The 2020 Election & Your Portfolio

ASSESSING THE IMPLICATIONS OF NATIONAL POLITICAL REALITIES AND POSSIBILITIES

In all my years of managing client capital, covering now six Presidential election cycles, I have never received as many inquiries, expressions of anxiety, questions, and general concerns about what this election means to investors. Across all mediums, I have received 20x the communications about this election's impact on one's portfolio that I have received about COVID-19. In fact, I have received more inquiries about this election than I have each election this century put together, more than Brexit, more than various government shutdowns, and more than all the Fed meetings of this century put together.

A good part of this is, of course, not really economic or finance-centric. We live in polarized times politically, and opinions run strong on both sides of the aisle. The incumbent President evokes strong feelings of support from his supporters, and strong opposition from his resistance. The backdrop of a society and economy severely damaged from the health and economic ramifications of COVID-19 has not helped, nor has the tremendous social unrest we have seen across many American cities this summer.

Whether the context be medical, economic, or social, the amplification into politics is clear and understandable.

I do not believe in "hiding the ball" when I write, nor do I believe it is remotely necessary to do so. I am not writing on behalf of my own political or ideological sympathies, though I do believe those being on the table as you read support objectivity and a full and fair read of what I have to say here. But the focus of this piece is to prepare investors for what I believe makes for the best outlook and activity around the 2020 election, not to advocate for my own point of view.

Besides, my point of view is nuanced in 2020. I am a lifetime conservative in the tradition of William Buckley and Ronald Reagan, and I am not sure this sort of classical liberalism is much represented in this Presidential race. Like many fellow conservatives, I find the temperament and behavior of the incumbent President frequently off-putting, even where I may find support in certain (not all) policy leanings (i.e. deregulation, corporate tax cuts, originalism on the court, etc.). I have raised the ire of many these last four years, Republicans because of my frequent frustration with President Trump, and Democrats because I remain ideologically centered as a center-right conservative.

But one thing I can proudly say: ***I have never allowed my political inclinations to color my investment predictive work.*** Don't get me wrong – I can be wrong predictively about all sorts of things for all sorts of reasons, but I work tirelessly to not confuse what I may *want to be* with *what I believe will be*. Investors must invest based on *what is* and *what will be*, not *what they want to be*. I may have been opposed to much of the policy agenda of President Obama, but I never believed that he represented the death of the U.S. stock market. In fact, I pushed back more times than I can count when clients of mine suggested that their dislike of his agenda must equal a bearish view on markets. Coming out of the washed-out stock prices of the 2008 financial crisis, followed by the unprecedented central bank support for asset prices (sound familiar?), the Obama years saw not one single negative year in the stock market! We can debate what could have been with different policies, or why this may have been, but we cannot debate that it was. And to even out the bipartisan nature of my point, I never believed that a President Trump presidency would be the disaster for stock markets that so many high-profile economists and media outlets predicted, either. This, too, was not just because of the policy benefits that may have been on the table (deregulation, tax reform), but also because I have learned in over 20 years of managing money and in studying these things going back a hundred years, that markets do not coincide with politics very often. The connection is highly over-rated.

Truth be told, one of the reasons I should be least concerned of the impact of this election on investment portfolios is not merely the historical precedent for a justified lack of concern, but also because of the very dynamic I described in my initial paragraph … the sheer volume of concern about the issue is, itself, a serious source of comfort. I mean this as a basic reaffirmation of the time-tested principle of *contrarianism* in investing… I have seen modest volatility from time to time around things that people brought up en masse (even that, rarely), but I have never, ever seen something that everyone was talking about for months become a *true, deep, black swan disruption in markets*. The true lasting disruptors in markets have always been unforeseen events (COVID, CLO leverage, 9/11, etc.) – and even those were of limited duration in the grand scheme of things.

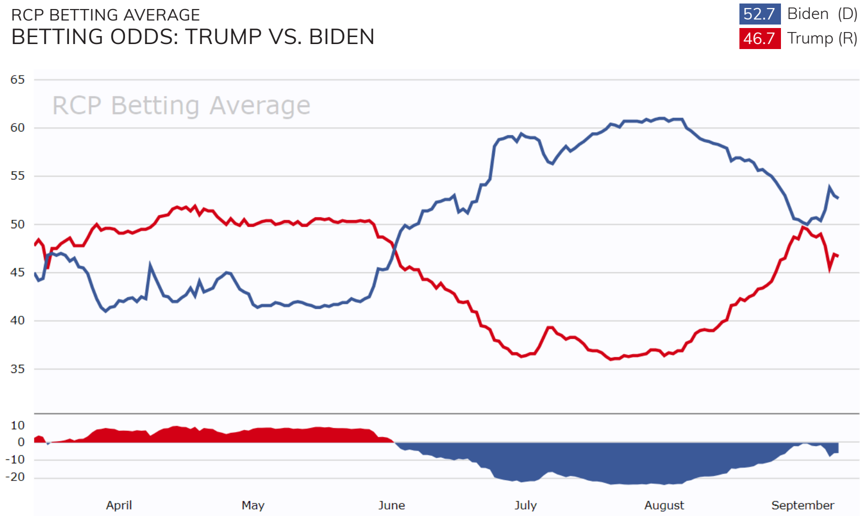
But there is a lot on the line in this year's election. We entered the 2016 period ready for a pick-up in business investment and capex that had been lacking in the prior regime, and that gave a new lift to equity markets that had been pretty flat from mid-2014 through mid-2016. We entered the 2008 election in the midst of the worst financial crisis since the Great Depression. Some policy decisions made things better, and some policy decisions made things worse, but things were bound to get better at some point – they had already dropped so, so much going into that new Presidential regime. You can go back to every new President we have had in your lifetime and the circumstances that drove markets during their time in office, and in every single case you will see unique and specific conditions and realities. The markets are responding more to the economic, monetary, and geopolitical realities of that period than they are the President himself. That is not to say a President cannot impact markets via policy or personnel (they can, indeed, and we will talk about some of those very things in this paper). But it is to say that *Presidents always get more credit than they deserve for what happens in an up stock market, and more blame than they deserve for a down stock market.*

And I really have to make this point: *The investment implications of a Presidency transcend stock markets*. The present investment landscape is not just about equities. The bond market, real estate, credit, interest rates, GDP growth, international investing, commodities, labor markets, wages, currency exchange rates – the list goes on and on of what is impacted in this discussion besides the mere stock market.

