[Divided We Rise!]

Bottom Line:

Markets seem destined for new highs despite presidential pugilism. A Republican majority in the Senate assures us of shared governance responsibilities. This outcome should enable sizable stimulus legislation while disabling historic tax hikes and industrial re-engineering. Historically, the highest near term returns for the market synchronize with two-party rule. Perhaps it's ironic that, given all the polarity in the country today, the best environment for investors is one of diverse opinion and shared responsibility.

The Full Story:

Despite not knowing the outcome of the presidential election (*unknown at time of writing*), markets staged the largest post-election rally on record in the days following November 3rd. Casual observers may wonder why such a bitterly competed and yet unresolved presidential contest would elate investors to such an historic degree. The answer? The ballot undercard. The retained Republican majority within the Senate ensures either legislative compromise or legislative gridlock in Washington for at least the next two years. The first two years of any presidential term tend to house the most ambitious legislative proposals. President Obama took office in January of 2009 and signed the Affordable Care Act in March of 2010. President Trump took office in January of 2017 and signed The Tax Cuts and Jobs Act in December of 2017. Both acts led to sizable adjustments and unintended consequences across the US economy. More importantly, both acts required single party control of the White House, the Senate, and the House of Representatives. No single party control, no transformational legislation.

There have been 58 presidential elections since 1789. There have been 19 Democratic sweeps. Over the two years after a Democratic sweep, the stock market gained a mere 3.4% annualized, on average. This history likely informed the strong sell-off right before this election as polls strongly suggested a cresting “blue wave”. However, when Democrats have won the White House without winning Congress, the stock market gained 14.5% annualized, on average. This two-year rate of return outpaces the historic rate of return for all other legislative combinations.

Both Donald Trump and Joe Biden favor more fiscal stimulus for those financially injured by the pandemic. While the negotiations between Trump, Nancy Pelosi and Mitch McConnell failed to bear fruit in advance of the election, each professed their support for more stimulus. The shape and size of the stimulus to come will change depending on the ultimate electoral count, but we expect another $1 trillion or so injection into our $20 trillion US economy. Pair this 5% stimulus boost with the release of pent-up demand post-vaccine and the economy should grow 4-5% in 2021 and beyond. Furthermore, a Biden presidency likely revives immigration volumes and reduces tariff drags, adding even more stimulus. His less-stimulative agenda items like major tax increases, major regulatory changes, and social reengineering plans seem implausible given McConnell's reign over the Senate. Therefore, the economy should enjoy the fiscal policy pleasure without the fiscal policy pain. While this may enlarge the budget deficit, with interest rates anchored at record low levels, federal debt carrying costs are more than manageable, for now, and we have a weak dollar investment posture for insurance.

Lastly, if the two runoffs in Georgia reconjure the blue wave, the historical return drag for the first two years of a unified presidential term does not carry into the four-year return calculations. Over the full four years, blue waves have produced 8.2% annualized returns compared with 8.6% annualized returns for a red wave. Why such parity? Because US corporations are the most resilient, dynamic, and adaptive institutions on the planet. Private sector consultants, lawyers and accountants > government bureaucrats.

Post-Script: Americans resoundingly voted against extremism from both sides this week. I find this particularly heartening and hope you do too. While traditional and social media may have lost their pragmatic anchors, the rest of us have not. Whether you were for a Blue Wave or a Red Wave this go round, it's the Purple Wave in governance that has historically best served Americans. Our differences make us great. Compromise keeps us balanced. The reason the rest of the world trusts the US dollar so categorically is that they ultimately trust the judgement of Americans. We may look incompetent at times, but we are not. As Winston Churchill (may have) quipped, "Americans will always do the right thing, but only after they have tried everything else". Which seems to perfectly punctuate the 2020 election.

Have a great weekend!

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Sources: Fidelity, The Wall Street Journal, Bloomberg