The Election is Over – Or is it? November 2020

OVERVIEW

- **Joe Biden surpassed 270 electoral votes to become President-Elect, but legal proceedings and key Senate races could delay definitive results.**
- **A new Biden administration will likely pursue several policy changes relating to taxes, spending, regulations, climate, etc.**
- **However, with a divided Congress new policies may be difficult to push through, leading to less financial market uncertainty.**

Background

Joe Biden secured the majority of the electoral college votes (exceeding 270) to become President-Elect. Currently, it seems likely that Republicans will maintain control of the Senate and Democrats will hold majority in the House of Representatives. A split Congress should lead to continued gridlock, making it more difficult for the new administration to speedily enact its full agenda. However, outstanding votes in Georgia could still swing the Senate back toward Democrats. Regardless of the outcome of the elections, the immediate task for the new President will be managing the nation's economic recovery from the COVID-19 pandemic. Below, we highlight policy issues most likely to be in focus under the administration and the anticipated impact on markets.

Taxes and Spending

Perhaps the most anticipated change for investors is an increase in taxes on wealthy individuals and corporations (top income tax bracket increasing from 37% to 39.6%, long-term capital gains taxed at ordinary income rates for those exceeding $1 million in income and the corporate tax rate jumping from 21% to 28%).

Biden's justification for raising taxes is to pay for the new administration's increased spending on COVID-relief, state and local governments, infrastructure (clean energy, school modernization and road repairs), childcare, education, health care, retirement, disability benefits, and climate change.

If the House and Senate remain gridlocked, the probability of these fiscal policy changes would be materially reduced. ***Market Impact*** - *positive for equities, negative for municipal bonds, lower yields* for longer.

Regulations

Again, a split Congress could reduce the anticipated regulatory pressure directed toward Technology (anti-trust), Energy (climate/environment) and Banking (Dodd-Frank) sectors, and federal courts may play an increasing role in the outcome. ***Market Impact*** - *positive for equities (favors quality growth).*

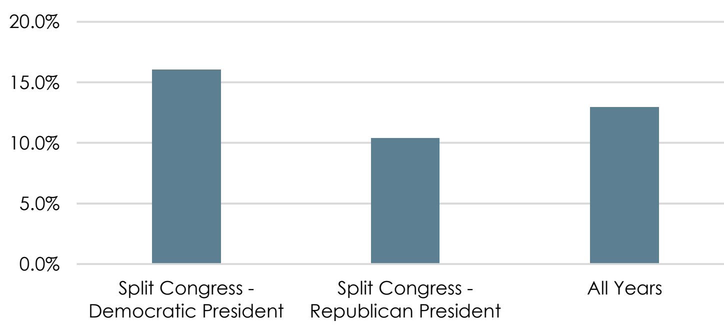
Trade

A Biden administration would likely result in more predictability and transparency on trade, and a more united approach to confront China on technology and intellectual property issues. The use of tariffs is popular with some on both sides of the aisle, so any attempt to eliminate them could meet firm opposition. Biden has introduced proposals to ensure products are made in the US and boost manufacturing jobs, including a plan for the federal government to spend $400 billion over four years on American goods. ***Market Impact -*** *benefit global trade, supporting both US and non-US equities (moderately weaker USD).*

Other Considerations

Should fiscal policy be more constrained, the Fed may be required to adopt a more proactive approach with monetary policy - maintaining lower rates (through 2023), expanding use of lending programs, especially for small businesses and state and local governments. ***Market Impact*** - *positive for equities, corporate credit and duration as rates and inflation are likely to remain range bound and more predictable.*

S&P 500 Index Average Calendar Year Return Under Different Split Congress Scenarios Since 1933



Source: ACG Research, Bloomberg (Return data is YTD through September 2018.

ACG's Position

Volatility can be expected in the short-term as we await the final elections results and investors may react differently based on their political leaning. However, in the long run, Presidential elections generally have limited impact on financial market outcomes. Rather, future returns are driven by fundamental factors: interest rates, valuations, inflation, etc. With that said, a split Congress with a Democratic President, has historically been bullish for equities.

COVID-19 continues to pose a larger near-term risk than any specific policy changes. If the virus is not contained and shutdowns persist, economic growth will remain challenged.

Increased deficit spending will further contribute to the national debt, but it will also incentivize the Fed to keep interest rates low and contain the cost of borrowing. To date, record-high debt and record-low interest rates have not meaningfully impacted inflation. Despite the Fed's best efforts to boost inflation, it has stubbornly remained below the stated 2% target. Valuations will continue to be driven by investor sentiment, which can be difficult to predict.

Even with safe-haven bonds yielding around 1% or less, it is still prudent to maintain some exposure to traditional fixed income, including cash, for portfolio ballast and liquidity. However, for investors seeking to achieve meaningful real-returns going forward, portfolios should include considerable exposure to equities and real estate. Depending on risk tolerance and liquidity needs, investors should also evaluate private market opportunities in equities, credit and real estate, where less transparency and more complexity can create unique opportunities to enhance returns.

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