So we have a very important conversation ahead, with multiple categories impacted by the outcome. My goal herein is to provide history, perspective, and analysis – all towards the dual goals of (a) Avoiding mistakes that ought to be avoided; and (b) Optimizing decisions which facilitate the successful achievement of an investor's goals. To these ends we work.

Who Is Going To Win?

RCP BETTING AVERAGE
BETTING ODDS: TRUMP VS. BIDEN



Source: REALCLEARPOLITICS

Let's just get this part out of the way up front – this paper will not help you very much in predicting how the election is going to go. I can provide the most current information we have, but (a) That information gets outdated very quickly, (b) Many people do not believe the information, especially if it contains news they do not like, (c) The lesson of 2016 for many, including this author, is that sometimes we just do not know what is going to happen, and (d) No matter what you think, see letter C again.

The right approach to take entering election day is one of humble agnosticism. Those who really believe in a certain outcome, let alone those who really want a certain outcome (especially the latter), simply do not know what is going to happen. The polls on both a national and battleground state basis do reflect a Joe Biden lead as of press time, just as they did a Hillary Clinton lead four years ago. Some polls can be right, some polls can be wrong, but in reality we do not know if the polls adequately capture (a) Who will end up voting, and (b) How they will end up voting.

My amateur study of where the race stands certainly puts Joe Biden in a good position, but with three debates ahead still, and the ability of this news cycle to turn on a dime, I simply have no confidence in my own (or anyone else's) ability to forecast this Presidential election.

The "betting odds" have moved from a significant "Advantage Trump" this spring, to an even bigger "Advantage Biden" this summer, to a recent "tie," with all sorts of expected widening and tightening around the expectations between now and election day.

The Senate races are even harder to call, and there at least four if not more that will likely determine where the fate of the Senate majority is headed. The Republicans enter election day with a 53-47 lead in upper chamber and are very likely to pick up one traditionally Republican seat in Alabama. However, the Democrats seem highly likely (though not assured) to pick up a Senate seat in both Arizona and Colorado, at least based on present polling. That would mean the Democrats need to pick off three seats from the "toss-up" races in Iowa, Maine, Montana, and North Carolina (all currently held by Republicans). Even if the Democrats do pick up three or four seats here, there is some small indication that they may have to defend seats in Michigan and Minnesota, as well, though that theory may be premature.

Either way, the Senate seems very likely to come down to the wire, with one or two states likely to determine which party will have majority control. And if you really want to be frustrated, Georgia has not one, but two Senate seats that will likely be headed to a December run-off based on their unconventional election rules.

To make things more complicated, some of the best indicators of how a Presidential election may go seem obsolete in this COVID moment. Most polls that have President Trump losing to Joe Biden also show voters having more confidence in Trump than Biden on the economy, and yet the economy is in the midst of total chaos around the COVID lockdowns of the spring. The economy was booming before COVID, and is beginning to recover, yet will voters *credit* Trump for a recovery, or *blame* him for the contraction, or neither? It is extremely hard to predict how this parses out in such unconventional times. Historically, a tough economy was a surefire predictor of re-election failure. Might the uniqueness of the COVID circumstance make this time different? Time will tell.

Bottom line: The markets are *well-aware* of the polls and the betting odds and the various scenarios that linger as either possible or probable. But "discounting" with confidence a certain outlook in the Presidential race, let alone the Senatorial outcome, is impossible. As investors we enter the final months before the election with total uncertainty as to what may happen.

President	Herbert Hoover	Gerald Ford	Jimmy Carter	George H. W. Bush	Donald Trump
Years in Office	1929–1933	1974–1977	1977–1981	1989–1993	2017–Present
Lost Election (Successor)	1932 (FDR)	1976 (Jimmy Carter)	1980 (Ronald Reagan)	1992 (Bill Clinton)	?
Unemployment Rate	23.6%*	7.8%*	7.5%*	7.4%*	8.8%
Recession or Depression?	Yes	Yes	Yes	Yes	Yes
Annualized Return	(35.6%)	14.4%	5.7%	13.5%	13.2%

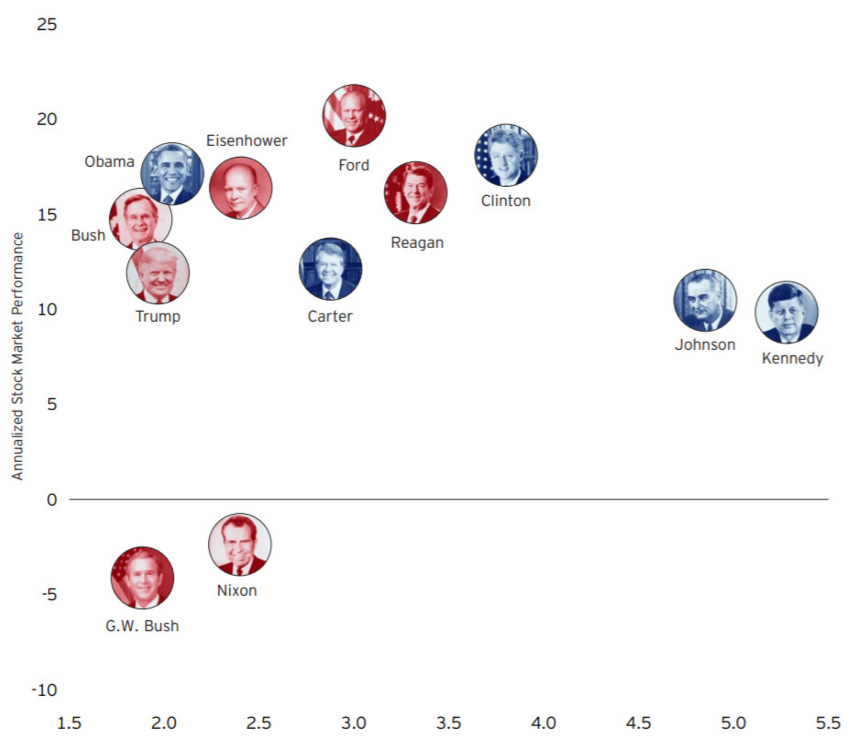
Source: Bloomberg and AB

Historical Realities

I do not buy into any attempt to correlate stock market performance with partisan controls. The market did very poorly under the Republican Presidencies of Nixon and Bush Jr., yet did very well under Republican Presidencies of Coolidge, Eisenhower, Ford, Reagan, Bush Sr., and Trump (the post-March stock market recovery has moved the returns during Trump's term higher). The markets did very well under Democratic Presidencies of Clinton and Obama, but were more muted under Carter, Kennedy, and Johnson (in the latter two cases, the market delivered mediocre returns, but GDP growth was stellar). In all cases, and I mean all of these, I could find three factors per administration that drove markets (either up or down) more important than who was President.

