Election Preview

To state the obvious, 2020 has been full of surprises. On the political front, the changes in such a short period of time have been remarkable. The Democratic field has been torn apart by Joe Biden's comeback with Elizabeth Warren and Bernie Sanders just distant memories now. Even for President Trump, the election landscape has changed beyond comprehension from one in which the economy was experiencing a 50-year low in unemployment to one in which the unemployment rate was at depression levels of 14.7% in May (13.3% in June). This has given Democratic presidential candidate Biden a lead in the Midwest, but also in swing states such as Florida and Arizona.

Biden's moderate stance on the U.S. economy, healthcare, and education are striking versus his prior Democratic contenders. But equity markets are apprehensive over Biden's wish to repeal the tax cuts enacted by President Trump, thereby raising the corporate tax rate from 21% to 28% while proposing to hike the individual income tax rate to 39.5% and increasing the long-term capital gains tax rate. Biden is also proposing to impose a minimum corporate tax rate of 15%, a potentially costly outcome for some major companies that pay little, or no, tax today. Biden has said he will seek to raise the federal minimum wage to $15/hour. He also wants to fund an extensive infrastructure spending package through higher taxes on corporations and the wealthy. However, on technology company competition and anti-trust concerns, Biden has signaled a much softer approach than Trump, calling for more investigations first before any actions are taken. Other parts of the Biden agenda would be greeted with relief from investors. For instance, Biden is viewed as less likely to impose tariffs on trading partners than Trump, who has famously dubbed himself the Tariff Man.

Market pundits believe a Biden tax cut rollback would create a mid-single dollar impact on S&P 500 earnings, marking the potential for a 100 to 150 point decline on the S&P 500 as one baseline. Of course, any impact on investor confidence or business investment that drags economic growth lower could compound this effect. Conversely, if investor confidence and business investment was stronger despite the tax changes or if there was a phased implementation of potential tax changes, the impact could be much more muted.

For sure, Wall Street will be focused on taxes and potential government regulation and oversight of some industries such as healthcare and banking in its assessment of the Presidential election. Meanwhile, Main Street is likely to focus on employment conditions and income inequality. As the election gets closer, we will no doubt experience market gyrations related to perceived impacts from the evolving political landscape. We caution investors to stay focused on fundamentals as market responses to elections are often short-lived and unpredictable. While politics shape the operating environment of the companies in which we invest, we are not investors in politicians or their political platforms. Rather, we invest in enduring business models led by strong management teams who have seen it all and built their companies to be flexible and resilient to changes that may come from politics or even, most recently, pandemics. We invest in them because we believe they will still manage to deliver strong results regardless of these macroeconomic factors for their investors throughout time.

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