O'Brien WEALTH PARTNERS
ADVISORS | ANALYSTS | ADVOCATES

October 21, 2020

Dear O'Brien Client,

The whirlwind that is 2020 shows no sign of abating as we enter the final quarter of the year. Yet, despite significant uncertainty – and the market pullback in September – the markets delivered another period of strong performance during the third quarter with global stocks up 8%, the S&P 500 up 9% and bonds rising slightly as well. **Since the market bottom in March, the S&P 500 has now risen almost 50%, global stocks almost 45% and the U.S. Aggregate Bond Index almost 7%. Stock markets are now positive for the year.**

Those are incredibly strong returns for any six month period and speak to the continued progress – despite the many twists and turns – on the path to recovery.

But at the same time, uncertainty persists. While the healthcare and economic backdrop are better than they were in March, they are by no means "good." Nor have they improved as much as the stock market. This brings up a question about whether the market has gotten too far ahead of the economy.

Financial markets outperforming the economy following a recession is not unprecedented. For example, stocks bottomed in March of 2009 during the Global Financial Crisis, while the economy did not exit the recession until June that year. So from that standpoint, seeing stocks performing better than the economy is not that surprising.

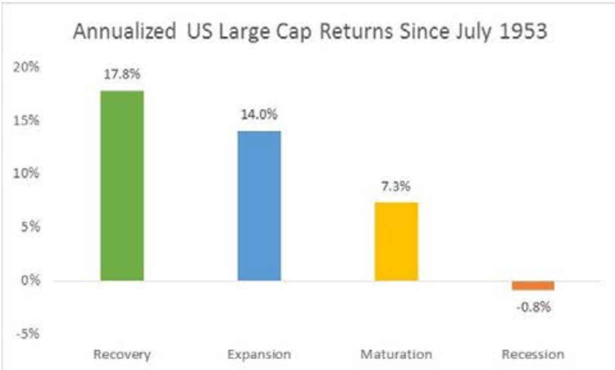
The magnitude of outperformance, however, is more surprising. It took several years for the stock market to make a new high after the Global Financial Crisis, versus roughly five months today. In our opinion, proactive stimulus from the Federal Reserve (Fed) and to a lesser extent fiscal stimulus from Washington D.C., are the primary reasons for this occurring.

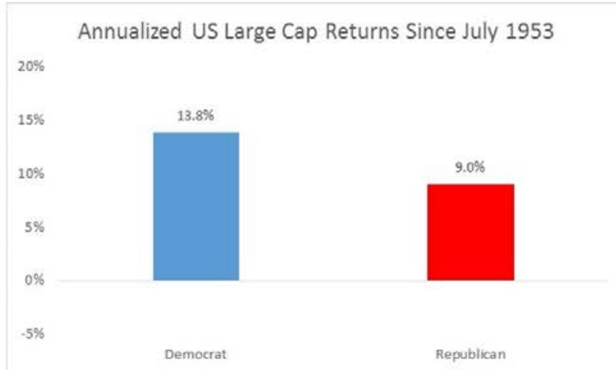
Quantitative easing – the purchasing of treasuries and mortgage-backed securities by the Fed – has shown to have a significant impact on asset markets and a relatively insignificant impact on the economy over the past decade. Moreover, the Fed has indicated they stand willing to do more if necessary. As long as that stimulative backdrop, coupled with incremental improvements in healthcare and the economy, continues there is probably more room for markets to rise.

Beyond the gap in performance between markets and the economy, perhaps the next most front-and-center uncertainty surrounds the upcoming elections. This is clearly a sensitive topic and passions are high, particularly against the backdrop of what has been an extremely bifurcated recovery.

As passionately as we may personally feel about this topic, our job as stewards of your assets is to strive to remove emotion from the investment process. As such, we would like to provide you with our objective thoughts on the key dynamics to watch – and their potential implications – going into the elections.

Historically, economic backdrops matter more for financial markets than election outcomes. The charts below illustrate this point by comparing the annualized return of U.S. large cap stocks (think S&P 500) since 1953 by phase of the business cycle versus by political party in the Oval Office. On average, there has been significantly more variation in market returns when the economic backdrop changes than when the political party of the President changes. Incidentally, the economy exiting recession (as we believe it is today) has tended to be an extremely positive backdrop for stocks.





Source: IHS Markit, O'Brien Wealth Partners, as of 01/30/2020.

All that said, the election can and likely will influence shorter-term market performance. As such, we have some additional observations about what that impact might look like.

Both current polling and political wagering markets are pricing in a Democratic sweep of the House, Senate and Presidency, so we will focus the bulk of our observations there. However, the historic predictive power of polls this far in advance of the election is not perfect. There is still time for the situation to change between now and the election.