History provides no convenient correlations, and one of the reasons is rather obvious for all but the most partisan among us: ***Markets just plain generally do well.*** Give markets enough time with a Republican President or a Democrat President or a split Congress or a unified Congress or whatever other scenario you want – *markets probably pencil pretty well because the profit motive works, and talented companies and executives are good allocators of capital.*

PRESIDENTIAL TERM STOCK MARKET V.S ECONOMIC GROWTH (1957-PRESENT)



**Invesco Asset Management, 2020 U.S. Presidential Election, p. 3*

If one could prove from any historical data that markets do best with A, B, or C scenario, they would still be arguing only on the margins, as basically most combinations of political possibilities have created pretty similar outcomes over time.

But that itself is a fallacious point, or at least an unhelpful response to a fallacious question, as the real issue is not the political affiliation of the President, but (a) The circumstances in which that President presides, and (b) The policies of the President. Market-friendly policies can come from

S&P 500 AVERAGE ANNUAL PERFORMANCE UNDER PARTISAN CONTROL SCENARIOS

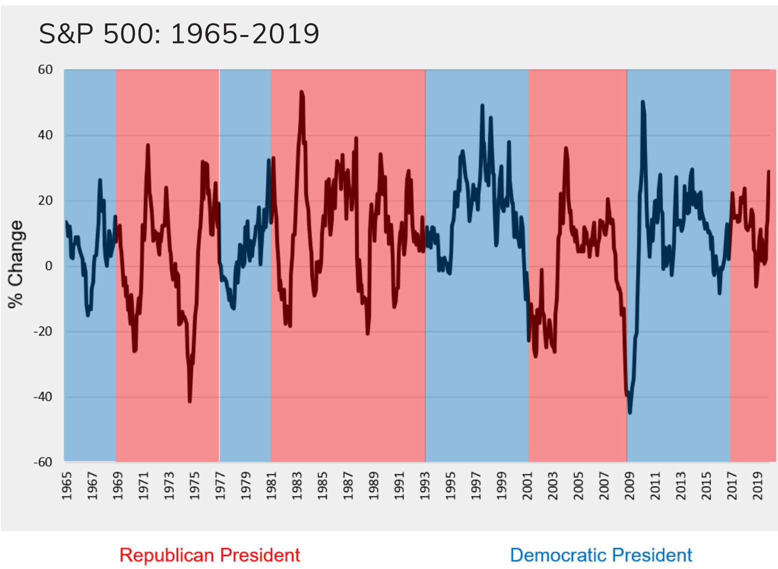
	1933 - 2019		1945 - 2019		1965 - 2019	
Political Scenarios	**% Change**	**# Years**	**% Change**	**# Years**	**% Change**	**# Years**
Unified Government	**10.03%**	**42**	**10.63%**	**30**	**8.79%**	**18**
> Democratic President	9.34%	34	9.79%	22	7.76%	12
> Republican President	12.95%	8	12.95%	8	10.86%	6
Unified Congress	**7.42%**	**32**	**7.42%**	**32**	**7.50%**	**24**
> Democratic President	12.96%	10	12.96%	10	16.28%	8
> Republican President	4.91%	22	4.91%	22	3.11%	16
Split Congress	**10.38%**	**12**	**10.38%**	**12**	**10.38%**	**12**
> Democratic President	13.60%	4	13.60%	4	13.60%	4
> Republican President	8.77%	8	8.77%	8	8.77%	8
All Years	9.11%	86	9.20%	74	8.57%	54

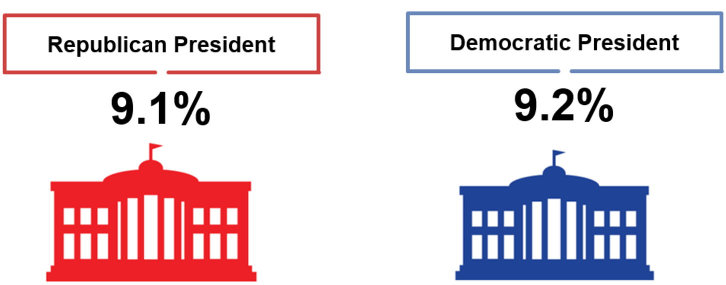
*Data excludes 2001 due to Rep Jeffords changing party mid-year

**Strategas Research, Policy Outlook, June 24, 2020, p. 1* a member of either party, and market-unfriendly policies can come from a member of either party. And, to really top it off, market-friendly policies (for example, Bush's tax cuts) can go against a global economic crisis (see: 2007-2008) and become quite obsolete. Market-unfriendly policies (for example, Dodd-Frank) can go against three rounds of trillions of dollars of quantitative easing (and eight years at 0% interest rate) and also become obsolete.

Please read between the lines, here: *A host of other factors, notably the Federal Reserve, will have a bigger impact on investment markets than the Presidency in nearly all situations.*

None of this is to say that in the here and now there are no implications to investors around the election. It is to say that history forces us to stay humble in trying to align an investment outlook to a partisan outcome. But what is even more humbling, and perhaps confounding, are surprises in the current environment.





Past performance does not guarantee future results. An investor cannot invest in an index.
As of December 31, 2019
Returns reflect annualized returns for each Presidential Term dating back to 1937, based off the Dow Jones Industrial Average.
Source: Thomson Reuters, Bloomberg and AB

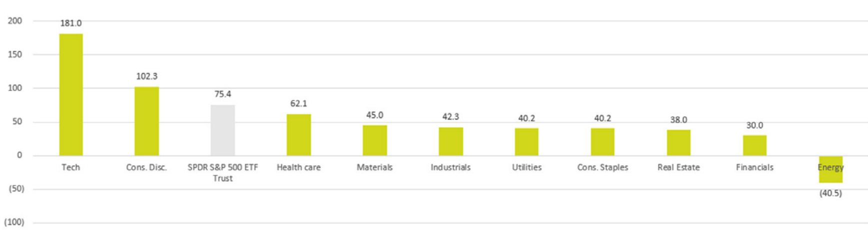
Contemporary Realities

Because one of my explicit goals in this writing is to challenge your underlying assumptions about the way politics impacts investment markets, or to at least challenge the conclusions we often draw from even accurate premises, it may prove useful to look at a few recent realities and see if what we find softens our forecasts for the future.

