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Election 2020: Potential Market Implications

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Key Takeaways

- The financial markets may experience some near-term volatility ahead of the presidential election.
- Historically, the long-term performance of stocks hasn't been impacted by which party occupies the White House.
- Investors should stick to their long-term strategy and not try to time the market based on the election.

Some people are characterizing the upcoming presidential election as the most consequential election in our country's history. Hyperbole aside, many believe there is more at stake than just the market reaction to the election buildup and results. That said, our role as market analysts and portfolio managers is to focus on the potential portfolio positioning implications of each outcome.

Since World War II, there's been no long-term performance differential in U.S. equity markets based on which party occupies the White House. However, there may be some near-term volatility leading up to the November vote. Aside from the election, the ongoing fiscal relief debate, increasing tension between the U.S. and China, and the progression of COVID-19 infection rates could have a more significant impact on markets over the coming months.

Below is a high-level overview of each candidate's potentially market-moving policy initiatives and the bipartisan initiatives that are likely to be enacted in some form under either administration. Most legislative initiatives will impact individual industries or sectors as opposed to the entire equity market.

Initiatives of Former Vice President Joe Biden

For our discussion of a Biden presidency, we're assuming the Democrats win the Senate and eliminate the filibuster, which would make it easier to pass their agenda. Continuation of a split legislative branch will make it difficult to implement most policies in a gridlock environment.

- **Businesses**
  The most discussed equity market impact of a Democratic win is the potential increase in the corporate tax rate from 21% to 28%. This increase would only claw back half of the reduction included in the 2017 Tax Cuts & Jobs Act. Even so, a higher corporate tax rate could reduce earnings growth in the year it's implemented. It might also negatively impact the onshoring of jobs and manufacturing that has occurred over the past four years. Additionally, higher taxes on capital could reduce access for start-up companies, an important part of U.S. economic growth. It's likely Biden would defer any corporate tax increase if the recession continues or the recovery notably weakens.

  Biden may also use his executive authority to introduce tighter regulation of certain industries, including health care, technology, financial services and energy.

  There has been some speculation that higher corporate tax rates and greater regulation could finally allow the performance gap to close between U.S. and international equities. Closing the gap would be a welcome byproduct for U.S. investors who have suffered lower performance for most of the last decade from diversifying globally.

- **Individual Income and Payroll Taxes**
  In addition to increasing corporate taxes, Biden says he plans to increase the tax rate of wealthy individuals and the wage base for Social Security taxes. Higher rates could help the municipal bond market through increased demand. Any lifting of restrictions on SALT (state and local taxes) deductions on federal income taxes could also boost the market. Greater federal support of state and local governments and a slowing of the recent exodus from high-tax states would improve the credit quality of many municipal bond issuers.

- **Health Care**
  Given his connection to the Affordable Care Act, Biden will probably push for more access to Medicare, putting pressure on private insurance companies. Pharmaceutical pricing will be an issue for whoever wins. Biden, with a Democratic legislature, is more likely to implement painful drug pricing restrictions.

- **Environment**
  More environmental legislation would likely occur, which could benefit the electric vehicle industry and the alternative energy industries engaged in solar, wind, and hydroelectric production. While more green initiatives would come at the expense of the fossil fuels industry, Biden will probably tamp down the more extreme restrictions championed by the Democratic party's progressive wing.

Initiatives of President Trump

There's less mystery surrounding market-moving initiatives in a second administration. For this discussion, we're assuming a split Congress (Republican majority in the Senate and Democratic majority in the House) will accompany a second Trump presidency. Note: A split Congress has historically been the best outcome for stocks as opposed to one-party control, regardless of the party.

- **Businesses**
  The first initiative would likely be an extension of the Tax Cuts and Jobs Act provisions set to expire in 2025. This extension would provide more certainty around corporate tax rates. Any further rate reductions would be difficult with a split Congress.

  Deregulation would also receive significant attention. The energy industry would benefit from increased drilling and any deferral of more onerous carbon emission laws and regulations.

  The stock market's initial reaction to Trump's re-election would likely be positive. This response could stoke better performance from the downtrodden cyclical sectors with the hope of a faster return to pre-pandemic economic growth rates. A cyclical recovery could lead to a broadening of the strong, but currently narrow equity market performance and some closing of the gap between value and growth stocks.

- **Payroll Taxes**
  In recent weeks, the administration has discussed eliminating the payroll tax with funding of Social Security payments coming from the government's General Fund. It's highly unlikely this initiative will come to fruition. If it does, it will put further pressure on the budget deficit, meaning higher taxes elsewhere and possibly more debt financing. The bond market (yields rise) and dollar would likely decline in that environment.

- **Trade**
  Unfair trade practices would remain a focal point of the administration with ramped up pressure on China in the form of additional tariffs. A Biden administration would probably look to repair certain aspects of the relationship while aggressively seeking more equitable trading terms.

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Likely Bipartisan Initiatives

It may seem hard to believe, but both parties appear to agree with certain initiatives, although the scope and approach vary.

- **Infrastructure**
  Given the highly publicized age and condition of our roads, bridges and tunnels, both parties would look to implement an infrastructure spending program. However, aside from these obvious areas, a wide chasm exists about how much to spend and what else should be considered infrastructure. The resolution of this debate could significantly impact industries outside of the engineering and construction space, such as broadband and clean energy.

  Any spending would entail the continued issuance of Treasury notes and bonds at an ever-growing rate to finance the debt. Ultimately, the lack of concern about deficit spending may lead to the "crowding out effect," in which capital for private investment suffers due to excessive government debt.

  Theoretically, this increased issuance should lead to an increase in interest rates. But the Fed's current policy of buying term paper could preclude that occurrence. In addition to the impact of higher taxes mentioned earlier, this deficit-financed spending trend could put downward pressure on the dollar.

- **Onshoring of Manufacturing**
  The move to bring back manufacturing facilities and jobs from overseas has been a major initiative of the current administration and would likely continue under Biden. It's generally more expensive for companies to produce their goods in the U.S. The promise of tax credits and greater utilization of productivity-enhancing production techniques could soften the blow to earnings. More higher-paying jobs could also boost domestic consumption (consumer spending).

- **Technology Sector**
  Increased scrutiny of firms in the technology and social media industries will likely happen in either administration. At this time, the potential magnitude of fines and laws, which could befall the major players in these industries, is uncertain. Any legislation would impact 2022 earnings at the earliest.

What This All Means for Investors

Beyond the potentially market-moving initiatives discussed above, other issues are fanning the flames in these intensely partisan times. As such, a contested election can't be ruled out, with a winner not determined for days or weeks as mail-in ballots are counted. This uncertainty would likely negatively impact the equity markets until a winner emerges.

Regardless of the winner in November, history has shown that timing the market based on anticipated election outcomes is dangerous to your financial health. Staying invested and diversified continues to be the best long-term investment strategy. Financial markets adjust to whatever policy changes occur and find a way to grow in new administrations and old. There is no reason to expect a different outcome this time.

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