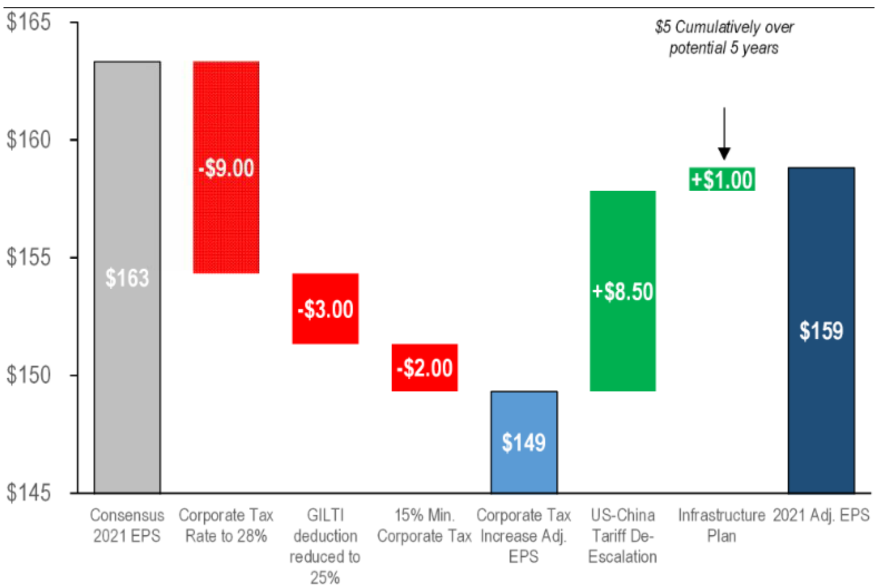
Perhaps the most important question is who ultimately controls the Senate, as that control opens the door for more meaningful policy shifts to occur. The table below summarizes the policies of both candidates. Proposals in red text are changes that could be accomplished via executive order or presidential direction (i.e. without congressional approval) if Biden becomes President. There is more leeway with executive orders, but less ability to make a meaningful change in policy.

	Biden	Trump
Corporate taxes	**Raise corporate rate** to 28%; create minimum tax rate of 15% on book income	**Corp tax rate lowered** from 35% to 21%
Personal income taxes	Restore **top rate to 39.6%; raise capital gains tax** to ordinary rate for those earning >$1mn; **wealth tax** (details unspecified)	**Lowered federal rates** from 10% to 39.6% brackets to 10% to 37%
Trade	Enlist US allies to challenge China on trade; advocates enforcing existing trade laws while writing new rules that protect workers, the environment and labour standards.	**America First** policy involving withdrawal from TPP, renegotiation of NAFTA, trade/tech/investment war against China and early-stage trade war with EU
Healthcare	**Improve Affordable Care Act** (ObamaCare) by adding public insurance option; Medicare to **negotiate drug prices;** link domestic to **int'l prices**	**Failed attempt to repeal Obamacare** in 2017
Energy	**Ban new leases** for drilling offshore and on federal land; partially supports **Green New Deal** end fossil fuel subsidies; supports **carbon tax**; **end fossil fuel subsidies; 100% clean energy** by 2050	**Opened** more federal land to drilling **Reduced** Iran/Venezuela output through sanctions
Tech & Comms	Supports using **anti-trust legislation** to investigate anti-competitive practices	**No significant** sector-specific policies, though DoJ, FTC & FCC investigations ongoing
Finance	Support a **financial transactions tax**	**No signature legislation**, but more lenient interpretation of Dodd-Frank
Infrastructure	**$1.3trn** plan, including green proposals	**No signature legislation**
Immigration	End family separation; protect **DACA**; create a pathway to citizenship; give more resources to better leadership/training within ICE; don't decriminalize crossing the border	Border wall; record contraction in legal immigration through **visa limits**
Monetary policy	no public comments	Favors lower rates and **replacing Powell** Two open Board seats to fill
Other	**Raise minimum wage** to $15/hr	**Federal minimum wage unchanged** at $7.25/hr

Source: JPMorgan, O'Brien Wealth Partners, as of 09/30/2020.

Changes in corporate and personal tax rates, universal healthcare legislation, minimum wage changes, infrastructure plans and stimulus proposals all require the approval of both chambers of congress and are therefore unlikely to occur absent a Democratic sweep. And even a minimal majority in the Senate is probably not enough to enact the most progressive or conservative aspects of policy platforms as there are widespread views on these topics even within parties.

Further, even if a meaningful policy change occurs – such as higher corporate taxes – it is unclear whether it would be enacted immediately or gradually and even whether the magnitude of the impact would be as bad as investors may fear. For example, if a democratic sweep occurs Biden has stated his intention to reverse one-half of the statutory tax rate cut for corporations, establish a minimum tax rate, and reduce the deduction for global intangible low-taxed income (aka GILTI). As shown below, JPMorgan estimates these policy changes would reduce expected corporate profitability for 2021 by $14 per share (red bars) or about 10% if enacted immediately.



Source: JPMorgan, O'Brien Wealth Partners, as of 09/30/2020.

But at the same time, Biden's policy platform also suggests he would reduce trade tariffs and enact a large infrastructure spending package as part of a broad new fiscal stimulus package, which could result in a boost to earnings of around $10 per share (green bars). Put together, the Biden policy platform would probably still be a headwind for the stock market, but not nearly as large as the market fears.

If a Democratic sweep does not occur, potential policy shifts become significantly more limited and could be a net boost to the markets (specifically if it means higher taxes are off the table). At the other extreme, a Republican sweep could mean further reductions in taxes than have already occurred, which would likely also support asset prices.

A key dynamic to focus on heading into the election is identifying what exactly the market has priced in as a base-case expectation. Looking at hedging markets we can see the market is anticipating above-average volatility the day of the election, the week of the election, the month of the election and into 2021. In other words, the market does not expect the results to be known until well after the election.

Pulling all of this together, it is clear to us that uncertainty is not going to change anytime soon. While the results of the election will have a short-term impact on markets – as well as create relative winners and losers – it is unclear whether it will be a net headwind or tailwind.

We are not short-term investors. As such, we believe the economic backdrop will remain the key driver of longer-term return potential. As long as that backdrop continues to improve and the Federal Reserve remains stimulative we see the potential for markets to continue to move higher over time.

We hope you are all taking care and staying healthy. If you have questions, or would like to talk, please call us at 617-547-6717.

Your O'Brien Team

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