November 12, 2020

STEVE ROBBINS, CFP®
WEALTH MANAGEMENT FOR A FLOURISHING RETIREMENT

2020 ELECTION AFTERMATH

First off, this letter has nothing to do with politics. It has *everything* to do with investing.

On Saturday, November 7, major news outlets called the 2020 presidential election in favor of Joe Biden. Once inaugurated, he will become the 46th president of the United States. This election made history, because it marks the first time that a woman – Senator Kamala Harris – will serve as vice president.

Now, elections have become more and more partisan in recent years, and this one was no exception. Some people do not believe the election is decided, and President Trump has filed several lawsuits contesting the results. I'm going to stay away from any controversy in this message and just assume Biden will be inaugurated in January. I'm not doing that for political reasons, but for *planning* reasons. As your financial advisor, you don't pay me to give political opinions**. You pay me to help you plan for the future** — which means we need to plan for a possible future with Joe Biden as president.

Every four years, clients ask me what the elections mean for the markets. I'm going to address that now. But first, I want to stress one *very* important point. Few things stir up emotions as much as politics. When our preferred candidate wins, it's easy to feel elation, or at least relief. But when our candidate loses, anger and fear are both natural emotions.

As you know, though, investing and emotion *do not mix*. So, I want to make one thing very clear: If you are happy with the outcome of this election, then I'm happy for you — **but it's not time to make dramatic changes to your investment strategy.** If you are unhappy, then I understand that this adds to your stress and anxiety — **but it's *still* not time to make dramatic changes to your investment strategy.**

Now, let's examine why by looking at some of the ways a Biden administration may affect the markets. First, I'll give a short primer on a few of Biden's stated policies and how the markets may react to them. Then, I'll discuss two important caveats that investors need to know. Let's start with:

COVID-19[1]

Back in March, Congress passed a bill known as the CARES Act. This provided trillions in stimulus for businesses and individuals impacted by the coronavirus. For months, the markets have been waiting on a second round of stimulus, but negotiations between Republicans and Democrats have routinely broken down.

On the campaign trail, Biden repeatedly stressed that addressing the pandemic would be his top priority as president. To that end, he has proposed enacting:

- An emergency paid leave plan for sick workers or gig economy workers that will cover 100% of weekly salaries or average weekly earnings up to $1,400 per week.
- New interest-free loans to small businesses impacted by the virus.
- An expanded Paycheck Protection Program to help businesses pay their employees and avoid layoffs.

- A Local Emergency Fund that provides states with more resources to expand hiring and unemployment benefits in hard-hit communities. It would also provide mortgage and rental relief for workers who lost their job or had their hours reduced.

These provisions would likely be part of a much larger stimulus package passed by Congress. It's generally assumed that, now the elections are over and political posturing can die down a bit, Washington will find it easier to pass a new bill. The markets have reacted positively to almost *any* bit of news about a second round of stimulus, so it's no surprise that stocks have risen sharply in recent days as Biden's victory began looking more likely.

TAX POLICY[2]

In 2017, Congress passed the *Tax Cuts and Jobs Act,* the most significant update to the tax code in decades. Tax rates decreased for most individuals, and corporations saw the largest one-time tax cut in U.S. history.

Biden's plan is to keep those tax cuts in place for households making less than $400,000 per year. For those making more, he has proposed raising the top individual tax rate to 39.6% (up from 37%). Biden also wants to eliminate a 20% deduction on income from pass-through businesses, as well as limit certain itemized deductions.

For investors, the major item of note relates to capital gains. Specifically, Biden wants to increase the capital-gains tax rate to 39.6% for households with income exceeding $1 million.

On the business side, Biden's plan calls for raising the corporate tax rate to 28%. He also favors imposing taxes on foreign income that U.S.-based multinational companies make.

There are *some* tax cuts to be found in Biden's plan. For instance, Biden proposes "repealing the $10,000 cap on the state and local tax deduction and offering targeted tax credits for middle-income households."[2]

I'm not going to give an opinion here on whether these tax changes are good or bad for the country. I will say that Biden's tax policy is one area that makes the markets nervous, as investors generally favor lower taxes for both themselves and the companies they invest in. Indeed, Trump's tax cuts was one of the big drivers of the historic bull market that dominated the first three years of his presidency. **But there's a *big* potential caveat here that makes reacting to these proposed changes premature.** To put it simply, it's unlikely Biden will be able to enact *any* sweeping tax changes. We'll get to that in a minute.

