Post-Election Recap and Analysis

Will a Divided Government be a Boon or Bust?

Perspectives | **November 2020**

The Election is Over — Now What?

Voter engagement during this most recent election cycle was high. Data indicates that roughly 150 million citizens cast a ballot in 2020.[1] To put that into perspective, that number was about 139 million in 2016.[2] This year's high turnout may be attributed to several factors, including the increased access to mail-in ballots and early voting, both of which surged due to the coronavirus (COVID-19) pandemic. In addition, the polarized electorate and sheer contentiousness of the pre-election dialogue appear to have motivated many to cast their vote.

Though recounts in certain states and legal wrangling may continue as President Trump's allegations of voter fraud are investigated, the likely winner of the Presidential race is former Vice President Joe Biden. Against a historic backdrop of a worldwide pandemic, a victory in the battleground state of Pennsylvania, as well as crucial wins in Michigan and Georgia, gave President-elect Biden the more than 270 electoral votes he needed to win. President-elect Biden is joined by Vice President-elect Kamala Harris, who makes history as the first African American and Indian American woman elected to that office.

The Big Picture Implications of a Biden Win

Joe Biden's victory could indeed mark the beginning of a dramatic shift in America's attitude toward the world. Specifically, Biden has promised to take a different tack than President Trump and reverse some of his more controversial policies surrounding climate change, immigration and tax policy. He has also promised to work more closely with America's allies on several fronts. All of that said, the perceived order of operations during the first 100 days of a Biden administration will likely revolve around addressing the pandemic, and more specifically, the development, production and ultimate distribution of a vaccine to the masses.

United and Divided We Stand

Broadly speaking, Biden's plans for the next four years, and certainly policies of a more progressive nature, are likely to be challenged by a divided government. Put simply, it appears that the Republican party will retain control of the upper chamber of Congress pending the outcome of two run-off Senate races in Georgia. In addition, Republicans have gained seats in the House of Representatives. This could, some posit, make it more challenging to reach consensus on a variety of issues, and in the short-term could add to the partisan bickering we have become so familiar with. Again, however, at this point in time, the financial markets appear to be expecting that the Republican party will hold the Senate, President Trump's legal challenges will fail and that Joe Biden will become the 46th President in January 2021.

1 https://www.usatoday.com/in-depth/graphics/2020/11/10/election-maps-2020-america-county-results-more-voters/6226197002/.

2 https://www.businessinsider.com/trump-voter-turnout-records-history-obama-clinton-2016-11.

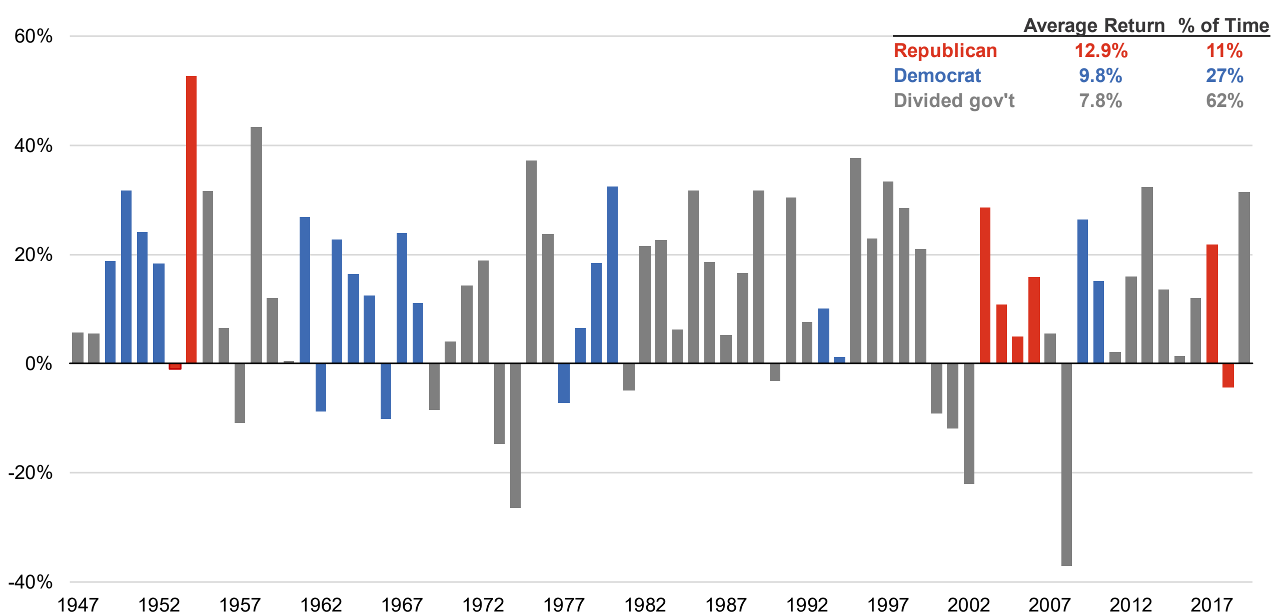
Market followers have generally argued that a divided government can be a positive for the capital markets. Why? The logic is that if neither the Democrats nor Republicans receive a broad mandate from voters, it generally makes it less likely that extreme left or right legislation will be signed into law. However, making an all encompassing statement that same party control of Congress and/or divided government is an absolute/definitive predictor of stock market returns is difficult at best.

