CONWAY• JARVIS LLC
Investment Outlook

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Update

Investors Focus on Policy, Not Politics

The stock market opened the New Year with a thud rather than a bang. Monday's sell-off could be ascribed to uncertainty surrounding the Senate election in Georgia that could impart a significant change in current US fiscal policy. Adding to the suspense is the dramatic surge in COVID cases and hospitalizations, coupled with a slower than expected vaccination rate. Monday's unexpected election result officially ceded control of Congress to the Democrats and confirmed the completion of a "Blue Ripple" in the November election. This raised the prospect of a dramatic change in current fiscal policy and an imminent market consolidation. Instead, investors flocked into equities this week, taking the stock market to new record highs.

The S&P 500 led the parade, with the DOW in lockstep, while the NASDAQ trailed as some investors lightened exposure to Technology companies that might not fare well under the scrutiny of the new administration. That remains only speculation until the new president's 100-Day Agenda is revealed later this month. At that point, we should have an idea of what headwinds or tailwinds the economy and its markets will encounter during the next biennium. With the November election behind us, we'll do something we generally avoid, discuss politics. We rarely do this and only then as investors reviewing policy expectations.

At present, the only certainty regarding policy is the Fed's commitment to long-term *monetary* accommodation through low interest rates. As for *fiscal* policy, we're expecting to see multiple iterations of stimulus acting as a significant *tailwind* for the economy in the months ahead. That's music to investors' ears. Unfortunately, that stimulus will almost certainly be paid for through a restructuring of the taxation landscape, a *headwind* for business, employment, and investment in the longer run. Indications are that an increase in corporate taxes and higher capital gains taxes for individuals head the administration's To-Do list. History has taught us that the economy and the market respond in the negative to higher taxes. Our concern is that higher taxes, coupled with the current government-imposed pandemic restrictions will push full recovery further into the future and perhaps pull the economy back into a second recession.

No doubt, more fiscal stimulus is required and higher taxes will eventually have to pay for it. We're hopeful that a balance can be struck between the two that preserves a continued expansion of the economy as control over COVID-19 is attained. The *timing* of any significant change in tax policy is critical to averting a double-dip recession. Democrats have, by a razor's edge, gained control of the legislative process. However, the divergent priorities of Progressives and Centrists within that party have shaped competing agendas. The former promotes a broad wish list of social, economic, and environmental objectives to be achieved *ASAP* at any cost to the economy. The deficit of economic and historical literacy within that group is staggering. Centrists agree in principle with the objectives of that agenda but recognize the need to maintain a strong economy, driven by the private sector, while moving toward those objectives.

Obviously, we're in the Centrist camp and believe they hold the majority of seats in Congress. We hope to see a return of bipartisanship among moderates in Washington and extremists within the respective parties marginalized. We believe that's what investors envisioned this week as they took the S&P 500 to a new record high. We'll have to wait months to determine if that proves to be the case. In the meantime, we'll be keeping an eye on moderates like Joe Manchin, Democrat senator from West Virginia. He's among those who could lead the charge toward a renewal of bipartisan policy formation. Stay tuned.

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