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2020 Election Analysis: What Does a Biden-Harris Ticket Mean for November's Election and What are the Implications of Higher Taxes?

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In less than 90 days, Americans will cast their ballots. All presidential elections are significant, but this one feels especially important given the COVID-19 pandemic and the economic uncertainty that has come with it.

Joe Biden's selection of California Senator Kamala Harris as his vice-presidential running mate pick was viewed by many on Wall Street with relief.[1] While she has a track record of being tough on banks, her selection over other potential candidates was welcomed by many. Of the vice-presidential candidates being considered, Senator Harris is widely viewed as one who is centrist and pragmatic in her approach to policy. The decision is also being viewed by some as signaling by Joe Biden that he will chart out a centrist, moderate path if he is successful in the November election.

Our goal in this election primer is <u>not</u> to endorse any person, party, or economic philosophy. Rather, we aim to provide a non-partisan assessment of potential outcomes, and how these outcomes may impact the U.S. economy, investment markets, and your financial wealth. As always, if you have questions about the concepts or ideas shared within this journal entry, we encourage you to connect with our team.

Expectations for Election Day

Today, the majority of national polls point to a Biden-Harris victory in November. Just like 2016, these polls project that President Trump will lose the election by a wide margin.[2] The critical question is: *are these national polls any more reliable than they were in 2016?* As the 2016 election made clear, polling data can miss the mark: on election night in 2016, an aggregate analysis of over 1,000 national polls gave Hillary Clinton a 71.4% chance of becoming the 45th President of the United States.[3] Simply put, these polls failed to gauge the widespread support that President Trump had in states like Pennsylvania, Wisconsin, and Michigan — three states which ended up being critical to his victory.

While we do not know who the ultimate victor of the November election will be, we do know that a Biden-Harris administration is a very real possibility. Accordingly, it is important for us to consider how Biden's policy decisions may impact the U.S. economy and investment markets.

1 Wall Street Journal, *As Kamala Harris Joins Biden Ticket, Wall Street Sighs in Relief* (link)
2 FiveThirtyEight, *Latest Polls* (link)
3 FiveThirtyEight, *2016 Election Forecast* (link)

As it pertains to policy, the financial media and markets have been focused on one topic in particular: personal and corporate taxation. For this reason, we'd like to start our analysis of the 2020 election by focusing on where Biden and Trump differ on tax policy and then share our view on how changes in the tax code should impact your personal wealth management strategy.

Divergence in Tax Policy

The Tax Cuts and Jobs Act of 2017 (TCJA) was a significant change to the tax code — one which was driven by President Trump and broadly opposed by Democrats. Most notably, this legislation lowered marginal rates across all tax brackets, expanded the standard deduction, and enhanced the child tax credit. While many of these changes are set to expire in 2025, Joe Biden's tax proposal includes several provisions to remove TCJA changes before 2025. The table below shows the current tax code and how this compares to proposals made by Biden and Trump in recent months.[4] For a description of the acronyms used in this table, please the footnote at the bottom of this page.[5]

	Current Rates	**Biden's Proposals**	**Trump's Proposals**
Individual Income Tax	• 37% maximum rate through 2025, reverts to 39.6%	• 39.6% maximum rate	• Make 37% rate and other TCJA changes permanent
Corporate Taxes	• 21% corporate rate • 20% pass-through deduction for QBI • Territorial style regime with BEAT, 10.5% GILTI rate	• 28% corporate rate • Repeal 20% pass-through deduction for QBI for taxpayers >$400K in income and for REIT dividends • Double GILTI rate 15% minimum global book income tax • Repeal like-kind exchange deferral for real estate • 6.2% payroll tax increase on employee wages over $400K (see below)	• Make 20% pass-through deduction permanent
Estate & Gift Tax	• Top rate of 40% with exemption of $11.58 million through 2025, reverts to $5 million (indexed from 2011)	• Return to "historical norm", perhaps this means restoring the $3.5 million exemption • Eliminate the step-up in basis for inherited assets	• Make TCJA changes permanent
Investment Income	• 20% maximum capital gains rate • 3.8% net investment income tax	• No preferential rate for capital gains for taxpayers over a $1 million income threshold • No financial transactions tax	• Supports indexing capital gains for inflation, further reducing the rate from the current 20% maximum

