October 14, 2020

With the first presidential and vice-presidential debates behind us, and less than a month to go before Election Day, now is an excellent opportunity to look at how the markets might react to a Trump presidency versus a Biden presidency. Specifically, I will discuss some of the broader themes concerning the candidates' different approaches that might impact your portfolio. After thoroughly researching this topic, it is not easy to discern from past results what we can expect. That said, there are a few key policy areas where Biden and Trump differ significantly. This newsletter will prepare you with several possible outcomes, each with different implications for policy, the economy, and the financial markets. We feel there are four potential outcomes to consider:

1. Status quo (Republicans retain control of the White House and Senate)

2. Biden presidency with split congress

3. Democrat sweep (Democrats take the White House, Senate, and retain the House)

4. Contested election

We evaluate these potential outcomes from an economic perspective – noting that the main differences between a Trump and Biden presidency will center on taxes, fiscal policy, regulation, and dealing with China trade.

1. Status quo: This outcome would likely cause the least amount of change from the prior four years. Horizon Investments notes, "This outcome would likely be viewed positively by the equity markets, the current market trends would continue. The current corporate tax rate of 21% would remain the same, but we could potentially see lower personal and capital gains taxes. Trump's deregulatory agenda would remain relatively unchanged." Horizon goes on to say, "We'd expect the administration to pursue its deregulatory agenda for energy independence, and finance. President Trump is a vocal supporter of low interest rates and current outlook for 'lower for longer' rates would likely persist in this scenario." [1]



**1401 4th St NE Watertown SD 57201-6027** **608 W 86th St Sioux Falls SD 57108** **www.bigsiouxwealth.com**
**customerservice@bigsiouxwealth** **Ph 605-882-4280** **Fax 605-753-0912**

Another item to watch under this scenario is the relationship between China and the U.S. Horizon remarks, "With rising anti-China sentiment in the U.S. and willingness to go against international norms, it's likely that Trump administration would push for further de-coupling between the two largest economies, potentially leading to a decrease in business confidence and investments as well as market volatility." [1]

Under this scenario Keith Parker, head of Global Equity Research, Global Equity Strategy at UBS, sees about 2% upside for the stock market in the election's immediate aftermath. [2]

2. Biden presidency with split congress: This is the least-discussed electoral outcome that should not be dismissed. Voters have often shown they like a power restraint on the presidency. If votes cast for Biden are meant to reflect non-approval for Trump as opposed to approval of Biden, down-ticket Democratic candidates might not benefit. According to Barron's, a split government of this sort might be the best for the markets. Investors may benefit from Biden's more predictable trade policy and a continuation of Trump's tax policy. "While markets might be assuming a Biden presidency, they aren't pricing in a Republican Senate," UBS analysts say. "That scenario could push stocks up 4% post-election, and prove more positive for markets than a status quo outcome. [2]

   However, Raymond James disagrees with UBS's positive view of a Biden win and a Republican Senate majority. Raymond James contends that this scenario would be the least likely to provide the economy with meaningful fiscal support in 2021. [3]

   When considering this potential outcome, Horizon states, "Major legislation will be difficult to come by in this outcome, muting the market impact of the Democrats' proposals that are currently on the table." Horizon continues, "This is especially true of taxes; it's likely that a Republican Senate would not pass any bill that would increase corporate or personal tax rates . . . [T]he regulatory outlook would become less market friendly, however. Akin to the middle-to-late Obama years, the Biden administration will likely use executive orders and appointments to impose a more vigorous regulatory regime . . . [T]he relationship with China would still likely deteriorate under this scenario but in a more traditional and predictable way then under the status quo option." [1]

3. Democrat Sweep: Horizon states, “A Democratic sweep would be the biggest change from the past four years and presents potentially the most difficult situation for the markets . . . [I]t's reasonable to expect that Democrats would view this outcome as a broad mandate for their agenda.” [1]

While there are many possible policy shifts under this scenario, we will keep our focus on how this might impact the economy and the financial markets. Many assume this so called "Blue Wave" will lead to reversal of policies put in place by the Trump administration, such as broad deregulation or even the Tax Cuts and Jobs Act of 2017. For markets, this outcome will likely mean higher federal tax rates for corporations and individuals. Increasing the capital gains tax is another area in which taxes would be increased, which would pose difficulties for equities broadly. Although none of these proposals are set in stone, Federated Hermes summarizes Biden’s projected fiscal policy below. [3]

## Fiscal Policy Trojan Horse Under Biden?

**Higher Corporate Tax Rates**

- Raise corporate tax rate from 21% to 28%
- Create a minimum 15% minimum book tax rate
- Double the global minimum tax on offshore profits from 10.5% to 21%
- Carried interest treated as ordinary income
- Introduce a financial transactions tax