It seems indisputable that President Trump entered office with a rather acrimonious relationship between him and Silicon Valley. He had made the perceived unfairness of certain tax arrangements, the issue of social media fairness, concerns around privacy, and overall monopolistic threats, all corner-pieces of his campaign and populist angst against the technology sector. Silicon Valley reciprocated, as both a war of words, of campaign dollars, and general political inclination all pointed to a seriously stressed relationship with the President. Additionally, the significant reliance of America's technology sector on China for manufacturing and production was criticized by the President, with frequent threats of disrupting that supply chain which big tech had become accustomed to. It was extremely logical as President Trump took office to assume that the tax and regulatory regime he would implement would do damage to the valuations and business models of at least the "big tech" sector.

On the flip side of that coin, President Trump ran on a platform of energy independence in America. He promised to breakdown the regulatory burdens that were blocking new energy infrastructure from being built, and indeed, his energy department approved dozens of projects previously being denied regulatory approval on a federal level. He appointed the long-time Governor of Texas, Rick Perry, to be his Energy Secretary (a former board member of a major midstream oil and gas company). A pro-fracking and pro-export worldview was at the center of President Trump's energy belief system. Additionally, he promised to ease the burden of the draconian regulatory regime on our financial companies that Dodd-Frank had created years earlier. He appointed as his Treasury Secretary a former Goldman Sachs executive and made his first National Economic Council Director the literal president of Goldman Sachs! I attended an investment conference at the New York Athletic Club in January 2017 where a famous hedge funder who was portrayed by Steve Carrell in the hit movie, *The Big Short*, non-controversially asserted that "the Trump years will be a bonanza for the financial companies who feel they have been held back by Obama-era regulations" (he was not saying it cheerfully).

With the two preceding paragraphs as context, note the top-performing sector in the Trump administration (by a wide margin), and the two worst-performing sectors… One could argue that Technology flourished under President Trump *despite* the political agitation, and that Financials lagged and Energy suffered *despite* political favorability, but that would just make my point for me.



**FactSet, September 2, 2020*

The reality is that things happen in the investing world despite agitations and supports *all the time*. If the politics alone were enough to dictate the result of an investment outcome, then technology would not have flourished as it has and financials and energy would not have lagged as they have.

This truism is not limited to equity sectors. Bond rates moved up significantly when President Trump took office, believing a huge infrastructure bill was coming, and that the real estate developer turned President known for his fondness of excessive debt and leverage would drive up bond yields. And while the COVID monetary response can fairly be described as an outlier, the ten-year bond yield had been cut in half during his term in office even before we had ever heard of COVID. Stock and bond markets do not pay along with our political narratives and assumptions, even when the premises that belie them are correct!

Explaining the Trump Stock Market

When President Trump took office, there was no magical reason the stock market took off. The 2017 performance in markets far pre-dated the corporate tax reform legislation that came at the very end of that calendar year. It would be true that much of the market's performance in 2017 could be attributed to anticipation of a tax reform bill, but after the failure to repeal the Affordable Care Act ("ObamaCare"), it is highly unlikely that the market viewed tax reform as a fait accompli.

Rather, what seemed to instantly change for the economy and markets was not so much a specific policy or legislative act, but a general and broad *confidence* change. The Small Business Optimism index shown below skyrocketed after the election, as did CEO confidence and any number of various business condition measurements.

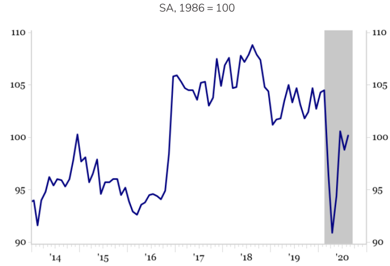
This same index obviously took a beating in the COVID shutdowns of spring, but has begun to climb in anticipation of re-openings, some form of normalization, and of course, the various stimulus measures that have been thrown at the economy.

More significant to me than even "measurable" questions like where corporate tax policy may go after the election is where overall business optimism might go. The reason business optimism (confidence) matters to investment markets is not mere "feel-goodism" or even Keynesian "animal spirits." Rather, as we saw in 2017 in spades, business confidence drives business investment, and the capital expenditures that come from that investment are part of a virtuous cycle for investors. The capex itself creates economic activity and investment opportunity (materials, industrials, etc.), but more importantly, it creates growth and productivity out of the life of the investment itself. Declining investment today means decreased productivity later; enhanced investment today means increased productivity later.

Out of the financial crisis and into the years of President Obama's two terms in office, business confidence and investment never resumed to trend-line level. As markets flattened out from 2014 to 2016 under this phenomena, it was the business optimism of late 2016 that sparked the next move higher in equities. However, the November 2016 through February 2018 rally driven largely by this very thing I describe was abruptly interrupted by the uncertainties of the trade war throughout 2018. Fast forward to the resolution of that trade war in 2019 combined with a more accommodative central bank, and the market rally resumed.

To summarize the Trump stock market (up over 50% since he took office cumulatively), there has been a pick-up in business confidence that is now at a crossroads. Where capex will go from here will have a lot to do with the next inning of this economic cycle. The trade war and now COVID have dampened capital investment plans, yet all things considered the outlook has been more positive than we have seen since before the financial crisis. Yes, the corporate tax cut enhanced stock market returns in this Trump term in office. ***But the story of the last few years in the economy and the market, and the story of the next few years, will largely come down to the business investment necessary to drive enhanced productivity in the economy.***

NFIB: SMALL BUSINESS OPTIMISM INDEX



Source: National Federation of Independant Business

Our System of Government

As we now delve into what various risks and what opportunities we see in potential 2020 election scenarios, it is incredibly important to remember the greatest portfolio hedge investors have ever had from the various dysfunctions of Washington D.C. – our system of government. I here refer to four primary things:

(1) SEPARATION OF POWERS – a President can desire as policy objectives a variety of things that are negative to markets, but the executive branch the President chairs is but one branch of government. The legislative and judicial functions, co-equal branches, are both vital to the administration of government (lawmaking in one branch; law interpretation in the other).

