the move will come after the election or perhaps it will never come. Regardless, currently we are in a state of turmoil, and
this period is likely to be remembered for decades.

Regarding the economy, we expect that one of the many vaccines is likely to prove at least partially effective and that most businesses will open albeit, many at reduced levels. However, in the meantime, infections are spiking, perhaps because of the move indoors resulting from the colder weather. An item, which has been neglected by many market observers, is the level of damage inflicted on some by the increased level of indebtedness resulting from the shutdowns. For example, a firm which has seen its leverage doubled because of the crisis will remain hobbled for several years. Some areas such as many store-based discretionary consumer retailers will find few options for avoiding a restructuring. Nonetheless, the market anxiously awaits an end to the crisis and with it a hopeful return to some normalcy. Below are comments on key areas:

GDP Growth – watch for major rebounds based on comparisons from depressed levels and pent-up demand (see our projections by country on page 3).

Interest Rates – the central banks have placed a thumb on the scale in an effort to ease the economic pain. The major open issue is the timing of a withdrawal of support and the corresponding impact on the economy. It appears that both political parties have in part embraced the Modern Monetary Theory (MMT), the central tenant of which is that federal debt levels for developed economies are irrelevant since the individuals and businesses have no alternative. Note, this MMT approach continues a trend toward further weakening of currencies tie to stores of wealth with (i) FDR's ending the free exchange of currency to gold, (ii) Nixon's decoupling the US dollar from gold in 1971, and (iii) now the unfettered printing of currency. (Figures A through F are sourced from Macrotrends)

Figure A: 10 Year US Treasury Yield

Inflation - While the growth in money supply typically results in inflation, to date there has been little. The underlying reasons appear to baffle economists, but the leading causes appear to be tepid demand and a shift in consumption patterns. Global population growth rates have slowed, household formation rates have slowed, and consumption has shifted to relatively inexpensive electronic/software-based services. Yes, homebuilding is up, but is still off from normal levels.

Figure B: Housing Starts Historical

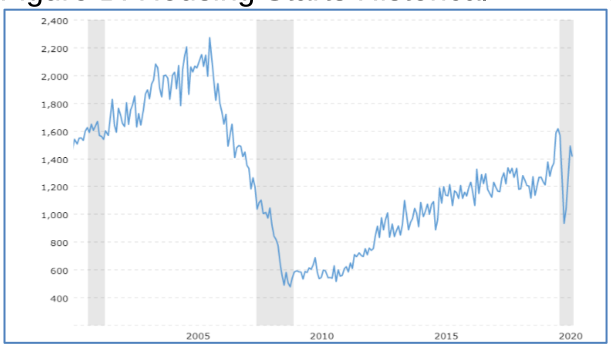


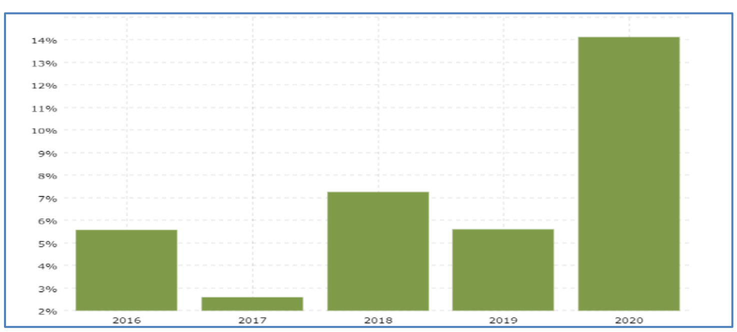
Figure C: National Unemployment Rate

Figure D: 5 year Forward Inflation Rate%

Figure E: SP500 PE Ratio

Overall Credit Quality – This is our "wheelhouse" and while there is little doubt that the country has weathered the worst of the COVID19 storm, (i) hopefully there will not be a relapse and (ii) many issuers are pressed as a result of increased debt levels and tepid demand.

Figure F: National Debt Growth by Year



The areas which are likely to experience the greatest stress are listed below (see our Industry Review for additional information) in addition to selected municipal credits such as MTA, New York City, and selected airports.

Airlines
Aircraft & Equipment Leasing
Energy Equipment & Services
Hotels Restaurants & Leisure
Commercial Marine
REITs (selected)
Retail
Textiles Apparel & Luxury Goods

Below is a summary of our expectations for the various economies:

Figure I: EJR Normalized Economic Expectations (next 12 months)

	Japan	Europe	U.S.	China	Emerg Mrkt
GDP Growth	1.0%	2%	3%	5%	6%
Stimulus Change	Moderating	Slight Rise	Moderating	Moderating	Little change
Earnings Trend	Slight Rise	Slight Rise	Slight Rise	Rise	Rise
Interest Rates	Negative	Negative	Zero	Low	Varied
Asset Valuations	Flat	Flat	Varied	Varied	Slight Rise

Regarding interest rates, the EU countries and credits cannot afford significant increases in rates. The periphery EU countries (e.g., Italy) are likely to see continued pressure because of increased credit quality concerns. Regarding trends, we had expected a slight rise in rates as economies recover but the market turmoil, tepid growth and central banks' money creation are depressing rates.

Figure II: Current and Expected Interest Rates

	5 year		10 year		30 year	
	Current (%)	Year End (%)	Current (%)	Year End (%)	Current (%)	Year End (%)
United States	0.38	0.28	0.87	0.79	1.65	1.24
Germany	-0.82	-0.83	-0.63	-0.63	-0.22	-0.21
Italy	0.09	0.09	0.72	0.71	1.59	1.66
United Kingdom	-0.04	-0.05	0.27	0.24	0.83	0.78
Japan	-0.09	-0.10	0.04	0.03	0.64	0.65

Source: https://tradingeconomics.com/bonds

Below are our expectations for major currencies:

Figure III: Currency

	Current	EJR Est. Year End
USD-EUR	1.16	1.18
Yuan to Dollars	6.68 $/RMB	6.73 $/RMB
JPY-USD	104.7	105
USD-GBP	1.29	1.28

Source: https://www.x-rates.com/table/?from=USD&amount=1