**Higher Individual Tax Rates**

- Restore the top tax rate at 39.6%
- Tax capital gains (20%) & dividends (22%) at ordinary rates
- Cap deductions at 28%
- Does not fully restore the SALT deduction

**Increase Social Security Benefits**

- Eliminate the income cap on Social Security taxes (12.2%), currently at $137,700

**Higher Estate Taxes**

- Increase tax rate from 40% to a graduated rate of 77%, reduce the exemption from $11.58M to $3.5M, and eliminate the step-up basis on estate taxes

**Double the Federal Minimum Wage from $7.50 to $15 per Hour**

- Higher consumer prices
- Lower profit margins
- Increased unemployment

**Free Health Care**

**Free College Education**

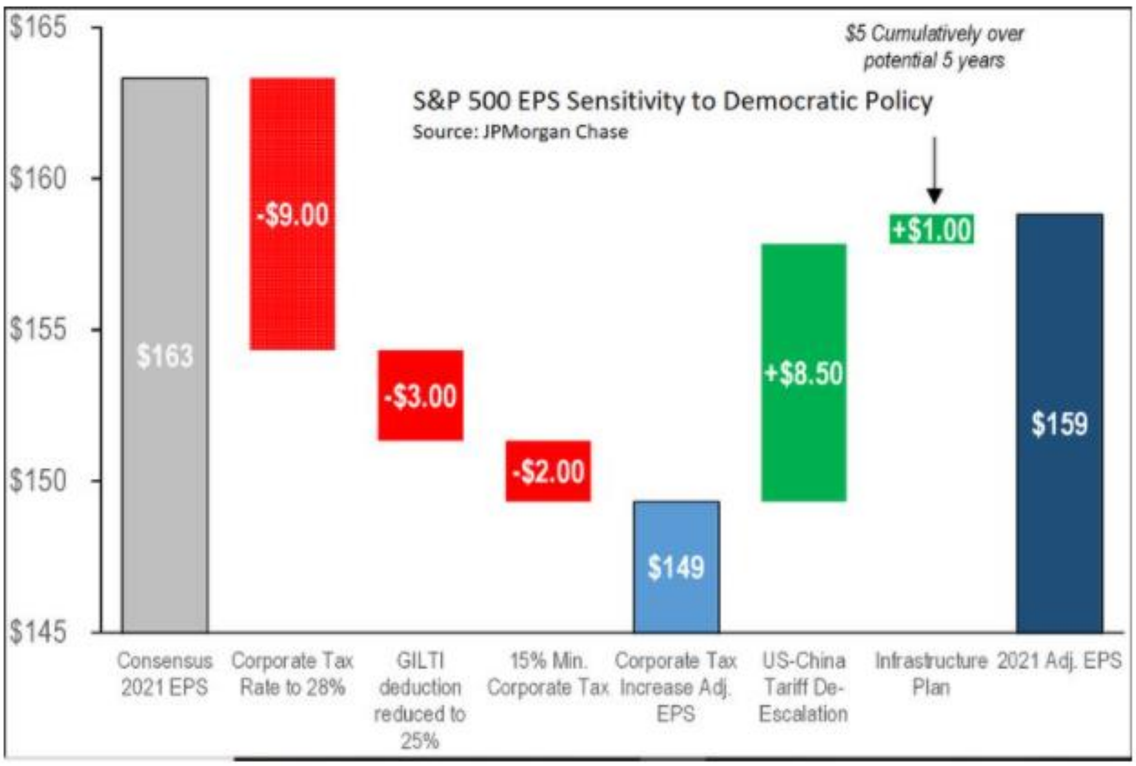
**Absolve $1.6 trillion in student-loan debt**



**1401 4th St NE Watertown SD 57201-6027 608 W 86th St Sioux Falls SD 57108 www.bigsiouxwealth.com**
**customerservice@bigsiouxwealth Ph 605-882-4280 Fax 605-753-0912**

Kay Sean Clark, CIO of Clark Capital Management says, "Biden's plan calls for raising the corporate tax rate from 21% to 28% and raising individual rates on those who make more than $400,000. The hike in corporate taxes would have an impact of reducing corporate earnings per share by between 4% and 13%." [4]

Other estimates, such as that of Raymond James indicates a 5%-8% reduction in annual earnings per share on an index level. [3] However, JP Morgan lays out a case where those lowered corporate earnings could be almost offset by an increase in earnings from potential de-escalation of trade tensions with China and a possibly larger infrastructure plan. The JP Morgan chart can be seen below. [5]



To make matters more unclear, Barron's attributed the recent stock market rally to the increased possibility of a "Blue Wave". Barron's argues that stocks are pricing in a Blue Wave, which would likely bring a "massive dose of fiscal spending". [7]