As evidence, during the Clinton and Obama presidencies, both of which began with same party Congressional control, market returns were extraordinarily high. However, under George W. Bush, who enjoyed a largely Republican Congress (to be precise: mixed for the first two years, Republican for four and Democrat for the last two), overall returns were generally low. Again, there are various factors, economic and non-economic, that ultimately weigh quite heavily on the overall equation and thus drive returns.

Digging Deeper into Historical Divided Government Stats

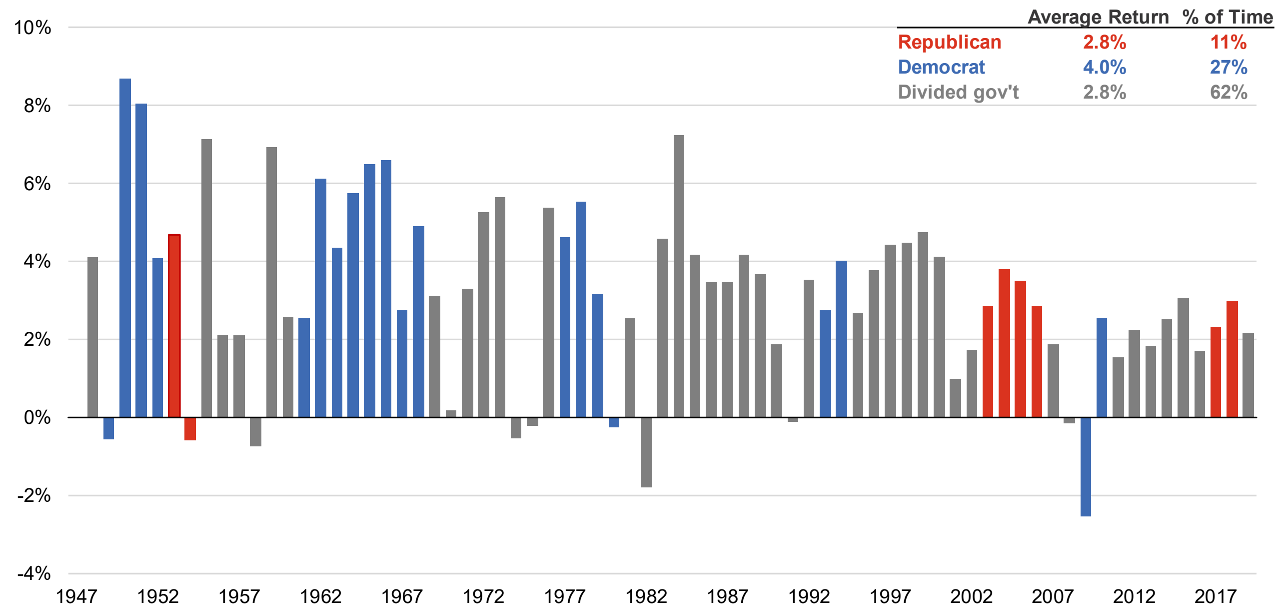
According to the chart below, the best-divided government scenario for the capital markets appears to be a Democrat President and Senate with a Republican-controlled House of Representatives. On average, the annual return under those conditions was +13.6%. However, that hasn't happened very often in recent history, and such a structure was only in place for four years during Barack Obama's presidency from 2011 through 2014. For this reason, it is hard, if not impossible, to extrapolate or suggest that this scenario would yield similar results in the future. Again, analyzing this type of data can be tricky, as there are also outlier years, such as 2009 when the market rallied sharply off the lows of the financial crisis, which can in turn, skew mathematical averages. Moreover, there a wide array of financial and political scenarios (including geopolitical conflicts) that have, or could in the future, impact returns. But again, the charts below and on the next page are food for thought and depict, at least historically, what has happened.