4 Andersen Global, *Biden Hits the Campaign Trail With Tax Policy Proposals* [(link)](#)
5 Tax Cuts and Jobs Act of 2017 (TCJA), Qualified Business Income (QBI), The Base Erosion and Anti-Abuse Tax (BEAT), Global Intangible Low Tax Income (GILTI), Real Estate Investment Trust (REIT)

The Implications of Higher Taxes

While there are numerous factors that move the capital markets, to gain additional insight on how tax rates influence markets, we looked back at past bull markets and the tax environment in which they existed. As the table below details, the U.S. economy has seen 13 bull markets since 1932, with each one lasting an average of 63 months and returning an average of 183%. The furthest right two columns within this table detail the prevailing tax environment at the start of each bull market. It is notable that the top personal rate has ranged from 35% to 91%, and the top corporate rate (before the TCJA legislation was passed in 2017) has ranged from 35% to 52%.

Biden has proposed increasing the top income tax rate from 37% to 39.6% and the top corporate tax rate from 21% to 28%. By comparison, during past bull markets the *average* top personal and corporate tax rate was 63% and 40%, respectively. While there will likely be elevated levels of volatility in the coming months, we do not feel that Biden's tax policies represent the "end of days" for the U.S. economy, individual companies, or investment markets.

Bull Market[6]	Start Year	Months	S&P 500 Return	Top Marginal Personal Tax Rate[7]	Top Corporate Tax Rate[8]
Recovery from the Great Depression	1932	57	325%	63.00%	12.00%
WWII	1942	49	158%	88.00%	40.00%
Post-war boom	1949	86	266%	82.13%	38.00%
Cold War ramps up	1957	50	86%	91.00%	52.00%
JFK Aims to "get America moving again"	1962	44	80%	91.00%	52.00%
The go-go years	1966	26	48%	70.00%	48.00%
Nifty Fifty	1970	32	74%	71.75%	49.20%
A modest bull	1974	74	126%	70.00%	48.00%
Reaganomics	1982	60	229%	50.00%	46.00%
Black Monday comeback	1987	31	65%	38.50%	34.00%
Roaring 90s	1990	113	417%	28.00%	34.00%
Housing Boom	2002	60	102%	38.60%	35.00%
Long, slow recovery	2009	131	401%	35.00%	35.00%

6 CNBC, *A look at bear and bull markets through history* (link)
7 Tax Policy Center, *Historical Highest Marginal Income Tax Rates* (link)
8 Trading Economics, *United States Federal Corporate Tax Rate* (link)

Closing Thoughts

If Joe Biden wins the presidency on November 3rd, we believe a higher tax outcome is very likely. This is especially true if Democrats gain control of the Senate and maintain control of the House in a so-called "Blue Wave."

We would expect short-term volatility as a result of the election and any significant code changes, but we do not feel that tax increases will have lasting impact on U.S. equity markets going forward. History has shown us that previous periods of relatively high taxation have not impeded American prosperity. In our view, the conclusion of the COVID-19 pandemic remains the biggest variable facing the U.S. economy. However, with the prospect of a viable vaccine arriving in early 2021, we remain cautiously optimistic about the pace and trajectory of recovery.

All things considered, we do not advise significantly reducing market exposure as we approach November's election. Rather, we feel that now is the time to stick with your strategic asset allocation that reflect long-term investment objectives. Many of our clients have benefitted from an overweight to large cap growth equity exposure within their respective portfolios. We recommend that now would be a good time to compare your current allocation versus your long-term target allocation and rebalance as appropriate.

We also believe that now is a good time to give consideration to strategic tax planning opportunities that may be available to you. This is especially true for any investor who is contemplating transactions that could bring about significant capital gains taxes. For example, it may be beneficial to complete these transactions now, under the current tax regime, as opposed to delaying these actions into 2021 or 2022. If you are facing a large taxable event and would like a customized consultation, we encourage you to connect with our team.

As we have been before and during the pandemic, we remain ready to assist and guide you in any way we can during these uncertain times. We will continue to follow developments closely, and keep you updated as needed.