Investment Perspective

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RACE FOR A CURE

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As summer gives way to autumn, it remains evident that the coronavirus still has the upper hand in many regions around the globe. According to Johns Hopkins University, the number of new daily cases worldwide continues to hit new highs — although the rate of increase has slowed recently.

New cases in the United States are still well below their summer peak but have shown signs of entering a third wave following the resumption of the school year. Like a flood tide, the virus has spread west and southwest with high positivity rates in areas that had previously been largely untouched. Meanwhile, in New York City, one of the initial epicenters of the outbreak, authorities are reporting new clusters, prompting the closure of schools.

Fortunately, through trial by fire, the health care system has become more proficient at treating patients suffering from COVID-19. Therapeutics like the antiviral remdesivir, steroid dexamethasone, and blood thinners have helped reduce mortality rates. While more Americans are testing positive for the virus, relatively fewer are succumbing to the disease.

Nevertheless, it remains a serious threat, particularly for older individuals and those with co-morbidities. Behavioral shifts such as social distancing and the wearing of masks have helped bend the curve, but it will take safe and effective vaccines to ultimately turn the page on the coronavirus.

A Manhattan Project

Tremendous amounts of financial and intellectual capital are being expended globally toward that end. Funded by $10 billion from the CARES Act, the U.S. government's Operation Warp Speed (OWS) initiative kicked off in April. This is an ambitious public-private partnership to sharply accelerate the development, manufacturing, and distribution of COVID-19 vaccines as well as therapeutics and diagnostics.

Pharmaceutical companies have dozens of vaccine candidates in development with a handful of promising compounds now in phase three trials. Some are already being man-

ufactured, shortening the timeline if they are proven viable. OWS aims to deliver 300 million doses of a vaccine for COVID-19 by January, a goal most medical professionals still view as a stretch. The likelier scenario for early 2021: a more limited supply of doses for high-risk individuals and front-line workers.

Clear and present danger

Even if a vaccine were to become available early next year, there is a danger that economic damage in the intervening months will forestall a rapid recovery. The extraordinary fiscal lifelines that propped up the economy this summer have largely petered out. Many businesses have reopened but are not necessarily back to full capacity; others will never resume operations. And the new breakouts of coronavirus cases could again hamper activity.

Employers have restored half of the 22 million jobs shed in March and April with much of the nation locked down. As of September, the unemployment rate stood at 7.9%, down from the April high of 14.7%. However, the number of permanent job losses continues to rise and now totals nearly four million. In recent weeks, some large employers (e.g., Disney, United Airlines, American Airlines, Allstate, Dow) have announced sizable job cuts.

Left unchecked, rising joblessness will lead to lower spending which in turn will prompt more job losses. Fiscal policy is the instrument to short-circuit this vicious cycle by providing households financial support to shore up their spending.

While Rome burns

The Trump administration, Senate Republicans and House Democrats have been squabbling over a next round of stimulus for months. When a patient is hemorrhaging, physicians do not debate which bandage to use — they act quickly to stem the blood flow. Fed Chairman Jerome Powell recently warned that in the absence of more federal aid, household insolvencies and business bankruptcies would proliferate, threatening the nascent recovery. He argued that the risks from “too little support” outweighed those from “overdoing it”.

Most registered voters in both major parties favor additional federal assistance for displaced workers and struggling firms. Ultimately, a new stimulus deal will be brokered. The only questions relate to the timing, scale, and scope.

Blue wave?

With fewer than 30 days until the election, Donald Trump continues to trail Joe Biden in national polls and in those for several critical swing states. Biden's lead edged up further after their debate and Trump's COVID-19 diagnosis. Of course, as the 2016 battle demonstrated, polls can be far from definitive. And a candidate can win the 270 votes needed from the Electoral College — and thus the presidency — without necessarily earning a popular vote majority.

But political pundits are increasingly pointing to the possibility of a "blue wave" or Democratic sweep of the White House and Congress. So investors are speculating about the potential impact of such an outcome on financial markets.

Earnings hit

The simplistic narrative posits that a Biden sweep would hammer equities, given the likelihood of a regime with higher taxes and tougher regulations. For instance, Biden proposes moving the statutory corporate tax rate from 21% to 28% (it had been 35% prior to the 2017 *Tax Cuts and Jobs Act*). He would also impose minimum corporate tax rates for domestic and foreign income. As for individuals, higher earners would be subject to increased marginal income and capital gains rates, among other things.

Analysts generally estimate the corporate tax policy changes would clip S&P 500 annual earnings by 8%-10%. All else being equal, tax increases are a negative for equity investors — but all else is never equal. There would likely be second-order effects that would offset some of the hit to corporate earnings from higher tax rates.

More stimulus

Under a Democratic-controlled government, prospects would brighten for a greater amount of fiscal support as the nation combats the virus. Moreover, Biden's proposals call for significant federal spending on infrastructure, housing, and education.

Such fiscal largesse should initially boost growth. But there are no free lunches and accumulating budget deficits add directly to the national debt. With interest rates at rock-bottom lows, the government's debt service costs have been quite manageable. And the Congressional Budget Office expects

interest payments to be low for the next few years. However, the dynamics will shift in a higher rate environment.

On the other hand, if a blue sweep does not materialize, divided government persists, so expect ongoing gridlock. Equity markets generally do not mind such a state. Tax policy would remain largely unchanged. Federal spending would still expand but limited to areas where the two parties can find agreement. For instance, Republicans have also expressed a desire for stepped up investments in infrastructure.

We will get through this

Elections matter but it is worth reiterating the perils of mixing personal politics and investments. One's political views can be an inappropriate ingredient to add to one's long-term investment strategy. Reinforced by the media, individuals tend to allocate too much credit AND blame to elected officials for the state of the stock market. History indicates that neither political party is clearly associated with better or worse market performance.

Whether voters usher in a government that is all blue or a shade of purple, growth should revive next year as vaccines becomes widely available and a fiscal policy thrust resumes. In the meantime, stock prices will remain sensitive to the news of the day.

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