THE ECONOMY[3]

In the short-term, any stimulus bill Biden signs will make the biggest impact on the economy. Over the long-term, however, Biden has proposed policies he believes will both add more jobs and increase wages. Specifically, he wants to:

- Increase the federal minimum wage to $15 per hour.
- Invest $700 billion in American manufacturing and technology, with $400 billion going towards purchasing American-made goods.
- Strengthen public-private partnerships with American manufacturers, with a goal of creating at least 5 million new manufacturing jobs.
- Expand overtime pay for workers.

Market reaction to these proposals would likely be mixed. Some major employers would probably balk, which investors may not like. On the other hand, increasing the average worker's take home pay could result in increased consumer spending, which is a critical component of our economy.

There's a big caveat here, too, though. More on that below.

TRADE

Biden will likely reverse the nation's trade policy. Rather than use tariffs, as President Trump has done, Biden prefers a multilateral approach to trade negotiations. This means building consensus with key allies, and then pressuring rivals like China to change their trade policies as a *bloc* rather than going it alone.

The markets have taken a dim view of the trade war with China. It was never enough to derail the bull market – it took COVID-19 to do that – but it did lead to periods of volatility from time to time. Biden's more moderate "free trade" approach may be more to the market's liking.

TWO CAVEATS

As you can see, certain aspects of a Joe Biden administration could be net positives for the markets. Others may be negatives. But there are two big caveats here. Two reasons why we shouldn't make wholesale changes to our investment strategy just because of the election.

The first caveat has to do with the prospect of a *divided government.* For the next two years, Democrats will have control over the White House and the House of Representatives. The Senate, however, is still up in the air.

Republicans have enjoyed a majority in the Senate for the last six years. Going into this election, Democrats needed to gain three seats – assuming Biden won the presidency – to flip the Senate. But they were only able to gain two. They also *lost* a seat.

As of this writing, both parties control 48 seats each.[4] There are four seats yet to be called. Two of those four are projected to be won by Republicans. The other two seats, however, will likely be decided in **runoff elections**, meaning we won't know the winners until January. If Democrats win both those seats, the final count will be a 50/50 split, with Vice President-elect Harris serving as the tiebreaking vote. But if they don't, the Republicans will enjoy their Senate majority for another two years.

This is critically important! If Republicans do retain control of the Senate, we will have a divided government. Biden will have to negotiate with Republicans to get legislation passed, which means many of his policies – especially those relating to taxes – will need to be watered down or even shelved. That's why we should adopt a wait-and-see attitude when it comes to Biden's administration. We have no way of knowing exactly what legislative changes he'll be able to pass. In all likelihood, they will be modest. That means the status quo will be largely maintained.

Here's the second reason we need not overreact to the election results. History has shown us that the presidency – indeed, the government itself – has far less of an impact on the markets than people think. Here are some numbers for you to digest:

- On average, the S&P 500 goes up 10.8% under Democratic presidents and 5.6% under Republicans. Either way, the markets have risen over time.[5]
- Historically, when the same party controls both Congress and the White House, the average return on the S&P 500 was 7.45%.[5]
- When power is split and the government is divided, the average return was 7.26%.[5]
- Since 1929, the S&P 500 has risen 13% on average when a Democrat is in the White House, but Republicans control the Senate. [5]

These numbers illustrate an important truth: The stock market isn't driven by one person or one party. It's driven by the ebb and tide of trade. By the law of supply and demand. By innovation and invention. By international relations and consumer confidence.

The market is an *ocean* – and politics but a single tributary emptying into the vast, ever-changing sea.

Now, you've heard me say it before, but I'll say it again: *Past performance does not guarantee future results.* What past performance does do, however, is show us why overreacting to elections and headlines is such a bad investment strategy. When we do that, we are investing based on either emotion or guesswork. Neither are suitable replacements for actual *planning.*

As you know, planning is what we do.

So, what's the takeaway? The takeaway is that you might be happy Biden won, or you might be scared. Both are perfectly normal, legitimate emotions to feel. But neither emotion will drive our *planning*. Some of Biden's policies will affect the markets positively. Others will be negative. Some will have no effect at all, as they'll be swallowed up by the endless waves of news that investors react to over the next four years. So, rather than change our investment strategy, we'll continue to:

- Determine how much you need to reach your financial goals.
- Determine how much risk we must take on to help you get what you need.
- Position ourselves to take advantage of future market growth, while preparing to weather future market volatility.

In other words, we'll continue working towards your goals by relying on planning. Not politics.

I hope you found this message helpful. Of course, if you have *any* questions or concerns, please let my team and I know. That's what we're here for. In the meantime, enjoy the upcoming holiday season!

-STEVE ROBBINS, CFP®

SOURCES

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[4] "U.S. Senate Election Results," *The New York Times,* last updated November 9, 2020. https://www.nytimes.com/interactive/2020/11/03/us/elections/results-senate.html

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