The Implications of a Democratic Senate

January 7, 2021

Democrats have officially secured two additional Senate seats in the GA runoff election, splitting the chamber 50-50 between Republicans and Democrats (including 2 independents that caucus with Democrats). As a result, Democratic Vice President Elect Kamala Harris brings control of the Senate back to the Democrats at 51-50 with her tie-breaking vote as president of the Senate.

The outcome of these elections could prove pivotal in future legislation, notably implications for tax policy, regulation, further fiscal relief, and infrastructure spending. Yet with such a narrow margin in the Senate, as well as in the House of Representatives (222 Democrat, 211 Republican), the most likely outcome is to see policymaking pushed toward the center. For investors, it will be nearly impossible to know what initiatives have a realistic chance of being approved over the next two years. This will mean uncertainty for everything from stimulus spending to deficits and energy policy to healthcare.

POLICY UNCERTAINTY

The Biden campaign has promised to focus on issues such as climate change, healthcare, and racial injustice, which will require increasing taxes in order to accommodate these initiatives. Such measures included a restoration of the 39.6% top marginal income tax rate (currently 37%), reducing the size of the estate tax exemption, and taxing capital gains and dividends as ordinary income for those earning over one million dollars. Yet even with a 50R-50D Senate, there is not Democratic consensus on many of these proposals. The same can be said with respect to healthcare and energy policy, requiring a scaling back of many of Biden's campaign promises.

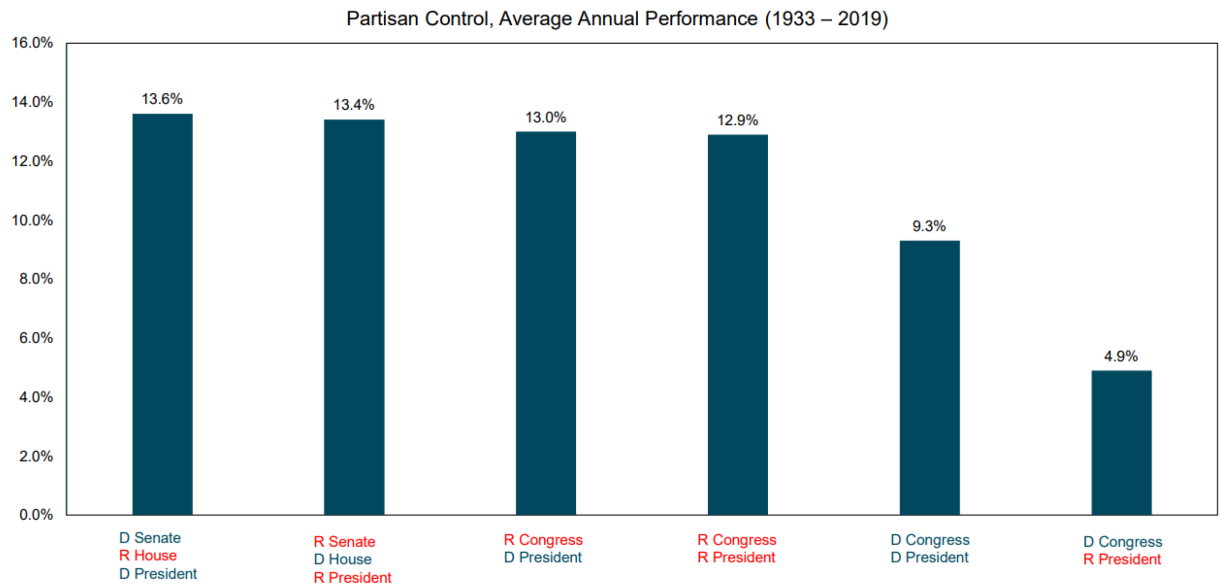
Yet Biden will have the ability to issue executive orders, enabling him to set policy without the consent of Congress. While he cannot alter the tax code in this manner, he can reverse Trump-era regulations related to immigration and the environment.

BIPARTISAN SUPPORT

There are certainly policy areas where both Democrats and Republicans are in agreement. Both parties will look to increase spending on infrastructure projects (roads, bridges, tunnels) in order to create jobs (outside, avoiding the spread of COVID), although how to finance these projects will be up for debate. Additionally, there will be support for changing retirement savings regulations, such as increasing the age of RMDs and the period under which employees can contribute to tax deferred accounts. Ultimately, the slim Democratic majority is enough of an advantage to pass additional fiscal stimulus, but not large enough to pass more ambitious legislation like raising taxes or a Green New Deal.

INVESTMENT IMPLICATIONS

The investment implications of the GA Senate run-off election are largely inconsequential. As we have shared with you in the past, elections simply do not matter with respect to expected stock market returns. Since 1933, a Democratic President and a Democratic Congress have resulted in a 9.3% annual return for investors. This has been by far the most common configuration in the US, occurring 17 times during this period.



Source: Strategas

Under a unified government (such as a Democratic President, House, and Senate) the economy is likely to recover more swiftly. We can see this already, with calls for additional $2,000 stimulus checks in the works.

We expect this news to continue to support our key investment themes – specifically overweighting international developed and emerging markets – as further stimulus, increased deficit spending, and a more robust COVID recovery will likely weaken the US dollar and favor higher growth international markets. It also supports our belief in an economic recovery in 2021, and a subsequent shift to small cap value, which is largely dominated by cyclical sectors such as basic materials, consumer cyclicals, financials, and real estate, and trade at a deep discount relative to growth stocks. From a fixed income standpoint, we would expect to see an additional stimulus package introduced in 2021, which would include support for state and local governments, thus supporting our core fixed income allocation to municipal bonds, while simultaneously supporting our shift into sovereign emerging market debt due to the expected dollar weakness referenced above.

Investors should remember that in the long-run, economies continue to grow regardless of the political configuration of Congress, and markets continue to provide investors with a positive return on their capital commensurate with the level of risk they are exposing themselves to. Maintaining a globally diversified portfolio of stocks and bonds is the most effective means of mitigating any volatility in the short-term.

ABOUT THE AUTHOR

BRIAN LUSTER is a Principal and Chief Investment Officer of Collective Family Office located in York, Pennsylvania. With over 20 years of Wealth Management experience, Mr. Luster has previously served as Founder and CEO of a boutique Multi Family Office in New York City, as the Managing Member and Portfolio Manager of a long/short US event-driven value-oriented hedge fund in New York, and as a Senior Wealth Manager for BNY Mellon Wealth Management in Central Pennsylvania.

An avid thought leader, he has authored over 60 articles covering investing, tax, trust & estate planning, family governance, and next generation education, featured in such publications as Forbes, Barron's, The Wall Street Journal, Private Asset Management Magazine, Family Office Elite, and The Huffington Post.

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