Beacon Trust
INNOVATING WEALTH STRATEGY

January 13, 2021

Post-Election Investment Landscape

As calm starts to settle over Washington following chaotic scenes last week, both Raphael Warnock and Jon Ossoff are declared winners of the Georgia runoff races and Democrats are set to take charge of the U.S. Senate with a 50-50 balance and VP-elect Kamala Harris casting a possible tie-breaking vote. Subsequently, Democrats look to have complete control of the federal government with a Biden Presidency and a slim majority in both chambers of the Congress.

Now that we know who will be in charge of governing for the next two years until the midterm elections, the important questions facing investors are what the legislative agenda will look like under the Biden administration and how the lawmaking process may impact investment portfolios.

Democratic leadership in the Senate will pave the way for an easier confirmation of Biden's cabinet appointees, federal judges and Supreme Court nominees. The House and the Senate can also pass certain budget related items under the reconciliation process with a simple majority. However, as it stands now, unless the Senate rules are changed to end the filibuster rules which is a difficult task, most other legislation needs 60 votes in the Senate, which is not easy to achieve on any proposal unless there's widespread support across both parties. Sure, any president can issue executive orders unilaterally, but they are narrower in scope than laws passed by the Congress, and unlike legislation, they can easily be reversed by future presidents.

In a split Senate, there's usually some sharing of power between the two political parties. By way of example, in 2001, the last time we had a 50-50 Senate, the parties agreed to split committee memberships evenly. Early retirements and illnesses can also complicate the outcome of certain votes in Congress, hence there's no certainty of outcome with most policy proposals.

While the leaders of the House and the Senate, Pelosi and Schumer, will set the parliamentary agenda, the power to pass legislation in the evenly divided Senate essentially shifts to centrist politicians such as Joe Manchin, Kyrsten Sinema, and Jon Tester on the Democratic side, and Susan Collins, Lisa Murkowski, and Mitt Romney on the Republican side, who will play the deal making role.

Based on the final outcome of the 2020 elections, here's what's likely to happen on different financial and investment matters:

- Additional fiscal stimulus should pass easily, including an increased amount of $2,000 in direct payments to individuals, and aid to states and municipalities, which was not included in the $900b coronavirus bill that was passed last month.

- U.S. GDP is expected to grow at above-average rate in 2021 due to the pent-up demand following the 2020 recession, however, with additional fiscal spending by the unified government, GDP can grow at an even stronger rate, which can lead to higher inflation and higher interest rates. The rise in yields boosts margins for banks and improves their share prices.

- Taxes are not likely to go up significantly. The possibility of moving just the top individual tax bracket from 37% back to 39.6% exists, as well as increasing the corporate income tax rates and/or capital gain tax rates by a few percentage points. However, an across the board tax increase or taxation of capital gains at ordinary tax rates is not likely. It would take only one moderate Democrat to vote against such legislation to defeat it.

- State and Local Tax (SALT) deduction could be allowed again on federal tax returns. The rationale for repealing it was to not have the residents of high-tax states benefit disproportionally from reducing their federal tax bills than the residents of the low-tax states, but that could change again with the Democratic Party, which represents most of the high-tax states, becoming the majority party in government.

- Tech sector will likely come under pressure with potential for higher corporate taxes, tougher regulation, and higher interest rates. Potential for higher corporate tax rates impacts the tech sector more than others as tech companies currently pay the lowest effective tax rates. The bi-partisan momentum to toughen regulation of the Big Tech companies has been gaining steam over the past few months and a Democratic control of the Congress can only add to the momentum. Lastly, higher interest rates would lower the current value of the future corporate profits and lower the earnings multiple investors are willing to pay for those profits.

- Industrials sector should benefit from increased spending on infrastructure to fix aging roads, bridges, tunnels, airports, railways, utilities, as well as develop the next wave of wireless towers and fiber networks.

- Clean energy sector should continue to thrive with increased spending on renewables such as wind, solar, and hydroelectric power. Electric cars and battery technologies should also continue to do well in a push to reduce carbon emissions.

- Small cap stocks should take the market leadership from large cap stocks, which have done well during the pandemic, with additional federal aid for small businesses. When the economy comes out of recessions, small cap companies tend to outperform historically. They are also less sensitive to rising trade tensions.

- Higher deficit spending can lead to further depreciation of the U.S. Dollar, which makes international stocks, especially those that grow at above-average rates found in emerging markets, more appealing.

- Cannabis stocks, which we do not currently invest in, will likely do well as it becomes more likely to be legalized at the federal level. It's already legal for recreational use in 15 states and for medical use in 35 states.

- Federal minimum wage, which currently stands at $7.25/hr can double to $15/hr. Many argue that the current rate, which corresponds to $15,000 per annum, has not kept up with the rise in cost of living since 2009, last time the minimum wage was raised.

- Renters should benefit with likely passing of additional rental assistance and further extension of the ban on evictions. Student loan forgiveness is also more likely in 2021.

- Progressive ideas such as Medicare for All, Green New Deal, adding two additional states to the union or expanding the number of Supreme Court justices, i.e. "court packing", face slim prospects due to filibuster rules. The highest priority of the new administration and the Congress will clearly be Covid-19, vaccination and the economy.

All things being considered, we think the next two years may be net positive for the stock market. Any negative impact of higher taxes and increased regulation is likely to be more than offset by the positive effects of strong federal stimulus, expected to be in the amount of $2 - 4 trillion in government spending, in addition to extremely accommodating monetary policy by the Fed.

Every Democratic president since Woodrow Wilson (1921) served with full support of a Democratic House and Senate to start his term. The stock market performed well in such periods, up 11.3% on average over the first year of the term. In fact, S&P 500 is up 15% in just over two months since the Election Day. That being said, elevated market volatility is likely to persist over the short-term until we get better visibility on the legislative and healthcare fronts. A selloff is also likely to occur in 2021 as it does in almost every year.

As we wrote in our past commentaries, we do not structure our portfolios based on political events with binary outcomes. Politics can add uncertainty to the markets, but over the long-term, it is not a core driver of the U.S. markets. We view the market fluctuations as a buying opportunity for those areas that previously looked expensive and as a portfolio rebalancing opportunity to bring our investment portfolios in line with strategic targets that are set for each client. Active management is especially important in times of uncertainty that brings a wide range of outcomes for different segments of the investment landscape. We are well positioned at Beacon Trust to navigate through a multitude of investment scenarios in 2021 and beyond.

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