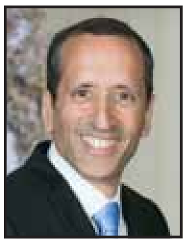
The Election Question



By Jonathan Caplan

As always, the Tishrei holiday season is a propitious time to assess our personal and spiritual needs and goals for the coming year. During the past few weeks, while on hiatus from writing, I have spent much time reflecting on ways to enhance my communication of relevant and timely information in a more interactive way. So, I will be welcoming your input, which will allow me to address a broader range of topics including the economy, financial markets, tax planning and financial planning, just to name a few.

This week's column will introduce the new format with an interesting and timely question recently posed to me by one of my clients. He was concerned about how the upcoming presidential election could impact his investment portfolio.

Q: With the increasing likelihood of a Democratic sweep in November, should I expect stock market performance to remain strong in coming months?

A: In fact, we recently penned an article (posted on our website www.caplancapital.com/investmentreviews) that outlines our thesis as to why the stock market has been hovering near record levels, given the uncertainties engendered by the upcoming presidential election. While some pundits have proffered the thesis that a potential "blue wave" in November would crush stock prices (think higher taxes and increased regulations), market participants have a seemingly different view. As a matter of fact, the stock market appears to be performing better when the likelihood of a fiscal stimulus plan is improving.

Multiple news sources reported that in a September 29 research report, Goldman Sachs stated that "a victory of Democratic candidate Joe Biden in U.S. elections along with his party controlling the Senate and the House of Representatives would be slightly beneficial to S&P 500 profits through 2024." Goldman acknowledged that their prediction was in stark contrast to the consensus of market participants. Moreover, the report concluded that "regardless of the outcome, the resolution of the election should help reduce equity risk premium and support valuations." The bottom line is that once the uncertainty associated with the election passes, the stock market could move even higher.

I believe that the benefits of a stimulus bill from Washington will more than offset the drag from potentially higher taxes in the near term. Moreover, if there is a Democratic sweep in November, we could see a massive spending bill in early 2021. You may recall that the last time a Democratic administration came into office, Congress rapidly passed the 2009 American Recovery and Reinvestment Act. At that time, the size of the stimulus program was a record $787 billion. The necessity and spending priorities of that plan are debatable. But the spending plan came into effect at the dawn of one of the longest economic recovery cycles in U.S. history.

Political junkies surely remember that the Tea Party was born in the wake of that stimulus plan, which was well below $1 trillion. This time around, there seems to be bipartisan support for a multi-trillion-dollar bill. I believe that the Democrats are angling for a plan well surpassing $2 trillion. This type of stimulus will reverberate through the economy for some time.

A large stimulus plan, particularly with an emphasis on infrastructure spending, may be a boon for a number of industry sectors that could be significant beneficiaries. Lagging market sectors such as industrials, banks, energy and materials could accrue some significant benefits. I believe that equity investors are already expecting a surge in profit growth in 2021 if a large stimulus package is passed.

Presidential Transitions From a Historical Perspective

Despite investor skepticism and concerns about potentially higher taxes and regulations, the history of Democratic presidential transitions has been rather encouraging. In the past century there was only one transition from a Republican to Democratic administration that experienced a decline in stock prices in the following year. It seems as if all the hand wringing over a potential transition to a Democratic administration could be overdone.

Up, Up and Away?

Before you take all your assets and go "all-in" on equities, I would like to share some caveats. First, I believe that an election result that is too close to call, where it takes weeks for a winner to be declared, would likely precipitate an adverse impact in the equity markets in the near term. Political uncertainty is the nemesis of equity investor bullishness. Political instability could cause investors to quickly take profits and wait until the uncertainty clears.

Longer term, any delays in the speed to market of a COVID-19 vaccine could cast a shadow on the nascent economic recovery. Moreover, because there is little historical precedent, the potential long-term adverse consequences of these gargantuan fiscal stimulus programs are difficult to assess.

Your Questions Answered Right Here

In the next few columns, I hope to give you the opportunity to have your questions answered. Please submit your questions by visiting our company website (caplancapital.com/contact). Even if I do not have the opportunity to address your question in this column, I will make sure to answer your inquiry directly. Looking forward to hearing from you soon!

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