BIG SIOUX
WEALTH MANAGEMENT

October 20, 2020

As laid out in our prior newsletters, our view is that the election is unlikely to have a large impact on the overall direction of the markets from a macro perspective. Nonetheless, on a micro level we are likely to see certain industry groups and individual companies impacted differently. From an investment strategy standpoint, the minor changes we intend to make may only be carried out in the event of a "Blue Wave" (Biden White House victory, and Democrat control of the Senate and House). As a reminder, these potential portfolio changes would be in response to policy changes and made objectively, without political bias. But even so, some strategy changes may not be carried out because of the markets already pricing in the impact of a possible election outcome. Clients who are invested in our discretionary portfolios can take solace in knowing we are actively monitoring and managing their investments. For the minority of our clients who require us to ask their permission before placing trades on their behalf, we invite you to contact us for a portfolio review prior to the election. But to reiterate, discretionary and non-discretionary clients alike should be reminded that we do not foresee the election having a major impact upon the overall direction of the markets. Below, we list several areas that the election could impact, including certain sectors and industries on a micro level.

TAXES

Under a Democrat led White House, Senate, and House of Representatives, new tax reform changes would likely have an impact on businesses and investors. These changes would be seen in the form of individual and corporate tax rate hikes, as well as through an increase of the capital gains tax for individuals. Columbia Threadneedle sees these changes resulting in an average drop in earnings per share of around 5% for businesses -- though this drop is unlikely to be evenly spread across sectors [1]. While we do not see a 5% decrease in earnings per share leading to a broader market collapse given the likely increase in fiscal stimulus, it may lead to a rotation in the market.

Raymond James', Travis McCourt, discussed the impact of a "Blue Wave" in a recent research note saying, "That could all mean a rotation out of big technology stocks into cyclical stocks and investments that benefit from the expected extra stimulus a Democrat-led government would bring." [2]

Horizon investments shared their views on how a Democratic sweep might impact Big Tech saying, "In this outcome (Democratic sweep) the risk to Big Tech is very high, due to both increased taxes and an actionable consensus on how to hinder their strength through regulation. Given Big Tech's weight in the domestic stock market, this could weigh on broad equity indices and potentially cause U.S. equity underperformance versus the rest of the world." [3]

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In the event of a "Blue Wave", we predict many investors will sell their "winners" before the new tax changes presumably take effect after 2020. This will allow investors to pay a lower capital gains tax this year, as opposed to paying a higher tax rate in the future. Considering the large gains tech companies have seen over the last decade, along with the increased oversight lawmakers on both sides of the aisle seem to be pushing for, a "Blue Wave" may be the thing that finally triggers a selloff of Big Tech.

TRADE

According to State Street Global Advisors, they consider Biden to be more of a globalist. They predict he will likely repeal the current tariffs set in place by the Trump administration. Given the sweeping trade powers past U.S. Presidents have wielded, a Biden administration should not have a difficult time implementing their trade policy changes. SSGA's analysis recalls how Trump's Chinese tariffs roiled Chinese equities in 2018. SSGA contends that a reversal of these tariffs could lift Chinese stocks hurt by the 2018 tariffs. Similarly, European countries who saw a number of U.S. tariffs imposed could also see a reversal of U.S. trade policy. This reversal could help to improve investor sentiment in this region as well. [4]

FISCAL POLICY & REGULATION

Columbia Threadneedle presents a compelling sector outlook in their 2020 election piece remarking, "There will also be likely winners and losers on the sector side due to shifts in policy. Energy, financial services and healthcare will likely be affected. Healthcare is interesting – the potential expansion of Medicare and Medicaid may benefit the hospital subsector, but pricing restrictions may impact pharmaceuticals." [1]

Barron's agrees that both parties have high drug prices in their sights, but the risks to shares of pharmaceutical companies are far less without a "Blue Wave". [5]

Columbia Threadneedle goes on to say, "Other sectors such as energy and financials will probably feel the effects of any increase in regulation, as regulation represents a cost to business . . . [I]t's more expense for a company's balance sheet and may affect smaller companies more than large companies that have the resources to deal with the additional requirements. More expense for companies, implies potentially lower returns for shareholders." [1]

Another area of importance is the Democrats' labor agenda, according to Andy Laperriere in an interview with Barron's. Laperriere states, "A Democratic sweep would probably lead to a higher minimum wage and more protections for gig-economy workers, making companies such as McDonald's (MCD) and Uber Technologies (UBER) vulnerable. While both parties have been critical of Big Tech, a Blue Wave would be the bigger threat to Amazon (AMZN), Facebook (FB) and others, since Democrats have been more vocal about breaking up, regulating, and taxing tech giants." [5]

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The Barron's article continues, "The impact of a "Blue Wave" on the economy and stock market could be lessened if spending outpaces tax increases, as seems likely. The effect on corporate earnings would be neutral, Parker (head of global equity strategy at UBS) says. Democrat's spending priorities would center on health care, education, and infrastructure, focusing on an expansion of the Affordable Care Act, universal pre-kindergarten, student-loan forgiveness, and outlays for schools, highways, and a transition to a green economy." [5]

Martin Jarzebowski of Federated Hermes indicates that a "Blue Wave" would result in hundreds of billions of dollars in green energy subsidies, making various alternative energy areas like solar, wind, and others big winners [6]. Cornerstone's Laperriere seems to agree, saying, "Investors creating a 'Biden portfolio' should overweight green-energy stocks." [5] Laperriere goes on to note that under the "Blue Wave" scenario, he also likes a number of infrastructure companies, as well as the cannabis sector. He indicates that the Democrats may relax banking laws that currently restrict doing commercial business with companies in the cannabis sector. Although we as a firm would be hesitant to take a position in the cannabis sector, his view is worth noting.

