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PEAK CAPITAL MANAGEMENT

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Political handicappers and forecasters do not have any better track record than those forecasting the weather. While the latest election seemed anything but a “Blue Wave” with Republicans in the House picking up seats, the reality is that Democrats now control the White House, Senate, and House and have an agenda ready for their vision of America. The implications are likely to be widespread in terms economic and market impact.

The new President signed 17 new Executive Orders on his first day in the White House, more than the prior 3 Presidents combined. At a minimum, this gives us insight into the direction we should expect the Executive and Congressional branches of government to gravitate toward. Some of these actions have the potential to impact the markets in the short-term, while other priorities, such as tax increases, are likely to impact the economy and earnings gradually.

Here is a look at potentially the most meaningful shifts in policy:

Taxes: President Biden campaigned on reversing the Trump Administration’s corporate tax rate cut, and there is no reason to believe they will not follow through now that Democrats have 51 votes in the Senate. You could argue that cutting the corporate tax rate from 35% to 21% on January 1, 2018 was the largest driver of stock market gains over the following years. Since the tax cut was enacted, the S&P 500 has gained 34%, while the Nasdaq soared over 80%. Analysts from FactSet estimate that returning the rate to 35% will cut earnings on the S&P 500 by approximately 10% from $189/share to $170/share. A drop in earnings of that magnitude has not been priced into the markets today.

Trade: As Vice-President, Biden championed the Trans-Pacific Partnership (TPP) and has been a reliable proponent of free trade. I expect to see many of the punitive tariffs implemented by Trump removed, and trade relations with Asia and Europe are likely to improve. While you could argue that many of Trump’s policies were good for American workers, the economy should benefit from a more free-flowing trade and, at the same time, keep inflation in check.

Energy: Biden revoked the permit for the Keystone XL pipeline on his first day in Office, and the company sponsoring the pipeline announced 1,000 job losses the same day. It has been estimated by some that 11,000 jobs will be lost, but that may just be speculation. Biden also signed an order putting the U.S. back in the Paris Climate Accord that, according to NERA Economic Consulting, will cost 6.5 million jobs and $3T in reduced GDP by the year 2040. Regardless of how many jobs are lost or the economic impact, the reality is that we will see higher energy prices and that will negatively impact earnings and low-income wage earners who are most impacted by rising gas and electricity prices.

Immigration: Changes to immigration policy may have the most long-lasting impact on the economy as more of an “open border” approach is taken to immigration. Work on a border wall was immediately stopped, and steps to make DACA permanent are being taken. The cost burden on states for the increase in immigrants arriving will likely be borne by the Federal government, and history suggests areas with large new immigrant populations stifle wage growth for the middle class, resulting in lower per capita consumption.

With Democrats in control of Congress and the Executive Branch, we should expect to see more stimulus, which should benefit the economy and markets in the short term. Goldman Sachs Chief Economist Jan Hatzius is optimistic about GDP growth in 2021, expecting growth to accelerate to 6.6%, well ahead of the consensus among economist of 4.1% growth. He is expecting a mid-year consumption boom as the economy reopens following successful vaccine administration. He does point out risks associated with a vaccine-resistant strain of COVID that may require a new vaccine to be developed.

There is an interesting divergence occurring in the markets right now, with the sentiment on the NFIB survey plunging more than 5% in December while small cap stocks, measured by the Russell 2000, are moving higher. It is unusual to see higher appetite for risk while sentiment is falling, but it signals the markets may move higher in the short-term.

I am reminded of Newton’s First Law of Motion, which states that a body in motion will remain in motion until acted upon by an outside force. Markets are trending higher, and that trend will likely remain until an outside force, currently unknown, appears. Last year it was COVID, but we saw a V-shaped recovery. It is anyone’s guess what it will be in 2021.