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What Now?

America still doesn't know who will win the White House, and an official announcement could take some time. However, Congress appears to be taking shape, and this alone could be a good outcome for investors.

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Gridlock

America still doesn't know who will win the White House, and an official announcement could take some time. Elections are supposed to alleviate uncertainty, not perpetuate it, so this is likely bad news for investors that were hoping for some clarity this week.

On the other hand, Congress appears to be taking shape. We won't know for sure until January (thanks to a runoff in Georgia), but as it stands today, the Democrats will likely keep the House, and Republicans should hold the Senate. If so, no matter who wins the White House, two outcomes are certain.

First, any attempt to raise taxes will be dead on arrival to the Senate floor. If Biden wins, he may be able to make some benign changes to the tax code, but only those that won't raise taxes.

For example, he may convince Republicans to approve an increase in the State and Local Tax Deduction (SALT). This could help voters living in high tax states like California (Democrats win) but also still be viewed as a tax cut (Republicans win).

The current corporate tax policy is one of the most favorable in decades. Lower taxes fuel higher earnings, fortify dividends, and allow companies to pay employees more and reinvest for future growth. Lower taxes also improve the long-term competitiveness of the U.S. versus other developed nations.

Keeping this policy intact would be a big win for long-term investors.

Second, the size and scope of any fiscal stimulus bill will likely be a fraction of the \$7 trillion over 10 years that Biden had proposed. Republicans simply won't allow the deficit to run that high.

The scope of stimulus will also narrow. The trillions earmarked for climate change and social programs are probably gone. Some may get reallocated to infrastructure and other areas of the economy that are less politically charged, but those are few and far between these days. There will also be virtually no shot of any bailout package and/or subsidy to states (unless the Federal Reserve were to step in).

Less stimulus could take longer for growth to return to pre-pandemic levels, but many argue that slower organic growth is better long term than artificial/subsidized. In any event, it won't stop the recovery. Earnings should keep rising, and unemployment should keep falling. Interest rates will also remain low for longer, which is a mixed bag. Growth investors should benefit, but those seeking income will continue to struggle.

Simply put, no matter who wins the White House, a divided government will prevent any progressive policy initiatives and maintain the status quo. Given the current policy in place, this is most likely a positive runway for investors through 2022.

The Bottom Line

Divided governments diminish presidential powers because passing policy becomes harder. Anything too radical from either side tends to get shot down, so less gets done. Fewer things happening in D.C. fuels less uncertainty about the future, and that's almost always a positive tailwind for markets because investors usually hate uncertainty.

In fact, the chart below shows that the stock market has done great during gridlock because the U.S. economy can grow with little interference from politicians. Even when existing policies are less economically favorable, the rules aren't changing, and investors know what to expect.

Recent history is a testament to this notion. The Democrats controlled Congress when Obama was elected, but two years later, the Republicans won the house and four years after that the Senate. No major legislation was passed during those six years, and the S&P 500 returned over 105%¹.

The same situation happened to President Trump. He got two years of a Republican Congress before losing the House to the Democrats in 2018. Since then, no major legislation has passed (except the bipartisan CARES Act earlier this year), and the S&P 500 has returned 30%¹.

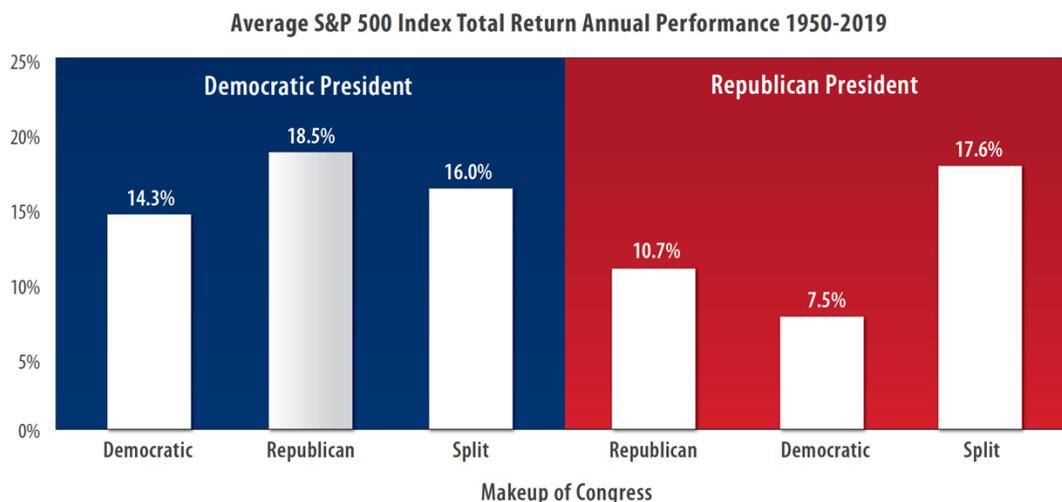
The bottom line is that politicians set the rules. They are the referees on the field, but they aren't scoring goals, nor are they driving the tally higher. Consumers and businesses are the players doing that, and they are going to do just fine no matter who wins the White House.

Sincerely,



Mike Sorrentino, CFA

Chief Investment Officer



Source: First Trust Advisors

Sources

1 Bloomberg, As of 11/5/2020

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