(2) CONGRESSIONAL CYCLES – the House of Representatives, required for legislation to become law, requires a re-election every two years, historically ensuring a constant shifting of the center of power, and forcing incumbents to stay accountable to their constituents if they ever become too partisan, too extreme, or too inefficient.

(3) SENATORIAL ZONING – while local House districts can be (and are) quite "gerrymandered" to particular demographic and socio-economic trends of that local district, it is quite difficult to do that for an entire state. That our U.S. Senators have such significant leverage in their legislative voting, and yet must appeal to the voting needs of their entire state, not just one "zone," has facilitated a more moderate approach to legislation from most Senators concerned with their electoral prospects.

(4) NON-IMPERIALISM – it is, candidly, my opinion that even in the non-imperialistic approach to government our country has which seeks to limit powers over the administration of the economy the President may have, there have been too many executive orders from both Presidents Trump and Obama in this regard. That said, and especially relative to most countries, the President is limited in how much impact they can have over the economy based on the authorities they have, and the basic structures of government.

I dare not suggest that the Presidential race has no implications for investors or the economy because of our system of government. From executive orders to personnel selection in cabinet departments, the President still has plenty of authority and oversight, not to mention their required signature in what bills become a law. However, whether your favorite founding father is Alexander Hamilton, James Madison, or Thomas Jefferson, a significant and intentional effort was put into limiting the power or impact a single political figure can have. That Constitutional reality has served our economy (and country) well for almost 250 years.

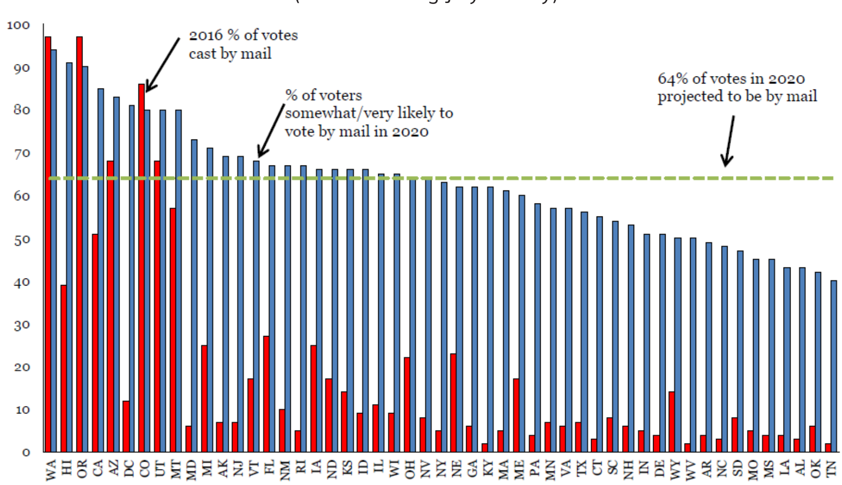
Various Risks & Concerns out of the Election:

#1 NO WINNER (FOR A TIME)

I remain somewhat confused that neither party seems to see what many of us can see coming from a mile away – and that is a contested election where neither side trusts the outcome of a close election. The possibility of an uncertain outcome the night of the election itself is extremely high unless the results move to "blowout" territory for one candidate or the other (a double-digit win, for example), something that seems unlikely in our highly split country and with our electoral college system. Large-scale vote disqualifications (even if procedurally necessary and valid) will be divisive and contested, as well a reliance on mail-in ballots to secure a victory. Should the election come down to a Bush v. Gore scenario where there is one state that will determine the outcome (or more likely in the 2020 version of this, a few states), court battles and various fights and contests could take s to sort out, creating an uncertainty that will rattle markets.

What can one do about it? Not much. Obviously they can hide a portion of their portfolio in cash for a few s or so, but it is hard to see what benefit that will produce. It will create a timing risk in the exit. It will create a huge timing risk in the re-entry. It will likely create a substantial tax ramification. And it will forfeit portfolio income generation in that time period. And for what? A modest and partial avoidance of the possibility of a couple s of gyrations? Those gyrations are (a) Embedded in the reality of being an investor, and (b) Impossible to foresee, predict, or manage, *especially in the dynamic I am specifically describing here*. Do I believe we will have a couple weeks of volatility and confusion? I think it is entirely possible – let's even call it 50% - which is not huge odds, but it is not small, either. Do I think we will have resolution in terms of who our next President is? Most assuredly. After that legal resolution comes, will there be one side who is aggrieved that their side was denied electoral success, even resulting in enhanced social unrest? I would gently say that such is a "distinct probability." And do I think that will impact markets beyond a few days or few weeks? Absolutely not.

PROJECTED 2020 VOTE BY MAIL PERCENTAGE VS. 2016
(Covidstate.org July Survey)



**Strategas Research, Election Chartbook, September 2020, p. 31*

#2 TAX POLICY

No area is more quantifiable in concerning investors than potential changes to tax policy. Even this area cannot be fully assessed in advance of the election, because (a) No presidential campaign proposal in the history of presidential campaigns has actually turned out to be passed tax law, and (b) The outcome of the Senate will determine if the entire Biden tax proposal is dead on arrival, or else just partially modifiable.

Ironically, as Joe Biden is campaigning on raising taxes on the wealthy and on corporations, his proposal calls for bringing the back the so-called SALT deduction (state and local taxes) – a deduction repealed in the Trump tax plan, resulting in higher taxes for high earners in high tax states like California and New York. If Biden were successful in repealing this deduction, even with the slightly higher marginal rates he is proposing for the top income bracket, the net result would be significantly lower federal income taxes for high earners in high tax states.

Biden is calling for a 28% corporate tax rate, up from the 21% rate President Trump signed into law, but down from the 35% rate we had throughout the Obama/Biden years (and many years before that). This produces a mathematically measurable [negative] impact on corporate profits, but does not seem to be one that Wall Street could not wrap its arms around. Furthermore, the most significant impact of the Trump corporate tax plan was repatriation of foreign profits, something already successfully done to the tune of over $1.2 trillion (that capital is back onshore, post-tax, and going nowhere).

Apart from the Biden tax plan's negatives to markets, the additional possibilities for supply-side growth initiatives in a second Trump term would surely be off the table if Biden were elected. The market is hardly expecting these things, though, so an immediate negative impact is not likely, but there is an opportunity cost in markets to not receiving an extension and expansion of business expensing, capex deductibility, etc.