In a recent Barron's article, they discuss the energy outlook under a "Blue Wave" saying, "A Biden presidency would still mark a dramatic shift and be a boon for solar and wind-power companies in particular . . . Under Biden, it (the transition to alternative energy from traditional energy) would likely accelerate . . . His plan to put 500,000 electric-vehicle charging stations on highways would help vehicle makers like Tesla (TSLA) and General Motors (GM)." [7]

Thomas Thorton of Hedgefund Telementry offers his perspective saying, "It's rather interesting as we head into the last few weeks of the election that the consensus is thinking Biden with a double-digit lead will win easily and bring the Senate majority with him. The markets have been pricing in some of what to expect with a Biden win. Solar and clean energy companies have ripped higher. Cannabis stocks have risen from the dead . . . It seems so easy however it's not over . . . I'd bet this election is a lot closer than the polls and Trump is rallying his base hard." [8]

The Invesco sold ETF (TAN), which buys shares expected to gain from policy support for green energy, closed at $62.52 per share on September 29th, the day of the first presidential debate. As of market close on October 20th, TAN finished the session at $77.73, 24.33% higher than September 29th [9]. Is the pathway to a "Blue Wave" as easy as TAN seems to be indicating?

In addition to a "Blue Wave" seeming to be the market consensus, many economists are beginning to discuss the positives of a Biden presidency. Jan Hatzius, Goldman Sachs Chief Economist, discusses the impact of a Biden administration on the economy insisting, "A Biden win and a 'blue wave' in Congress would be good for the economy because it would likely mean greater fiscal stimulus, more cyclical upside, less trade policy risk and a weaker [U.S. dollar]." [10]

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A Biden administration may lead to a weaker dollar, as well as higher inflation. This may be a positive for some areas of the market and economy, such as farmers and commodity owners. 361 Capital's Blaine Rollins remarks, "Our combined deficits will continue to place long-term downward pressure on the U.S dollar which will only add to upward inflationary pressures. Good news for U.S. based multi-national exporters. And good for gold and your other commodity holdings. Great news for farmers and ranchers once the foreign trade tariffs are removed." [11]

Interestingly, according to 361 Capital, as the odds for a Democrat sweep have increased so have the spreads between 2 year and 30 year Treasury bonds. The steeper yield curve could be pricing in higher inflation and a weaker dollar [11]. In regard to the wider spread, a recent Morgan Stanley piece notes that a steeper yield curve typically signals expectations of a stronger economy ahead. Lisa Shalett, Chief Investment Officer for Morgan Stanley says, "Falling foreign demand for U.S. long duration bonds, even amid soaring treasury issuance . . . could contribute to yield-curve steepening." [12] In regard to sector implications of a steeper yield curve, this environment typically leads to higher profits for financials -- potentially offsetting stricter regulation.

SUMMARY

Should A Democratic Sweep Scare Markets? Probably Not

S&P 500 Index Returns When Democrats Control The White House and Congress

Year	President	S&P 500 Index Return
1951	Harry Truman	23.7%
1952	Harry Truman	18.2%
1961	John F. Kennedy	26.6%
1962	John F. Kennedy	-8.8%
1963	John F. Kennedy/Lyndon B. Johnson	22.6%
1964	Lyndon B. Johnson	16.4%
1965	Lyndon B. Johnson	12.4%
1966	Lyndon B. Johnson	-10.0%
1967	Lyndon B. Johnson	23.8%
1968	Lyndon B. Johnson	10.8%
1977	Jimmy Carter	-7.0%
1978	Jimmy Carter	6.5%
1979	Jimmy Carter	18.5%
1980	Jimmy Carter	31.7%
1993	Bill Clinton	10.0%
1994	Bill Clinton	1.3%
2009	Barrack Obama	25.9%
2010	Barrack Obama	14.8%
	Average	13.2%
	Median	15.6%
	% Positive	83.3%

Source: LPL Research, FactSet 07/14/2020 (1950 - Current)

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

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With the large majority of pollsters predicting a “Blue Wave”, we felt it necessary to spend most of our time discussing what a Democratic sweep could mean for the financial markets. While it is easy to speculate on how various components of the market will perform based on the outcome of the coming election, basing one’s investment decisions on politics is never prudent. If history is any guide, it is impossible to make such predictions consistently and accurately. Gradient Investments, LLC provides an excellent overview saying, “Personally, it can be more comforting when you agree with Washington’s policies philosophically, but your portfolio is not invested in the president or congress. Your portfolio is invested in the economy and the corporations operating in it. You can be a staunch Republican, Democrat, or Independent, but don’t let your political views derail your investment plan. Keep your investment program focused on your goals, risk tolerance, and time horizon and avoid unnecessary complications of mixing political views with the long term objectives for your money.”[13]

We have developed strategies to keep our inherent political biases in check and will not be adjusting our portfolios drastically. It is our opinion that markets tend to adapt and move higher regardless of who wins. Perhaps Jeff Saut of Saut Strategy put it best, “Presidents don’t make markets. Markets make Presidents.”

Sincerely,

D.P.

Dustin Padgett

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