

The Market in Review

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This week's articles and insights

1. *The 2020 Election Cycle*
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“Strive in hard times, perish in contentment.”

- **Traditional Chinese saying**

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	28,164	+ 1.43%	+ 20.73%
S&P 500	3,154	+ 1.61%	+ 25.80% (+22.44% in \$CDN)
TSX	17,115	+ 0.68%	+ 19.49%

The 2020 Election Cycle

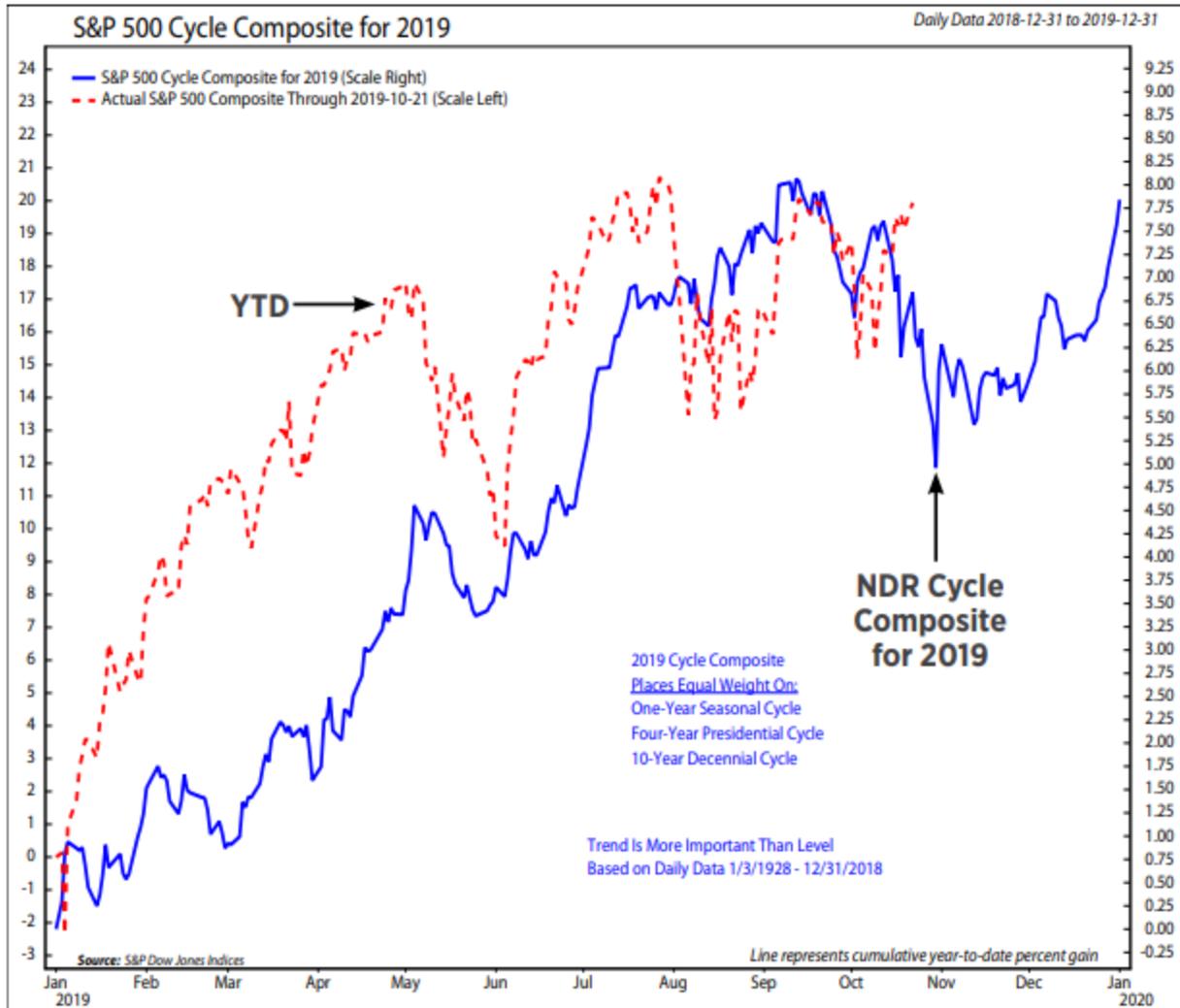
As much as we try to separate politics from investing, it is difficult. Politics and money, governments and economies, are co-joined twins everywhere you look around the world.

In Canada, the election cycle is less of an influence, perhaps because the distance between the main parties is so narrow. In the U.S., the election cycle affects the stock market much more definitively. Or, does the stock market affect the election? Perhaps both.

Much depends on who wins the election next year. Shown below is the typical 3rd year of the US election cycle. It shows the current 2019 year superimposed on 90 years of Dow Industrial Average prices for the 3rd year of a Presidential term.

So far, the year is playing out close to the long-term average. This year is typically the strongest of all 4 years of the election cycle.