The most damaging proposal from a Biden administration (for investors) would be equalizing the dividend and capital gain tax rates to that of ordinary income rates. One could include the idea of an enhanced payroll tax of 12.4% on incomes over $400,000 as well, but truthfully it is hard to believe either of those changes would become law. But they could, and that risk cannot be dismissed out of hand. My best guess is that should Biden prevail and have a Democrat majority in the Senate, ***securing the votes of moderate Democrats would require a much watered-down tax plan from what is currently on the table*** (not to mention that has to be the political self-interest of 2022 midterms).

The Biden team has circulated a proposal to eliminate step-up in basis on capital gains at death. I strongly suspect that such a statute would end up only being applied to estates over a certain threshold in size (i.e. $10 million). The policy is, no doubt, a net negative to those who have saved capital with the goal of transferring to their heirs some day without burdensome capital gains tax (which itself does not factor in the role of inflation). However, such an elimination of step-up could also incentivize capital gain realization now, promoting new capital formation and reinvestment, rather than holding an asset that has seen its best days. I do not favor eliminating basis step-up, but in the details there would very likely be a short-term offset to the long-term consequence. (I should anecdotally mention for real estate investors, the Biden tax plan calls for significant roll-back of the 1031 tax provisions that allow for capital gain deferrals by exchanging into a new like-kind property; this strikes me as exactly the kind of proposal someone campaigning would mention, who has not yet faced the mighty arm of the real estate lobbying industry).

In past cycles I would have forecasted that elevated taxation on dividends or even taxable bonds (because of higher marginal income rates) would be a boon to tax-free municipal bonds, but in the present rate environment with tax-free yields already south of 1%, it does not seem there is much margin for that asset class to be the net beneficiary of such a move. I anticipate Biden potentially doing what President Obama did with his tax proposal – which is "punting" it past the mid-terms, allowing the COVID economic conditions to be a cover for such (President Obama punted elevated taxes on investment income all the way to 2012, after his re-election, and then didn't even raise them!).

I do not disagree with my friends that "this time could be different." I disagree with those who suggest we should cut off our nose to spite our face. Investment policy cannot be made out of tax policies that might get passed in some time frame if a candidate wins and if there is sufficient legislative support. There are four or five variables at play here that simply require patience and prudence.

#3 ELIMINATION OF FILIBUSTER

A legitimate and concerning risk that lingers in the event of a Democratic sweep (i.e. Senate majority and White House) is the idea that the procedural tradition of the filibuster which essentially makes a 60-vote majority in the Senate necessary for successful passage of legislation would be repealed. A few comments are in order:

1. I am skeptical that this will be an easy sell for moderate Senate Democrats. Even with 51 or 52 Senate Democrats, it is not clear to me they would have the 50 they need to amend Senate rules to strike the filibuster. Sen. Sinema in Arizona, Sen. Manchin in West Virginia, and Sen. Tester in Montana are all on the record opposing the abolition of the filibuster. Additionally, the Senators who, in this scenario, deliver a majority to the Democrats (swinging purple states from red back to blue) will be under tremendous pressure from their constituents to not enact such a radical measure. Joe Biden has also previously expressed strong defense of the filibuster as “protecting the guard rails of democracy,” but our radar is up on a potential shift in his position since President Obama has come out in favor of striking it.
2. For those who remember Harry Reid amending Senate rules to make it easier for the approval of Democratic judges, the lesson is rather clear that when Senatorial rules are changed to benefit one party, it is only a matter of time (sometimes not very much time at all) where that rule change will bite the party that enacted it, hard. Though the filibuster has served to limit the excesses of both parties for two centuries, and has traditionally forced more coalition-building and compromise in the legislative process, a repeal of the filibuster would make certain Democratic wishes easier to come true now, and would make certain Republican wishes easier to come true later. What is sauce for the goose is sauce for the gander.
3. A more likely scenario, in my opinion, is that Democrats wait for a particular bill (that has decent public support) which cannot get the 60-vote threshold, and then use that bill to drive partial changes to the filibuster, but not a full repeal. An aggressive use of the budget reconciliation loophole is also likely (as both parties have done countless times going back to 1980), whereby legislation can be fast-tracked by simple majority as long as it is attached to a broader spending or budget bill. There are parliamentary limitations, but it is a pretty broad brush for skirting the filibuster.

Ultimately, the concerns I would have about repeal of the filibuster speak more to the benefits it represents in our democracy than anything particularly portfolio-sensitive. And to the extent there are regulatory matters that may get forced through now in the event of a repealed filibuster, I believe markets would have to weigh that against the offsetting impact of (a) The damage it would do to the incumbent party in the next election, and (b) The blunt instrument it would provide the other party for use in the future (see: judges).

#4 ENERGY POLICY

This is the only area you will see in both the "risks" section of this paper and the "opportunities," and there is a good reason for this. The rhetoric against the fossil fuel industry will be severe in a Biden administration, but of course rhetoric against the fossil fuel industry is severe in all sorts of mediums these days, with little effort to differentiate coal from crude oil from natural gas, etc. There is no question that various pipeline approvals are likely to face headwinds in a new administration, which has the ironic effect of boosting up the value of legacy assets that now face less competition for their services. My experience with more stringent regulation on sectors like this hurt smaller players and benefit larger, more entrenched ones, which is where I see both risk and opportunity in this potential election outcome.

A Biden administration policy in line with the Obama policy on fracking would not be as damaging to the upstream or midstream energy sectors as some policies in circulation would be. But in no scenario should a Biden energy portfolio be seen as favorable as the current administration's posture would be. Ultimately, this sector will perform off of its present valuation and its cash flow fundamentals, far more so than from the political/regulatory environment.

#5 INCREASED FINANCIAL REGULATION

As mentioned earlier, the de-regulatory relief that Secretary Mnuchin, NEC Directors Gary Cohn and Larry Kudlow, and President Trump collectively brought to the financial sector did not push the financials up to the top of the pack in sector performance. But nevertheless, Wall Street benefited from some relief in what had become an excessively and often inefficiently stringent regulatory environment. On the margins, I have no doubt that the banking/finance sector would benefit more in a second Trump term than a Biden one. But the extent of that margin is unclear at this time. Two things will dictate how this plays out:

1. **PERSONNEL** – will a President Biden surround himself primarily with the neo-Keynesian influences of the Clinton and Obama regimes, or will he incorporate less conventional voices that are more progressive and even extreme in their views of capital markets? Bluntly, will Elizabeth Warren have a voice in his financial administration (Treasury, Commerce, CFPB, etc.)? This will be monitored closely.

