THE VALUE OF DIVERSIFICATION

Despite concerns that a Biden win would be bad for stocks, the S&P 500 rallied approximately 7% last week. Additionally, news on Monday that initial trials showed 90% efficacy for a Pfizer Covid vaccine caused a sharp rotation out of sectors that had previously benefitted from Covid lockdowns (online shopping, streaming, video-conferencing etc.), to sectors that had been negatively impacted by the virus (energy, industrials, financials, real estate). These two developments underscore two crucial investing guidelines:

1. It is very difficult to predict market reactions to expected events (market-timing is very difficult).
2. In the digital age where information is widely and quickly disseminated, it pays to be well-diversified because changes in investor sentiment toward economic sectors / themes can play out very quickly.

Still, top of investors' minds is the timing and extent of possible tax hikes under a Biden administration. The 117th Congress begins on January 3rd, but Senate control will not be known until after Jan. 5, 2021. Based on the latest information, the Senate split appears to be 50 Republicans and 48 Democrats. Neither the regular nor special Georgia Senate races had a candidate capture more than 50% of the votes, so a run-off will take place between the two leading candidates in each race. If the Democrats win the presidency and both Georgia seats, Vice President Kamala Harris would break the tie, giving Democrats control of the Senate. It is not the Blue Tsunami many pollsters had predicted, but it would be a Blue Sweep nonetheless. The policies of a Biden administration would differ dramatically depending on the results in Georgia.

If a Democratic Senate majority does actually materialize, it is probable that cyclical stocks (stocks sensitive to economic growth) could benefit from huge stimulus, while more government borrowing could lead to a steeper yield curve that would benefit financials and be less friendly to high-growth tech stocks. Beneficiaries of the 2017 tax reform might be exposed to higher corporate rates, parts of the health care sector could face regulatory scrutiny, and some energy firms could be forced to contend with strengthened environmental regulations.

Since investors ultimately don't know the outcome or reaction to these outstanding issues, the one known variable is that in the short-term some sectors may benefit, while other sectors may not. Though the losing sectors may underperform in the short-term, companies in those sectors will adapt to the new environment over time, providing new investment opportunities.

continued on page 2

As such, the second point above bears repeating - investors should remain well-diversified in their portfolios to smooth out the unpredictable ebb and flow of the market.

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