Stock market has tracked Cycle Composite in 2019

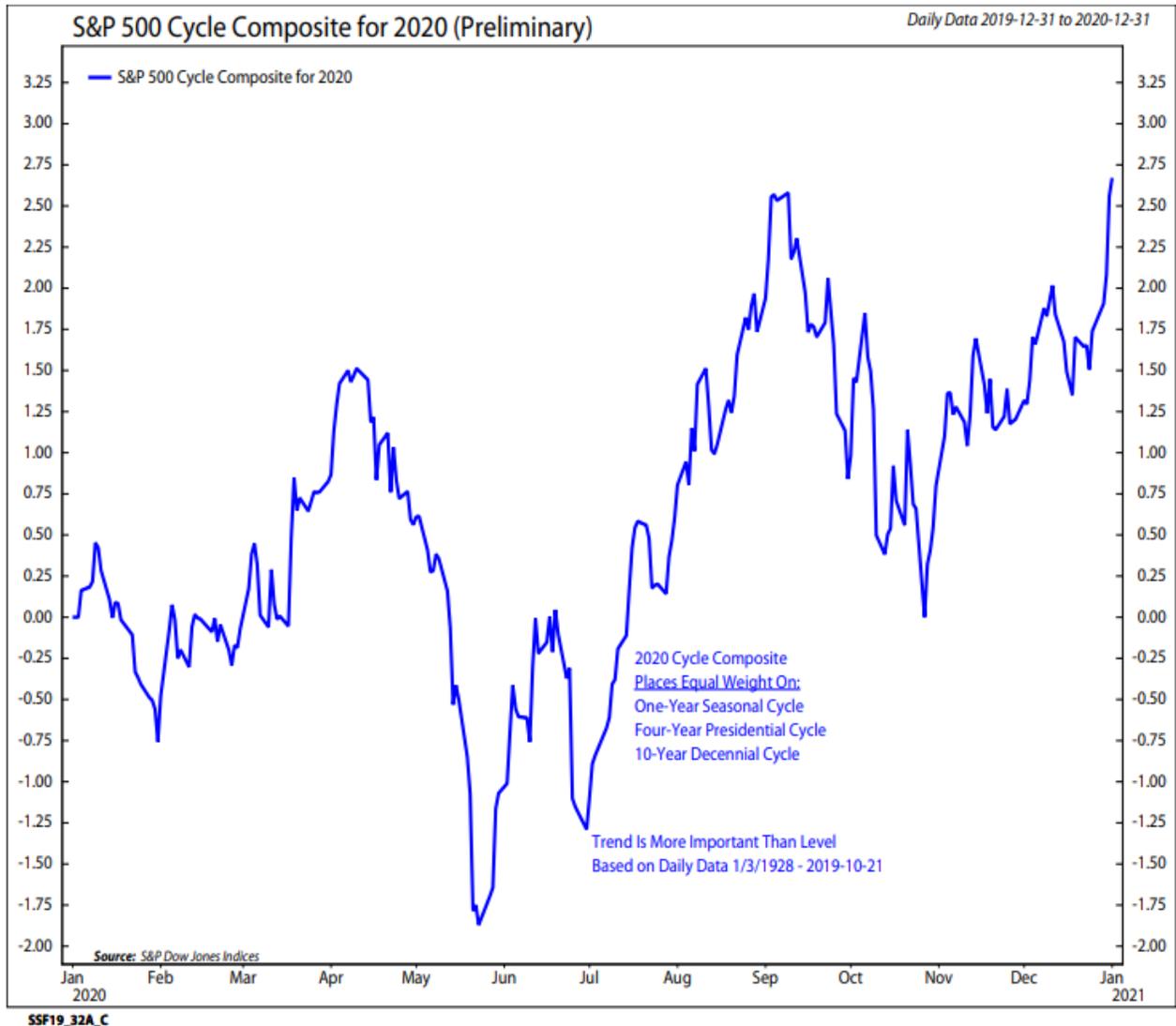


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The 4th year of the cycle, which will be 2020, is the election year. See how uncertain the market is until the mid-year?

2020 Cycle Composite choppy in first half



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Ned Davis explains it as follows:

“When the market has identified the likely presidential winner, the uncertainty has been lifted.”

This happens, on average, by May-June. The market then tends to rise through year-end, regardless of the political party about to win. The market simply wants certainty.

Of course, the electorate can pull a huge surprise, as it did with the election of Donald Trump in 2016. Markets had risen all year with polls showing a Democratic win, only to momentarily plummet after the results.

Is President Trump going to win or lose next year? One-term presidents since 1928 have generally had poor 3rd year stock market performance, so this year's 25% S&P 500 returns (this is the 3rd year of this cycle) suggests the probability of a second Trump term could be higher than many think.

Which leads to a brief story about chess, strategy, and what the Democratic Party has to do to avoid losing again.

Winning from the Middle in Chess

My friend Dr. John Oleson is an archaeologist at the University of Victoria. In 1991, John was excavating in Jordan at a site called Humayma, which was a trading post along the Via Nova Traiana - a Roman road and trade route linking ancient Persia to the new Roman empire of Byzantium. He unearthed a small square object that matched the rook chess piece found in later Muslim chess sets. The Muslims discovered chess from the Persians, who got it from India. It is approximately 1,500 years old and could be the world's oldest chess piece.