2. **CLAWBACKS** – it is one thing to not extend the same deregulatory philosophy to economic matters, but it is another to actively un-do some of what has been done. An attempt to re-amplify pressures around the Volcker rule, capital requirements, etc. will not be viewed favorably.

One area I expect to see non-partisan pressure on is that of share buybacks. Both high profile GOP Senators and Democrat leaders have taken to vilifying the concept of stock buybacks as a legitimate form of stewarding corporate profits. Any governmental intervention to such shareholder capital return may play to a populist appetite, but will interfere with valuations (across financials, but also other sectors of the public markets).

#6 CHINA DECOUPLING

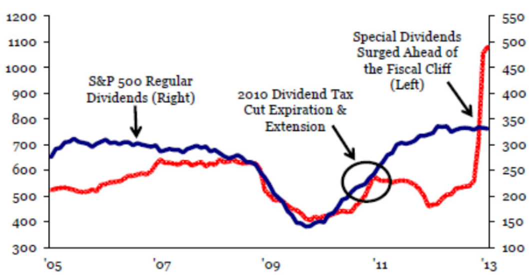
I absolutely admit that President Trump's rhetoric on U.S.-China relations has been and will be firmer than candidate Biden's, but I also believe some significant decoupling of the U.S.-China relationship is inevitable. Where this election will matter is in the speed, tone, and perhaps effectiveness of this process. I do imagine the blunt instruments of tariffs are less likely to be used under a President Biden, and I do imagine an acceleration of on-shoring vital U.S. production (pharmaceuticals, national security, etc.) will take place a President Trump. But I think companies or sectors more reliant on China for revenue and access to markets would, on the margin, likely benefit under a Biden administration. However, I believe the country's appetite for a decoupled and re-defined relationship with the Communist regime is unlikely to dissipate regardless of who is President.

Opportunities & Ideas

By now it should be clear to you that I do not have a forecast of how the election will play out in November, and while I am not wringing my hands over what the election may produce, I do see various challenges and headwinds certain scenarios are likely to produce. However, it would be incomplete analysis and rather pedestrian to ignore that potential areas could become opportunities based on certain outcomes. These things are not as executable in advance as we may wish… the nuances of our separation of powers do not make for an easy binary view. The policy wishes of a President must be reconciled to what is legislatively possible. Here are a few themes that will be on our radar based on different election outcome possibilities.

1. If Joe Biden is elected, we would expect a handful of U.S. companies to pay out **special dividends** prior to December 31 of this year. There is historical precedence for this in anticipation of the fiscal cliff in 2012.
2. Few things have ever had more bipartisan support and less of a path to getting done than **Infrastructure** spending. The House Democrats success in the 2018 midterms kept President Trump from getting his desired infrastructure bill, just as House Republicans in the second half of the Obama administration kept him from getting his. In both cases there were policy differences on what exactly an infrastructure spending bill ought to look like, but the sheer politics of it kept a compromise from being reached. The COVID moment and local state pressures are likely to now force the issue, regardless of who wins. From highway spending to transit, rail, water, and broadband, some federal infrastructure bill is very likely to get passed in 2021, and select engineering, construction, industrials, and machinery companies should benefit.
3. The simplistic call when it comes to **energy investing** is to say that a Democratic success in November bodes poorly for fossil companies and bodes well for so-called green energy companies, whereas a Republican success does the opposite. The truth is far more nuanced. Very large integrated U.S. energy companies like the idea of a carbon tax, in that it hurts their competitors marginally far more than them and enhances their opportunities in the marketplace. It also benefits non-U.S. energy companies who already have such cost structures priced into their stocks. Renewable energy names may also receive a boost in a Democratic agenda, but that boost cannot be a substitute for proper business fundamentals, a lesson many "green" investors learned the hard way in the Obama years.
4. One could argue this is true regardless of how the election goes, but greater exposure to **market neutral alternatives** (relative value, arbitrage, long/short credit, etc.) that derive their risk and reward less from directional equities and more from manager talent.
5. This also can and should be said regardless of election outcome, but there is always a benefit to the more **defensive and durable** parts of the market when one fears any macro risk. The most partisan person on the planet can't possibly believe that "the other candidate" will make diapers, your electric bill, bottled water, your phone bill, and toothpaste less important. **Consumer Staples, Telecom,** and **Utilities** are not growth sectors of the market, but if it is political headwinds one fears, defensive sectors have a reputation for a reason.

S&P 500 REGULAR DIVIDEND INCREASES & TOTAL SPECIAL DIVIDENDS, 12 MO. ROLLING

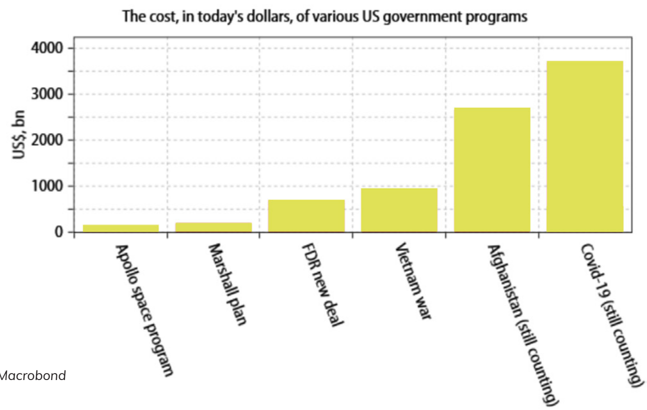


Strategas Research, Policy Outlook, June 2020

Fears Around the National Debt

The question of budget deficits and national debt needs to be addressed. The unprecedented COVID moment and stimulus/relief efforts that have been attached to it have resulted in the largest budget deficits as a percentage of GDP our country has seen since World War 2. Where future political leadership takes current national debt (~$27 trillion) and takes ongoing budget deficits (near $3 trillion for the current fiscal year, but still likely in the $2 trillion range for the 2021 fiscal year), is a profoundly important issue.

