Outlook for Financial Markets

"It is surmounting difficulties that makes us heroes."

- Louis Pasteur

Executive Summary

A broader fiscal stimulus package from Congress remains important to limit downward momentum in the economy

Europe's joint fiscal stimulus package and favorable pandemic mitigation bode well for its medium-term prospects

China faces headline and event risk in the run-up to the U.S. elections, but it is more likely to succeed in countering Biden's preferred coalition-building approach should he win the election

The first Trump-Biden debate is schedule for September 29 and there remains considerable room for President Trump to close the gap in the polls – at present, both the White House and Senate control is leaning positive for the democrats

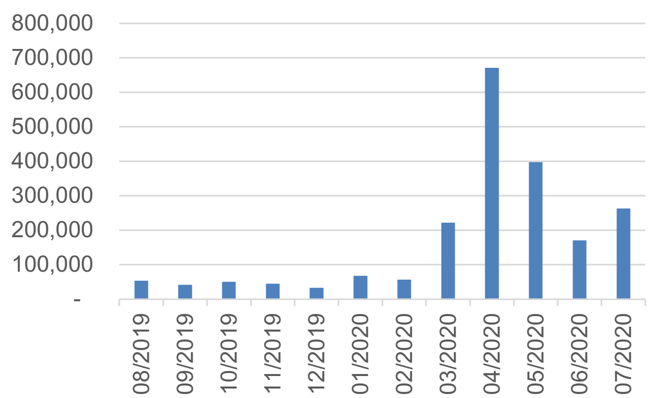
Fiscal stimulus, executive orders, and a $2 trillion divide

At the time of this writing, fiscal stimulus negotiations between Republicans, White House, and Democrats still have a $2 trillion chasm to bridge, but given what is at stake the potential remains for swift action. And just when it seemed that President Trump was in a tough negotiating spot, he signed executive orders that extended unemployment benefits and suspended payroll taxes for those making under $104k/year[1]. These measures are clearly inadequate to remedy the economic difficulties at hand, but they may serve to put additional pressure on democratic lawmakers who called for a resumption of negotiations shortly after the orders were given.

On the economic front, certain areas are clearly picking up while others are scaling down as indicated by an uptick in job cut announcements in July after having fallen for three straight months ***(see Exhibit 1)***. These layoffs are extending well beyond the companies most obviously affected by the pandemic, and include the likes of Nike, John Deere, Wells Fargo, AT&T, Walgreen's, and so on. Additional fiscal stimulus would go a long way towards halting the downward economic momentum as we navigate the months leading up to potential vaccine milestones. We expect the weight of struggling businesses and millions of unemployed workers will bend both parties toward agreement on a broader stimulus bill. Hopefully with haste.

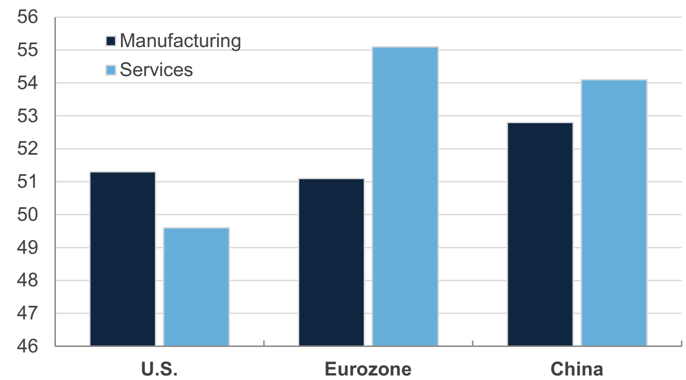
[1] The executive orders indicate an additional $400/week in expanded unemployment benefits, $300 of which is to come from federal disaster relief money with states expected to chip in the remainder. For the payroll tax suspension, only the collection is deferred and it will require subsequent legislation if those amounts are to be waived.

Exhibit 1 » Monthly job cut announcements



Source: Challenger, Gray & Christmas, Inc.