Early rooks first looked like chariots, with the two horns portraying horses.



Credit: John Peter Oleson, used with permission

As the Arabic empire spread, it carried the game all the way into Europe when the Moors invaded Spain. It has gone on to become the world's most popular game.

On a sociological level, chess has mirrored the culture of the era. For example, the early Persian chess pieces resembled people and animals. The Muslim faith does not like to depict people, so the shapes were changed to geometric ones. Piece names also evolved – especially the role of the Queen. Originally the Queen was not a woman at all but the Vizier - an advisor who stood to the King's side. Its moves were limited to single spaces diagonally. In Europe, with the coincidental rise of women's influence at court, the piece became the Queen and her power expanded dramatically. She became able to traverse the entire board in a single move and speeded up the game dramatically.

It was even known as Mad Queen chess for a time because of the chaotic power of the newly-empowered piece.

On a strategic level, chess has also evolved. In the beginning, it was all about capturing as many enemy pieces as quickly as possible. But as players studied and advanced, they realized their chances of winning increased if they controlled the centre of the chessboard. The centre allows you to command the edges and project power far more easily.



Today's market does resemble Mad Queen chess in that events move very fast and with great complexity. Chess strategy may help explain the recent rise in stock prices.

The Democratic Party in the US has drifted much further to the left since President Obama left office. Its ideas are very noble but often involve the obliteration of entire industries:

- Medicare for all.
- Free tuition.
- Guaranteed income for life.
- Taxes on capital in addition to taxes on income.

The markets, being capitalist in nature, have become increasingly terrified of the idea of a Democratic president leaning so far to the left. This led to stocks sliding in August.

In politics, as in chess, you must control the centre to win. Right wing warmongers and left wing socialists don't appeal to the vast majority of North Americans, and the Democratic Party may be figuring that out.

In the last month, we have seen one left-leaning candidate (Elizabeth Warren) slide her Medicare For All plan into the 3rd year of her proposed term instead of

the first. And, we now have a billionaire (Michael Bloomberg) in the running whose policies are far more centrist.

As a result, health care companies, banks, and technology companies have rallied as the potential for a more centrist opponent emerges. In other words, a Democratic president may be less scary than first thought.

The end result may be a much more equal political battle – and an uncertain market - from here into the middle of 2020 until the eventual winner is sorted out.

Wealth from Health

One sector we are keeping a close eye on is the health care sector. There are two reasons.

1. The potential moderation of the Democratic stance on health care in the US (see above). Political fears have kept people out of health care stocks because of the fear of socialized medicine. The US Health Care index has been flat for almost 18 months now.
2. It is now an inexpensive sector growing earnings faster than the general market.

There are 11 industry sectors that make up the broad S&P 500 index. Of these, 9 have seen their prices rise faster than their earnings. In other words, the stocks in these industries are now more expensive (compared to their earnings) than they were in January.

Not great value, in other words.

However, 2 of the sectors have seen their earnings grow faster than their share prices, making them relatively cheaper than they were in January.

The sector with the fastest growth and lowest stock prices is the financials. The US banks are growing their earnings, raising their dividends, and we love the group.

The second best is health care. As a group, earnings are up 18% while the underlying shares are up just 9%.

As Josh Brown of the *Reformed Broker* newsletter says in Fortune magazine:

“Health care is the second cheapest sector in the market. But here’s what’s interesting. In this quarter, health care is, I think, the only sector that’s growing earnings year over year. So what a puzzle that is. It’s got to be politics keeping people out of these stocks.

To me this is the fattest pitch that exists right now: 74 million boomers in the United States, even more overseas. They will now spend the next 20 years trying to replace every body part they have and living their best life literally until the last day, and that’s admirable, and I’ll be there soon.”

TFSA for 2020

The Canadian government has announced that the 2020 limit for Tax-Free Savings account contributions will be \$6,000. This is the same as it was for 2019.

With this new \$6,000, the total contribution room available in 2020 for someone who has never contributed since the TFSA was introduced in 2009 is \$69,500.

TFSA annual dollar limits by year

For 2009, 2010, 2011 and 2012:	\$5,000
For 2013 and 2014:	\$5,500
For 2015:	\$10,000
For 2016, 2017, and 2018:	\$5,500
For 2019 and 2020:	\$6,000

For those with older teenagers, anyone aged 18 is eligible for a TFSA. However, British Columbia residents cannot open a TFSA until the age of 19 (the age of majority here), although they will still be able to contribute for their 18th year.

In our opinion, the TFSA is the single best place to save and invest. Everyone eligible should have one.

Happy U.S. Thanksgiving. Christmas is just a month away!

Thank you for your referrals this month! They are always handled with great care and discretion.

<http://www.dividendvaluepartners.com>

We thank you for your business and your referrals and we hope you find our site user friendly and informative. We welcome your comments.

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Prices shown as of November 28th, 2019

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