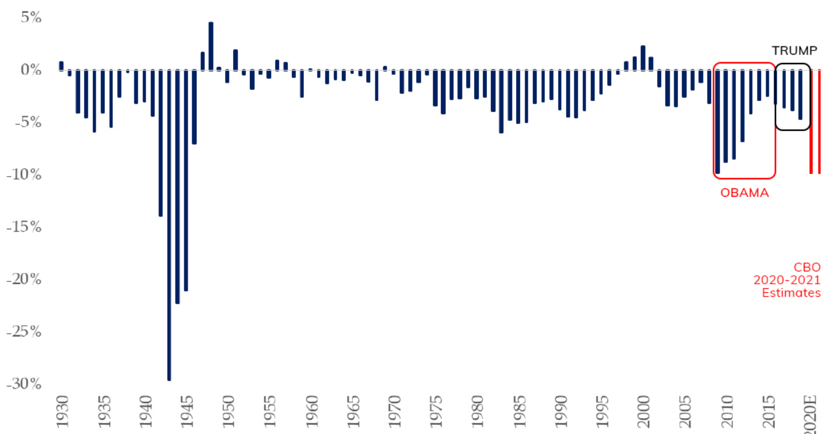
BIGGER THAN EVERYTHING THAT WENT BEFORE



Source:
Gavekal Data/Macrobond

Note in the chart below how budget deficits as a percentage of our economy were growing each year well before COVID. They were at peak post-war levels in 2009 and 2010 coming out of the financial crisis (reduced recession-era revenue and increased government spending that sparked the tea party movement), and the deficits came down each year thereafter as the economy moved further away from the crisis.

FISCAL YEAR FEDERAL BUDGET SURPLUS (DEFICIT), % OF GDP



Source: **Strategas Research, Policy Outlook, June 2020*

But something else happened in 2011 and beyond that brought the deficit down, and it was the same thing that led to budget surpluses in the late 90's, and reduced deficits in the second Reagan term (all of which are visibly evident in the second chart on the previous page): ***Divided Government***. There is no more restraint on federal spending, apparently, than when one party controls the White House and another party controls the legislative branch. Call it rank partisanship, selective fiscal discipline, or generic government dysfunction, but budget deficits tend to decline when there is divided government in our separation of powers, even if the reasons for this are less than noble.

My view is that a Democratic Senate and Biden White House would grow deficits. My view is that a Republican Senate and Trump White House would grow deficits. And my view is that a Republican Senate and Biden White House would shrink deficits (maybe not substantially, but directionally). I also believe a Democratic Senate and Trump White House would shrink deficits, but it is that combination politically I find least likely out of the 2020 election (though not impossible).

The sad reality of America's national debt situation is that it really is not going to be much impacted by what happens in the 2020 election. Neither candidate is pretending to run on a message of spending restraint, and neither candidate's support base seems to be asking for such. I suspect America's fiscal state (including entitlement reform) will be a bigger campaign issue in 2024 than it is now, but the major investment implications of the high levels of current deficits are simple reinforcements of our "Japanification" theme:

A. No appetite exists from elected officials or most of all the people who elected them to reduce government spending

B. Crisis level spending out of a place of a budget equilibrium is one thing; but crisis level spending on top of already trillion-dollar deficits is another

C. High levels of government spending as a percentage of economic activity compresses growth and re-allocates capital out of the productive private sector (i.e. it is deflationary)

D. Bond yields (interest rates) come down in response to deflationary conditions, and therefore, as a policy tool, a low cost of debt service is needed

E. Letter D enables more of Letter C which requires more of Letter D, rinse and repeat.

This negative feedback loop we have seen play out in Japan and Europe and which is beginning to play out in America now is not a particularly political phenomena, and is not something I believe will be significantly altered by one election outcome or another. And yet, it represents a significant reality for investors in the years ahead. **Ultimately, some form of debt monetization is likely coming from the nation's central bank. The question is when, and in how explicit of a form.**

Conclusion

I am quite prepared for readers of this work to be irritated with me. I believe passions are so high both for and against President Trump that any suggestion the world might not end with or without his re-election is sure to offend one side or the other on this subject. My passions are for a free, prosperous, and civilized American nation. Like most conscientious citizens, I have preferences around candidates and policies as well. But I also see the lesson of history, and I see the landscape in front of us, and I am fully convinced that the great challenges and opportunities for investors right now neither start nor end with this election.

Consider these five points the key takeaways of this work:

1. Portfolio maneuvering in advance of the election is ill-advised for the simple reason that adjusting investment policy around the unpredictability of election results is impossible, and tantamount to gambling

2. Investors will be wise to prepare for high volatility and uncertainty in the aftermath of the election, as any result that is "close" (regardless of who leads or who wins) is very likely to create controversy, legal contests, and uncertainty that may last weeks (or, God forbid, longer)

3. Any point of view that sees one outcome as absolutely devastating to an investment outlook and another outcome as absolutely splendid for an investment outlook fails to consider history, fails to consider our system of government, and fails to consider the nuances of policy.

4. Should Joe Biden be elected, we will need more than his acceptance speech to know his real governance and policy intentions. It will take time and a presentation of personnel to really know his policy agenda and what it will mean for markets. That said, should Joe Biden be elected but the Republicans maintain a Senate majority, I expect there to be various executive orders that, on the margin, clip away at Trump-era deregulatory efforts.

5. The biggest factors that will drive portfolio results in the years to come are ***company performance*** issues and ***central bank liquidity*** issues. The capability of the best operating businesses in world history to overcome unfavorable policies is unqualified and without contest. The existence of a monetary policy favorable to asset prices is more powerful than Presidential or Congressional realities. ***There is no political scenario – divided government, unified government, President Trump, President Biden – where the monetary posture of the central bank will be anything other than hyper-accommodative for several years to come.***

I could expand the summary list beyond five items, but I believe these five should serve as your key takeaways for how to think about the months ahead. New information will come, new policy intentions will be announced, new results in key electoral races will become evident, and we will have the chance to dynamically adjust as we go.

But what we will not do, and advise all investors not to do, is paint with a broad brush. At a 10-year treasury yield of 0.6% and a S&P 500 > 20x earnings multiple, and an economy struggling to fully re-open and re-engage normal economic life, investment markets have plenty of risk and plenty of uncertainty even apart from the complexity of electoral politics.

My best advice for all investors concerned about the election, or any other market circumstance, is to re-visit their asset allocation, re-visit their timeline and needed cash flows, confirm their tolerance levels for price volatility, evaluate not just potential outcomes from the election but also the reality of a zero-interest-rate-environment for years to come, and become confident that your portfolio is in line with your goals and desires as an investor. This process, healthy whether we are in a politically-charged environment or not, should not give way to violating investing principles. In fact, it should embolden the reliance on principles that drive investment execution and results.

No circumstance warrants the abandonment of principles. This is true for us as investors. And come to think of it, it is true of politicians, too.