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# Post-Election Investment Insights from Ballentine Partners

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With the final mid-term election results (mostly) decided, we can move onto contemplating the impact of the vote on the outlook for financial markets. In broad terms, the pollsters got it right. The Democrats regained control of the House of Representatives, and the Republicans added to their majority in the Senate. The prospect of a divided Congress, especially in the current hyper-partisan era, is likely to mean very little new legislation enacted in the next two years. Legislative gridlock is generally considered a positive for markets, since it reduces uncertainty. Nonetheless, the Trump administration's unconventional approach to governing is likely to keep things interesting. What follows is a brief discussion of the major issues facing Washington during the next Congress and the potential impact on financial markets.

**Trade.** Tariffs are a tax on economic activity. Trump's imposition of tariffs on many imported goods has resulted in retaliatory measures from many of our trading partners and has been a large contributor to the volatility in global stock markets in 2018. Trade policy will be one of the most important determinants of market behavior in 2019, as it will have a direct impact on economic activity.

Congress has ceded a great deal of authority over trade policy to the Executive branch in recent years. As a result, House Democrats will have little power to radically alter the administration's trade policy. Democrats are wary of the recent re-write of NAFTA and the administration's threats to impose additional tariffs on imports from the European Union. The new NAFTA legislation will require Congressional approval, and it is unlikely to be passed before the new House representatives take their seats. In any case, a rewrite or outright rejection of the new United States-Mexico-Canada (USMCA) agreement is unlikely to have a major impact on the US economy, since the changes from the old NAFTA are relatively minor.

Far more important is the outcome of trade negotiations with China. Many Democrats support Trump's efforts to crack down on China's trade practices, so they are unlikely to push for a major change in strategy with respect to the Chinese economic threat.

According to Bloomberg, the current US tariffs on $250 billion of Chinese imports are expected to slow China's GDP growth by 0.5% in the year ahead. If the Trump administration follows through with the threat to raise tariffs on the latest $200 billion tranche, the damage will be far worse. On the US side, the tariffs on $110 billion of US exports to China will likely be masked by the effects of the Trump administration's $1.5 billion tax cut. At present, this looks like a win for the US.

Trump has a lot of latitude to determine the outcome of this dispute. Should the stock market continue to express its dissatisfaction with the progress on trade talks, a softening in positions may occur. This would likely lead to a strong relief rally, led by those countries most heavily impacted by the current dispute (i.e. emerging markets). If positions harden and markets fall, Bloomberg estimates that a 10 percent decline in US stock prices could shave as much as 0.4% from US GDP growth and 0.2% from world output.

Should a full-blown trade war erupt with a 10 percent tariff on all US imports and a commensurate tariff on all US exports, US GDP is estimated to be 0.7% lower in 2020 than it otherwise would be. Under this scenario, trade among countries outside the US would likely increase, which implies a bias toward international versus domestic equities. Higher tariffs would likely slow domestic spending and curtail the Fed's efforts to raise interest rates.

**Taxes.** Trump's pre-election promise to enact "Tax Reform 2.0", billed as a middle class tax cut, is likely dead on arrival. Under a different regime, House Democrats might be supportive of tax relief for the middle class, but they might be hesitant because of concern about the federal deficit. Higher taxes on upper income individuals would be rejected by the Republican-controlled Senate. The unresolved question is whether this year's tax reform is likely to deliver sustainable economic growth or whether it will it fade in coming quarters. The answer will be important for 2019 market performance.

**Infrastructure.** This is a theme that in theory has broad bipartisan support, but because of philosophical differences in approach, it will probably go nowhere. Republicans prefer a public-private partnership that would involve a smaller contribution from the federal government, whereas Democrats would prefer more government involvement. The expected increase in the federal deficit is likely to prevent any significant participation from Republicans on a bipartisan infrastructure bill.

**Immigration.** The President probably perceives his hardline stance on immigration helps his standing with his Republican base, so he unlikely to veer from this course over the next two years. However, according to JP Morgan, the current worker shortage in the US, as evidenced by the lowest unemployment rate in 50 years, could contribute to somewhat slower economic growth in 2019 and 2020 than a more immigrant-friendly policy.

On a positive note, every 12-month period following a mid-term election since 1960 has seen higher stock prices, with the average gain of 17 percent. However, the unpredictable nature of this administration will undoubtedly deliver some surprises not addressed here, including the potential impact of the myriad of congressional investigations likely to ensue next year. While gridlock generally reduces legislative uncertainty, the next two years promise to be anything but calm in the halls of Washington.

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Bruce is a Partner and Director of Research at the firm. Bruce rejoined Ballentine Partners in June 2016 after more than 5 years as Chief Investment Officer of City National Rochdale, LLC, in Los Angeles. City National Rochdale, a wholly owned subsidiary of City National Bank, serves family clients across the United States with a staff of nearly 100 investment professionals. Before moving to Los Angeles, Bruce served as Chief Investment Officer of Ballentine in our Waltham office for three years. Prior to that, Bruce spent four years with Morgan Stanley Private Wealth Management in New York and eight years with Glenmede in Philadelphia as Chief Investment Officer and Portfolio Manager. In addition to working directly with a number of family clients, Bruce serves on Ballentine's Investment Management Committee, which is responsible for the oversight of all of the investment activities for the firm. Bruce received an MBA with a concentration in Applied Economics from George Washington University and a BS degree in Business Administration from Penn State University. Bruce holds the Chartered Financial Analyst (CFA) and the Certified Private Wealth Advisor (CPWA®) designations. He lives with his wife in Palm Beach Gardens, Florida.