Exhibit 2 » Latest PMI readings



Source: IHS Markit; Caixin

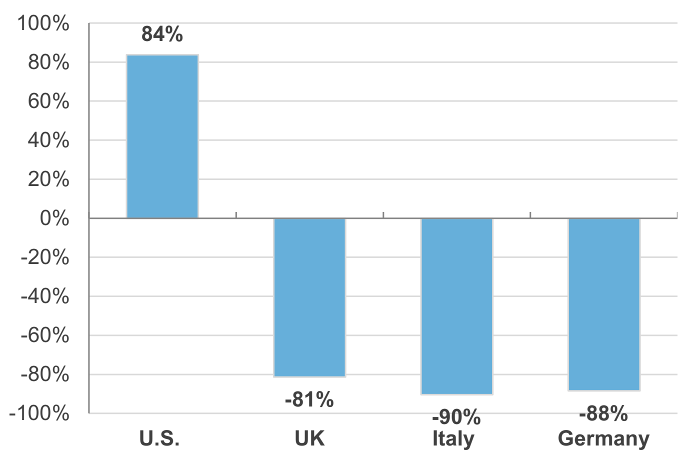
Better news internationally

There is a ray of hope emanating from both Europe and China where service-sector Purchasing Manager Index (PMI) readings are much healthier than those in the U.S. on the back of improved outbreak conditions *(see Exhibits 2 &3)*. While more concerted social-distancing measures have helped bring down case counts in the U.S., we still have quite a way to go relative to other developed countries.

The European Union also recently surprised to the political upside with the unprecedented step of issuing EU-backed debt to fund a large fiscal stimulus package that will disproportionately support struggling countries in the region. This development puts Europe's economy on a more favorable long-term trajectory and portends of future support and cohesion within the EU block. While we maintain our neutral rating on European equities we see these developments as positive and significant, and the weak U.S. Dollar (relative to the euro) has further bolstered European equity returns (in dollar terms). Yes, Brexit remains, but its importance has diminished and is more than outweighed by these recent events.

Meanwhile in China, by far the most dominant weight within emerging market (EM) equity universe, there has been a sharp rebound in exports and even small and medium size businesses are bouncing back *(see Exhibit 4)*. Of course

Exhibit 3 » Percent change in new COVID cases – early April to present



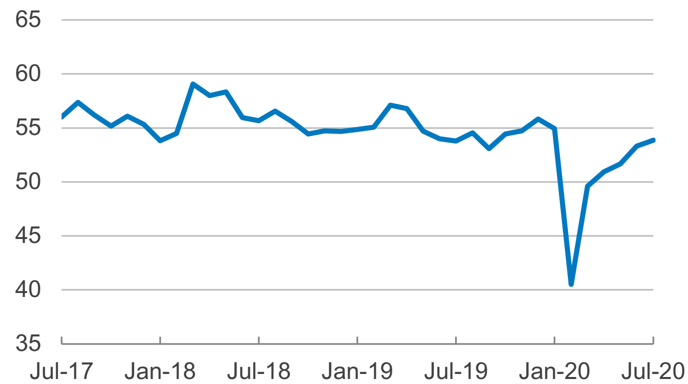
Source: John Hopkins University, COVID-19 Dashboard headline risk remains with the run-up to the U.S. presidential election, as bi-partisan support for being tough on China remains high. Near-term disruptions aside, China's longer-term economic trajectory remains favorable. Despite tough talk, a Biden presidency – should he win the election – would likely be more favorable to China than another four years under President Trump. In reality, "Getting tough on China" has been a consistent presidential election theme going back to Bill Clinton and George H.W. Bush in the 1990s. There is a reason that no one other than President Trump has followed-up with meaningful action – it's a difficult path to go down, as the past few years have shown. We believe that a divide and conquer strategy by China would prevent Biden's preferred coalition-building approach from having much success in vis-à-vis China.

And speaking of the election . . .

Einstein told us that the rate at which time passes depends on our frame of reference, but perhaps it has taken a pandemic to drive the point home. In less than three months the elections will take place. Current polling and prediction markets point to a real possibility not only of a Biden win but also democratic control of the Senate *(see Exhibit 5)*. We believe, however, there remains ample latitude for shifts to occur. The first debate is scheduled for September 29 in Cleveland. While we may know what to expect from President Trump, this will be Biden's first one-on-one debate for the presidency and a lot can happen. A democratic sweep, should it occur, presents an obvious headwind for the U.S. equity market as corporate taxes and regulation would almost certainly increase.

