Market Commentary
Special Edition

SIERRA MUTUAL FUNDS

OCEAN PARK ASSET MANAGEMENT

Three Ways to Invest for the Rest of 2020

In Jules Verne's *Around the World in Eighty Days*, Phileas Fogg, a wealthy mathematician, wagers that his calculations show he can circumvent the globe in, as the title says, 80 days. That time frame covers from now until the early weeks of 2021.

Elections are front of mind for many investors, but November 3, 2020 is hardly the end of the risks facing investors. The political uncertainties can last much longer, perhaps even 80 days. Regardless, there are plenty of other unknowns and worries, including a double-dip recession, the length and severity of the COVID-19 health issues, nosebleed federal deficits and the next black swan event.

We Believe Taxes Will Not Fall: Consider Municipal Bonds

Let us consider the first month of a Biden administration beginning in January as well as a second term Trump administration. Joe Biden has made it clear his top people will immediately look at emission standards, labor standards, and other regulations that were loosened over the past years to re-instate those regulation. He will look to raise taxes. The Biden Tax Plan outlines increases in corporate taxes, Social Security payroll taxes, individual income taxes, long-term capital gains taxes, qualified dividend taxes, estate and gift taxes, and more.

Let us also consider a second term Trump administration. Starting with taxes, he will look to make the tax cuts of three years ago permanent, rather than a phaseout in the future. Infrastructure plans will happen. He will complete the wall, nominate more judges, and create a healthcare plan.

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In our opinion, taxes will not fall and could very likely increase in virtually any scenario.

Municipal bonds and their tax-free income offer a potential way to mitigate risk in investor portfolios. Active managers with good knowledge recognize that certain sectors within municipal bonds represent the biggest default risk: specifically, senior living, single site nursing home and continuing care issuers. While a passive benchmark must own these sectors, active managers can step aside.

Our rules-based tactical process continues to indicate upward trends for municipal bonds.

Potential Lower Rates, Bigger Deficits, and a Weaker Dollar: Consider Emerging Markets Stocks

We are loath to make predictions. Economists and soothsayers can be far too sure of their visions. Instead, like the protagonist in Verne's epic adventure Phileas Fogg, we rely on math to drive investment decisions. Here is what we know for sure: the fastest bear market in history recovered to new highs in five months thanks to massive fiscal and monetary stimulus. The result is nosebleed levels of federal debt the likes of which have not been seen since World War II. Neither candidate cares about the exploding federal deficit, which will be $30 trillion in no time at all. Historically, widening U.S. deficits often correlate highly with a weaker dollar.

At the same time, Jay Powell, the Chairman of the Federal Reserve, has behaved in a manner that supports a stance that the Fed will do whatever it takes to keep markets calm. At the start of this year, for instance, the charter for the Fed did not allow for the purchase of uncollateralized corporate securities or ETFs, but that changed in 2020. The result is a price-insensitive massive bond buyer in the market. In our experience, big demand translates into higher bond prices and lower interest rates, and with that, a weaker dollar.

Low interest rates and widening deficits are a recipe for weak currency. A weak dollar is generally good for emerging markets countries and their stocks.

South Korea is the gold standard for economic, political, and any other risk that comes along. A broad country index may offer a terrific way to participate in the quick bounce-back we believe country is showing. We are seeing strong trends in these emerging markets country stocks, with "buy" signals based on our rules-based process.

Economic Risks Take Time to Unwind: Consider Junk Bonds

Remember our Four Horsemen of the Apocalypse? This was shorthand for the four metrics to watch as indicators of pending economic doom. To highlight one "horseman," we spoke widely that inversion of the 10s-2s Treasury yield curve has always preceded recession in the U.S. by six months. That inversion occurred in August 2019 and with spooky accuracy foreshadowed the recession that began in February 2020.

Now that we are in recession, it is not too early to consider assets that may benefit from an economic rebound, but we say loudly: do not ignore the many risks. We recommend high yield corporate (or "junk") bonds. Junk issues may look like other bonds, but do not act that way. Typically, the correlation of junk bonds to stocks is much higher than junk bonds to Treasuries or investment grade bonds. However, thanks to a juicy coupon yield, high yield corporate bonds may cushion downside and may have less risk than stocks. Again, our rules-based and tactical buy and sell discipline indicates upward trends for high yield corporate bonds right now.

The Three Ways to Invest Right Now

In summary, while we don't know what will happen in the next 80 Days between now and the first weeks of 2021, municipal bonds, emerging markets countries like South Korea, and high yield corporate bonds are three ways we believe you can invest productively between now and then.

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