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Wall Street Bets On Biden Win, GOP Senate, And Smaller Stimulus.

Wall Street is betting on Joe Biden winning the presidency, Republicans controlling Congress, and a divided government. As a result, there'll be a much smaller stimulus package in early 2021 and few, if any, tax hikes.

"Gridlock is the most likely outcome," Brian Gardner, chief policy analyst for Stifel & Co. in New York, told clients in a report, predicting that the GOP would retain control of the Senate.

"Progressives had their wings clipped" Gardner wrote. Bad feelings between leftist Democrats and conservative Republicans "will likely prevent widespread collaboration." He expects Congress, with the GOP in control of the upper chamber, will disappoint investors by spending less than the Democrats' promised \$2 billion to prop up the economy, though more highway spending is likely.

"The likelihood that the Senate will not flip to the Democrats gives comfort that major legislation is unlikely," James M. Meyer, chief investment officer at West Conshohocken-based Tower Bridge Advisors, which invests over \$1 billion, told clients in a note. "That leaves the economic reins in the hands of the Fed. Investors should like that."

Meyer added that, if the Senate remains Republican, "the stock market barely reacts to social unrest, crude political speech, wars, or climate change." It reacts, instead, to corporate profits and Federal Reserve interest rates. "No one can fault investors who want to see more of the same": cheap borrowing rates, modest but steady growth, and "hopefully, an end to the pandemic sometime in 2021."

In response, the Dow Jones Industrial Average jumped 367 points Wednesday to close trading at 27,847.

A divided Congress is unlikely to pass drug-pricing limits, so that's a good outcome for pharmaceutical companies, while a Biden presidency, even without full congressional support, could bring "a more rigorous and thoughtful approach to science," Geoffrey Porges, analyst at SVB Leerink, told investors in a note excerpted in Endpoints News, a drug industry newsletter.

The GOP majority "takes extreme scenarios off the table, including large tax hikes, major health care changes, and a huge stimulus package," said Jeff Mills, chief investment officer of Bryn Mawr Trust Wealth.

Biden has said he would only raises taxes on the wealthy, on those who make more than \$400,000 a year.

Strange as it sounds, divided governments often result in stock prices moving higher.

"Ultimately a gridlock scenario ends up being a good thing. We can start to focus on earnings, vs. handicapping major swings in policy," Mills said.

Key takeaways for investors under this scenario include a weaker U.S. dollar, compared with other currencies.

“We see pressure on the dollar under a Biden presidency, with a reversal of tariffs and trade policy,” Mills said. Tariffs tend to tamp down growth internationally, so scrapping the Trump-era tariffs would have the opposite effect.

“If tariffs are reversed, on a net basis, that’s better for growth in international markets, but has the opposite effect on the U.S. dollar,” he said.

Interest rates: With a smaller stimulus package, that means less possibility of inflation in the U.S. economy, Mills said.

“If we get a stimulus package, it won’t happen until Congress is sworn in Jan. 3, and then likely wouldn’t pass before February,” he said.

Less inflation means less likelihood of higher interest rates, so yields on Treasury bonds have dropped early today in trading.

Health care: This sector, which includes insurers, biotechnology, and pharmaceuticals, is “the biggest winner,” Mills said, since changes to the Affordable Care Act or a so-called “public option” would be off the table.

“That was weighing on this area of the market.”

Big Technology: Should the GOP continue to control the Senate, regulatory scrutiny of Big Tech will likely fade, which prompted share prices of Facebook (FB) and Amazon (AMZN) to rise in early trading.

Marijuana legalization: Voters in New Jersey, Arizona, Montana, and South Dakota legalized recreational marijuana, and now 1 in 3 Americans live in a state where adult pot use is legal.

The results sent a mild ripple through the marijuana sector. Shares of Canadian companies were down 7 to 9 percent. Canadian cannabis companies cannot own assets in the United States and they cannot sell Canadian grown marijuana in the U.S. So they had nothing to gain from the four states legalizing.

Stocks in the American-owned multistate operators — among which Cresco Labs and Green Thumb Industries are the largest — were flat to slightly up, according to analysts.

“On the whole, it was a wash,” said Pablo Zuanic, analyst for Cantor Fitzgerald

Pot sales tax revenue will help cash-strapped New Jersey and towns that allow and tax marijuana retailers, but it could take “two to three years” to start collecting even limited revenues, and by then neighboring states will have likely cut into New Jersey sales, Baye Larsen, vice president at Moody’s Investors Service, said in a report.

More drug-related initiatives were also passed, with Oregon becoming the first in the nation to decriminalize possession of “hard drugs,” while D.C. voters approved a measure decriminalizing “magic mushrooms” and other organic psychedelics. Denver, Oakland and Santa Cruz passed similar proposals.

Muni bonds: “As the economy improves and we get to a vaccine, we should see higher [interest]

rates no matter who is finally elected President,” wrote David Kotok, municipal bond and fixed income investor with Cumberland Advisors. For now, however, interest rates remain low.

“Munis should be fine,” he wrote, although these bonds “will probably not get a tax-increase boost right away, from a demand/supply standpoint they are in very good shape.”

Until a second stimulus bill passes Congress, “we may see some additional actions from the Federal Reserve to shore up markets if needed. We also expect further jawboning from the Fed to Congress on the importance of additional stimulus.”

Tax moves: Hank Smith, head of investment strategy at Haverford Trust said if Biden wins, and the Senate remains Republican, there is “no shot of any major legislation, tax increases or state tax changes” including a wealth tax passing Congress, he noted.

“We won’t see anything crazy in the cabinet because everything has to be approved by the Senate. Elizabeth Warren will not become Treasury secretary. All Biden will be able to do is issue executive orders,” Smith said.

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Staff writer Sam Wood contributed to this article.

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