"If Biden wins, the Democrats take control of Senate and retain the House, the market will likely see an initial sell off of between 2% to 5%, according to High Tower . . . [I]n the past, a Democratic President supported by a Democratic majority in both houses of Congress usually resulted in an initial sell off. 'Not surprisingly, the S&P 500 fell an average of 2.4% in November following the shock of a sweep, declining three out of five times,' says Sam Stovall, Chief Investment Strategist at CFRA Research. 'History hints but does not guarantee the initial shock will send stocks lower . . . [W]all Street always tends to worry about a Democratic President, yet the years in which they have Democratic majorities, the market's advance was the highest,' says Stovall." [6]

"One common mistake according to Michael Zezas, Morgan Stanley's Head of U.S. Public Policy Research, is miscalculating the likelihood of a candidate's policy platform becoming successful legislation, given the often bumpy road from campaign promise to enacted law." [7]

Under the Democratic sweep scenario, it would likely be by a very narrow majority. In that scenario, First Trust says, "We would imagine at least several Democrats balking at immediately imposing tax hikes. Remember, when President Obama took office in 2009, the Democrats had 59 seats in the U.S. Senate, and taxes did not go up until 2013. This was because the Democrats were hesitant to hike rates when unemployment was high and the economy was slowly recovering from the Financial Panic of 2008-2009." [8]

A recent Capital Group report mentioned, "While it's true that a new party typically brings in its own policy agenda, assuming such an outcome will lead to meaningfully lower stock prices is probably over-simplifying the complexities of stock markets." [9]

In summary, while a Democratic sweep may scare some investors and lead to increased tax rates, it may be difficult to pass new legislation, even with majority rule. If some or all of Biden's proposed policies are passed, there may be pros and cons for the markets in general. Although it may not be the best election scenario for the markets, this outcome could be far less damaging than many investors believe.

4. Contested Election: We know that markets do not like uncertainty, and regardless of who is declared the winner, supporters of the opposition may view the president as illegitimate. WealthAdvisor notes," The worst outcome for the stock market is delayed or disputed election results. Several factors could lead to contested results, especially given the rise of mail-in ballots as COVID-19 keeps many people from voting in-person. The last time presidential election results were held up was in 2000, when votes were so tight in Florida that a recount was initiated by the state. The election wasn't fully decided until a Supreme Court decision on December 12, five weeks after Americans cast their vote . . . 'I would very much expect that if we don't have a concession speech right away, either by the challenger or incumbent, it will be bad for the markets. It will be really bad,' says Charles Lemonides, CIO at ValueWorks." [6]

   "From an investment standpoint, we hope for a clear and decisive outcome on November 3rd. Failing that, we hope that a COVID-19 stimulus package has been passed and the Fed is actively supporting the markets on Election Day," says Michael Jones, CEO of Caravel Concepts, LLC. He adds, "If we are disappointed on both fronts, and we expect to be, then we are prepared for a 10% pullback as markets face an extended period of political uncertainty. We will view this pullback as a buying opportunity." [10]

   Ultimately, we expect that a contested election, along with social unrest will be a recipe for market volatility. That is why we are currently encouraging investors to prepare themselves for this scenario -- remember that 'being ready' does not always necessitate action. Often times, we feel the best decision in the face of a volatile market is to hold steady. As we have mentioned before, perfectly timing when to enter and exit the market is impossible to do on a consistent basis.

"Over the past 120 years, the long-term performance of the market has shown almost no correlation with government policies." Brian Levitt, Invesco Global Market Strategist North Americas, says instead, "The key drivers of stock market performance have been earnings and economic growth . . . Other factors -- like the decisions made by the US Federal Reserve -- have a much greater impact on market sentiment than any sound bite we hear from politicians." [11]

Tom Lee, Head of Research at Fundstrat Global Advisors says, “Equity markets are suffering from poor visibility jitters.” He goes onto say, “I still don’t see how anyone can say there should be a wildly different market outcome in 2021 between a Biden vs. Trump White House.” Mr. Lee indicates that he believes at least 90% of portfolio strategy would be identical under either a Trump or Biden win. He attributes this largely to his view that 2021’s economy will be a function of whether the virus is behind us. Regardless of the election victor, Tom Lee believes there will be further stimulus, the virus will probably be contained in mid-2021, and the US economy will be accelerating. Tom Lee indicates the only major difference between the two potential election outcomes is how each candidate will approach taxes. [12]

Goldman Sachs recently laid out a concise summary of different election outcomes, as well as where they anticipate the market to go post-election. This can be seen below. [15] [16]

Goldman Sachs

## Scenario analysis of S&P 500 index level

GS DDM-implied S&P 500 fair value depending on election outcome

**DDM-implied fair value S&P 500 level based on election outcome**

| | S&P 500 price | |
|---|---|---|
| **Outcome** | **Near-term** | **Mid-2021** |
| Divided Congress | 3700 (+10%) | 4000 (+19%) |
| Democratic sweep (expected policy) | 3400 (+1%) | 3800 (+12%) |
| Contested election | 3100 (-8%) | |

Nobody can predict who will win, or what the outcome will even mean for the markets. One thing we are certain of, is that we should not allow election predictions and outcomes to influence our investment decisions. As we laid out in our previous newsletter, history has shown that election results have had very little impact on long term returns. Expect volatility, but don't fear it. We would view any potential pullback surrounding the election as a buying opportunity. The next several weeks will be a challenging time for investor psychology. Our hope is that through putting the election in historical context, as well as discussing the potential outcomes beforehand, you will be prepared to face election volatility with confidence, not fear.

