Bridgeport Asset Management Inc.
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Q3 2020

Investment Commentary

Global equity markets continued to rebound in the third quarter after bottoming out in late March after the emergence of COVID-19. The MSCI World Index (a benchmark for global stocks) advanced 8% in Q3, although performance was uneven with most of this gain coming in July and August before markets declined again in September as COVID-19 cases increased. Growth and momentum stocks continue to outperform value-oriented equities, although this trend began to show signs of reversing with the market pullback late in the quarter.

Along with the pandemic, the upcoming US election is foremost on investors' minds as we head into the fourth quarter. Despite what the talking heads on TV may say, predicting the direction of the stock market based on which party may win an election has historically proven to be a crapshoot. Generally speaking, governments usually receive too much credit - and blame - for how markets and the economy perform during their tenure. This isn't to say that governments have no impact on the economy - government policy is indeed important to creating an environment which encourages economic activity - but the impact of these initiatives is often only felt over the long term and intervening events sometimes play a greater role in the near term.

One can make a case in favour of either party being "better for markets" depending on how data is analyzed. The truth is there has been no material difference in the performance of the US stock market under a Republican versus Democratic White House. This is not particularly surprising given the many variables at play, such as whether the President's party controls one or both of the House of Representatives and Senate, the phase of the economic cycle at which a President takes office and the prevailing geopolitical situation.

As such, we do not think it is prudent for investors with a long-term time horizon to make significant adjustments to their portfolios based on which candidate they believe will prevail. One needs to look back no further than the 2016 US election to see the difficulty in mixing politics with investing. Most polls at the time were suggesting that Hillary Clinton was going to win over Donald Trump and, on the surface, it seemed that equity investors were generally comfortable with this outcome as Clinton was considered the more predictable of the two. However, markets began to decline as the election approached in October 2016 and Trump's campaign began to gain steam after FBI Director James Comey reopened his investigation into Clinton's private email server. Fearful of a Trump win, many investors hedged their market exposure based on the commonly held wisdom - at the time - that the market would plunge if Trump won.

Late in the evening on the day of the election when it became apparent that Trump would indeed be the victor, S&P500 futures (which usually indicate how the market will open the following day) plunged 5%, the maximum allowed for an overnight decline. Everyone went to bed that evening expecting a market bloodbath the next day.

Surprisingly, sentiment completely reversed by the time the market opened the next day and the S&P500 actually closed up 1% on November 9, 2016. The fourth quarter of that year turned out to be a fantastic period for investors.

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The 2016 election demonstrates the difficulty and danger in trading the market based on election outcomes. That said, it is important to assess the range of possible outcomes from the election from the perspective of assessing risk and the continuing evaluation of all of our investments.

At present, most pollsters are predicting that Joe Biden will win the election and that the Democrats will retain control of the House of Representatives. Biden is even more heavily favored than Clinton was at this point in 2016 and seems to have a polling advantage in key swing states. Under a Biden Presidency and Democrat-controlled House, we expect to see increased fiscal spending targeted at sectors like healthcare, renewable energy and education as well as increased social support programs for lower income households. While this would provide a short-term boost to the economy (especially coupled with the delivery of a vaccine), it would likely require higher taxes on large corporations and wealthy individuals, both of which are generally considered to be a detriment to economic activity. A Biden win, however, should be positive for international trade and US-based multi-nationals.

On the other hand, a Trump Presidency would likely mean four more years of lower taxes, less regulation and a general continuation of pro-business government policy, albeit with the possibility of more international trade tension. One near-term issue could be Republican hesitance to push through a large fiscal stimulus package, which is arguably important for sustaining household spending, and is now somewhat expected by investors.

Overall, our belief is that while the polls are predicting about a 65% chance of Biden winning the Presidency, the stock market is prepared for either candidate to win and various scenarios are already reflected in stock prices, including an election result which requires the US Supreme Court to weigh in. It is worth noting that this occurred in 2002 when the S&P500 declined just over 4% between election night and the time the US Supreme Court ruled that Bush had defeated Gore.

Regardless of the outcome of the US election, we will continue to invest in companies that we believe will fare well regardless of the political environment. One such investment, bought during the quarter in our US Equity portfolio, is Ross Stores.

Ross is a leading off-price retailer of brand name apparel and home goods. No matter who is in power, consumers always love shopping for bargains. Off-price retail has steadily been taking market share from large department stores and specialty retailers over the past several years as consumers gravitate to well-known brands without wanting to break the bank. It is also a business model that has thus far been relatively immune to e-commerce. The company has been growing steadily while generating exceptional returns on invested capital. Their investment grade balance sheet ensures their ability to weather COVID-19 related challenges to brick-and-mortar retailing and could be in an even more dominant position in the years to come as department stores close their doors. Ross' stock has traditionally traded at a noticeable premium to the market but current weakness has presented an opportunity for buyers with a longer investment horizon to buy an excellent company at a below average valuation.

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Finally, we would like to make you aware of the upcoming launch of the Bridgeport Private Equity Opportunities Fund. This new fund will focus on investing in a diversified portfolio of private company shares in partnership with institutional asset managers. The fund's objective is to generate strong capital appreciation with relatively low volatility and serve as an important addition for clients looking to diversify a portion of their portfolios away from publicly traded stocks and bonds. The new fund is designed to be a complement to the Bridgeport Alternative Income Fund which is structured in a similar manner, but focused on generating income from a wide variety of income oriented private assets as opposed to earning returns primarily through capital appreciation.

We wish you all the best as for safe and healthy winter. Please feel free to reach out should you have any questions.

Yours truly,

John Fisher