The Where-Why-How of the Democratic Sweep

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As the 2020 U.S. election cycle finally comes to a close (only a 2020 election cycle could extend into 2021), we reflect on the results and the impacts they will have through the three stages of our investment process: Where, Why, and How.

As a reminder, we assess risks and opportunities in the global markets based on these three stages: (1) identification of value/price discrepancies (*Where* do prices differ from fundamental value?), (2) assessment of the macro environment (*Why* do prices differ from fundamental value?), and (3) designing, constructing, and maintaining the portfolio (*How* do we best capture value/price discrepancies?).

A Democratic Sweep

In early January, there were two runoff elections for the Georgia Senate seats. Democrats won both seats, which gave them half of the 100 seats in the Senate.

With a split Senate, any tiebreaking vote will be made by the new vice president, Kamala Harris. The Democrats now have effective control of the Senate as well as the House of Representatives and the presidency.

As we noted in a prior blog post, when we think about the policy implications of the current situation, what matters is not only which party has the majority but how big the majority is. The Democrats now have the slimmest of majorities in the Senate. To pass legislation, the Democrats cannot lose a single senator for any vote, unless there is bipartisan support.

In terms of how we view the Democratic sweep through the stages of our process, it is as follows:

The *Where*

From a long-term fundamental valuation perspective, the main implications we see from the Democratic sweep include the potential increases to corporate taxes, additional regulations on the U.S. energy sector, and more stimulus measures.

The first two changes may likely be negative for U.S. equities longer term. Biden has already said that he wants to increase tax rates, but as we noted, to increase taxes Democrats cannot lose a single vote in the Senate. Additionally, Senator Joe Manchin (D-WV) is one of the moderate Democrats whose vote will be critical for various Democrat policies. Overall, we view the Democratic sweep as neutral to valuation.

The *Why*

With Democratic control, there is an easier path to more fiscal stimulus. While there are rules about how much Democrats can spend and the processes they can use, we are likely to see a larger fiscal stimulus package with the Democrats controlling the Senate than we did with Republican control. This could be positive for U.S. equities and lead to higher yields on U.S. Treasurys in the short term.

During President Trump's tenure, we created the Globalism versus Protectionism theme to capture the risks emanating from his trade policies globally. With the end of his presidency, we have now neutralized this theme (more on that below).

With fewer headwinds, there may be a less obstructed path for price to gravitate toward value, which justifies retaining positions—or even increasing them—as we have done.

The *How*

With this administration change, we see uncertainty dissipating. In particular—and as noted—we retired our Globalism versus Protectionism theme as we expect the Biden administration to be less protectionist when it comes to trade and security. The threat of tariffs or a trade war is not eliminated, but the United States should return to an environment similar to that seen before the Trump administration.

From a *How*-stage perspective, this macro theme had the effect of increasing the risk of those markets and currencies we thought were most influenced by trade developments. This elevation of risk is now removed, and these exposures (mostly Asian markets and currencies) are now more attractive on a risk-adjusted basis than when this theme existed.

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