Sincerely,

D.P.

Dustin Padgett



**1401 4th St NE Watertown SD 57201-6027** **608 W 86th St Sioux Falls SD 57108** **www.bigsiouxwealth.com**
**customerservice@bigsiouxwealth** **Ph 605-882-4280** **Fax 605-753-0912**

BIG SIOUX
WEALTH MANAGEMENT

## References


[1] H. Investments, "Horizon Investments Insights, 2020 US Election Outlook," 09 September 2020. [Online]. Available: https://www.horizoninvestments.com/2020-us-election-outlook-financial-market-implications/. [Accessed 09 October 2020].

[2] L. Beilfuss, "Barron's Election 2020," Barron's, 07 August 2020. [Online]. Available: https://www.barrons.com/articles/how-to-prepare-your-portfolio-for-3-potential-2020-election-outcomes-51596842018. [Accessed 09 October 2020].

[3] Philip J. Orlando, CFA, Federated Hermes, "Orlando's Outlook: 2020 Election - Charter vs. Economy," Federated Advisory Services Company, Pittsburgh, PA, 2020.

[4] K. S. Clark, "Election Uncertainty Abounds, But History Can Help Ground Investors' Nerves," Clark Capital Management Group, 25 September 2020. [Online]. Available: https://www.ccmg.com/election-update/. [Accessed 09 October 2020].

[5] B. Joanna Ossinger, "Bloomberg Markets," Bloomberg, 06 July 2020. [Online]. Available: https://www.bloomberg.com/news/articles/2020-07-06/jpmorgan-says-wall-street-is-too-negative-about-a-biden-win. [Accessed 09 October 2020].

[6] F. Sergei Klebnikov, "Forbes Election 2020," Forbes, 10 September 2020. [Online]. Available: https://www.forbes.com/sites/sergeiklebnikov/2020/09/10/a-biden-victory-and-split-congress-is-best-for-stocks-but-heres-what-would-kill-markets-after-election-night/#129e838a24dd. [Accessed 09 October 2020].

[7] Morgan Stanley, "Morgan Stanley Research: 2020 U.S. Election Preview," 08 July 2020. [Online]. Available: https://www.morganstanley.com/ideas/2020-election-forecast-market-outlook. [Accessed 09 October 2020].

[8] First Trust, "First Trust Economics Blog: The Long Slog Recovery!," First Trust, 21 September 2020. [Online]. Available: https://www.ftportfolios.com/blogs/EconBlog/2020/9/21/the-long-slog-recovery. [Accessed 09 October 2020].

[9] Capital Group, "Market Insights: How the elections move markets in 5 charts," Capital Group, 18 September 2020. [Online]. Available: https://www.capitalgroup.com/ria/insights/articles/how-elections-move-markets-5-charts.html. [Accessed 09 October 2020].

[10] C. Michael Jones, "Implications of a Contested Election: The Fed Will Save Us (Eventually)," Caravel Concepts, Midlothian, VA, 2020.

[11] I. Brian Levitt, "2020 US Presidential Election: 10 Truths No Matter Who Wins," Invesco, Kansas City, MO, 2020.

[12] T. Lee, "FSInsight Blast: Would there even be a 10% difference in your portfolio depending upon a Biden vs. Trump win?," FSInsight, New York City, NY, 2020.



**Securities offered through Gradient Securities, LLC. Member FINRA/SIPC, and are:**

**• Not Deposits • Not insured by FDIC or any other governmental agency • Not guaranteed by the financial institution; Subject to risk, may lose value**

**Reliabank and Big Sioux Wealth Management is not a registered broker/dealer and is independent of Gradient Securities, LLC.**

**The individual sending this communication offers securities through Gradient Securities, LLC (Arden Hills, MN 866-991-1539). Member FINRA/SIPC. Investment advisory services are offered through Big Sioux Wealth Management, a SD registered investment advisor. Gradient Securities, LLC and its representatives do not render tax, legal, or accounting advice. Insurance products and services are offered through Big Sioux Wealth Management. Big Sioux Wealth Management and SmartVestor are not affiliated with Gradient Securities, LLC. Gradient Securities, LLC and Big Sioux Wealth Management are not affiliated with or endorsed by the Social Security Administration or any government agency.**