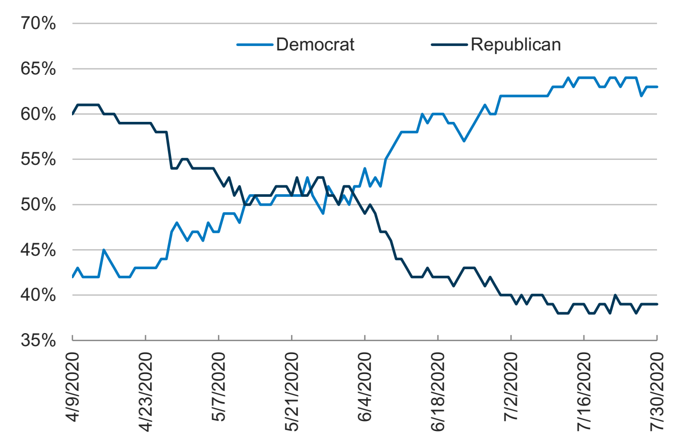
So far, the equity markets – amid unprecedented backing from fiscal and monetary policy – have managed to focus on a point in time beyond the pandemic, and seem to be taking a wait and see approach relative to the political landscape. As long as "whatever it takes" monetary policy and positive fiscal thrust continues, the odds of a significant selloff remains low.

Exhibit 4 » China small/medium business confidence index



Source: Standard Chartered

Exhibit 5 » Prediction markets: Probability of Republican/Democrat 2020 Senate majority



Source: predictit.org

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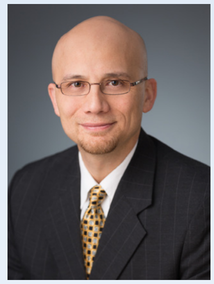
As Chief Investment Officer and National Head of the Investment team, Michael chairs the Personal Asset Management Committee and is responsible for setting investment policy and strategy for our clients throughout the United States. He joined BMO Wealth Management in 2013 as a Managing Director of Investments for our Ultra High Net Worth group, and became National Head of Investments in 2015. In January 2018, Michael took over the role of Chief Investment Officer. With close to two decades of experience in money management, Michael has a deep background in economic analysis, portfolio construction and risk management.

Michael earned a BA in economics from Northwestern University and an MBA with distinction in finance and decision sciences from the J.L. Kellogg Graduate School of Management at Northwestern University in Evanston, Illinois. He is a member of the Beta Gamma Sigma International Honor Society, holds a Chartered Financial Analyst designation, and is a member of the CFA Institute, CFA Society of Chicago, and the Chicago Quantitative Alliance. He is also a graduate of the American Bankers Association – National Trust School.



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As Chief Investment Strategist, Yung-Yu is responsible for performing macroeconomic analysis, valuation modeling and market analysis across asset classes to guide strategic and tactical asset allocations for client portfolios.

Prior to joining BMO Wealth Management, Yung-Yu was a finance professor at Lehigh University, where he taught courses in fixed income, equities and derivatives. His academic studies have been cited in the *Wall Street Journal*, in leading finance journals, top law journals, the *Handbook of High Frequency Trading*, and in *Oxford Handbook of Corporate Governance*. During his tenure at Lehigh, he was awarded the Staub Outstanding Teacher Award, awarded to one faculty member by a vote of faculty and students. Prior to his academic career, Yung-Yu worked for a global consulting firm performing financial and market analysis for global companies with operations in Hong Kong, Taiwan and Mainland China. Later, he oversaw the operations at a Fortune 500 subsidiary in Taipei and Mainland China.

Dr. Ma earned his Ph.D. in Finance at the University of Utah and his B.A. in Economics and Political Science, *magna cum laude*, at Williams College.

Yung-Yu lives in Portland, Oregon with his wife and two children. He is a basketball fan and enjoys cheering on his children's teams.

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