Stock Market Performance Under Different Parties
S&P 500 Price Index
Calendar Year Returns



Source: FactSet, Office of the President, J.P. Morgan Asset Management, and Standard & Poor's. Chart shows S&P 500 price returns from December 31, 1947 – December 31, 2019.

Annual Real GDP Change Under Different Parties
Change in Real GDP
Year-over-Year Annual % Change



Source: FactSet, Office of the President, J.P. Morgan Asset Management, and Bureau of Economic Analysis. Annual year-over-year changes in real GDP from January 1, 1948 – January 1, 2019.

Biden's Inheritance – A Boon for Consensus or Fuel for the Political Fire?

Biden is inheriting what some might term a "mixed bag" on the economic front. On the one hand, the nation's unemployment rate is above its historical average, and the country's share of global gross domestic product (GDP) is at the low end of its historical range at 24%.[3] In addition, the U.S. remains highly indebted and a significant portion of the federal budget (according to the September CBO Baseline Forecast) is spent on entitlements, which will only increase as our nation ages.

However, optimists will argue that the housing, household balance sheets and equity markets are in generally good health. This may provide a bit of a cushion for the cautious consumer, particularly during the pandemic.

Some have suggested that the muted economy could actually lead to some level of consensus among members of Congress. By that, we mean representatives could be guilted or forced to act in good faith and come to some legislative agreement on issues for the good of their constituents, including stimulus checks, infrastructure spending and tax policy.

Recently, Biden has urged Congress to pass a $3.4 trillion Democratic stimulus plan. While both parties remain at an impasse, there is a likelihood that lawmakers will be forced to act at some point, particularly as COVID-19 continues to overwhelm hospitals and force states and local officials to restrict economic activity.

Infrastructure is also likely to remain high on Biden's "to do" list. Members of both parties appear willing to address this important issue. It could be a good area for the newly elected President to gain the trust and confidence of his Republican counterparts. Again, while the pandemic will take precedent, action on infrastructure (bridges, airports, highways) is a distinct possibility early on in a Biden administration.

3 Bloomberg.

Finally, China will be high on the list of priorities and will need to be addressed. Will Biden seek out a second round of trade negotiations and/or look to stem China's military ambitions in the South China sea? Also, how will the newly minted administration tackle human rights issues and intellectual property (IP) theft? These issues/answers remain less clear. While candidate Biden maintained a hawkish tone when discussing China, President Biden may find it understandably more politically appealing to engage President Xi and try to work out long-standing differences.

Conclusion

Investing and attempting to game the implications of a particular election cycle accurately can be challenging, and 2020 has been no exception. While this election isn't officially over and legal fights may persist in the near-term, our view is that Joe Biden will be inaugurated, as planned, in January 2021. Moreover, we heartily believe that Biden's election will have important implications for foreign and fiscal policy, and we will be watching those closely. In the near-term, while political events may drive volatility, we do not believe they present a deterrent to economic recovery, which ultimately hinges on COVID-19, stimulus and economic re-opening progress.

As always, we stand ready to serve our clients through these trying and volatile times.