



Orlando's Outlook: Is gridlock good?

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Bottom Line *Equity investors breathed a massive sigh of relief this week as the feared “Blue Wave” in Tuesday’s midterm elections failed to materialize. The S&P 500 greeted the prospect of a split Congress with a powerful 2% rally on Wednesday, extending the equity market’s recent gain to 8% from its trough on Oct. 29.*

In the most contentious, expensive and engaged midterm election in history, both sides could declare a partial victory. It appears the Democrats were able to flip enough seats in the House of Representatives to regain a majority and establish checks and balances on the Trump administration. But the Republicans appeared to widen their majority in the Senate, rewarding President Trump for successfully transforming the U.S. economy with his fiscal policies.

The good news for equity investors, then, is that the risk of impeachment—and potential reversal of Trump’s fiscal policies—appears to be off the table. Even if a Democrat controlled House under the presumed Speaker Nancy Pelosi drafts articles of impeachment for Trump, the House needs two-thirds majority in the Senate (at least 67 votes) to execute it. That appears unlikely—short of a smoking gun on Russian collusion in Robert Mueller’s ongoing special counsel investigation.

So Trump’s key fiscal policies likely will remain in place: tax cuts, deregulation, repatriation and immediate expensing of capital spending. Collectively, these have resulted in the fastest GDP growth in four years and the strongest corporate earnings growth in seven years. Business and consumer confidence metrics are at multi-decade cycle highs, unemployment is at a half-century low, wages are growing at their fastest pace in a decade and retail sales are the strongest they have been in seven years. In our view, these have helped spark the equity market’s rally over the past eight days, a trend we believe will grow to record highs over the balance of this year and into 2019.

Common ground Exit polls Tuesday suggested that health care, immigration, the economy, gun policy and trade were key issues on the minds of voters. Will the new Dem-controlled House try to work with the Republican Senate and Trump to find common ground? Or are we destined for two years of subpoenas, hearings, investigations, increased oversight, demands for Trump’s tax returns and failed impeachment attempts, which will only serve to gum up the works in Washington and accomplish nothing? We’re taking a decidedly more optimistic view here and believe we may see some legislative compromise on some of the following issues:

- **Infrastructure** Everyone agrees roads, bridges, dams, ports, tunnels, airports, rail lines, the electric grid, rural broadband and refinery capacity, among many other areas, have deteriorated significantly and are badly in need of an upgrade. This provides the broadest possible bipartisanship between the two parties. Trump campaigned on a \$1.5 trillion infrastructure program spread out over a decade and funded by an estimated \$300-\$400 billion in repatriation taxes. He would lever this with some combination of a bond offering, the creation of an infrastructure bank and a public/private partnership. Democrats would like to see \$1 trillion in infrastructure spending, with an increased emphasis on so-called “green” initiatives (such as electric cars and renewable energy) paid for with higher personal and corporate taxes, a carbon tax and a bond offering.
- **Health care reform** Here, too, Republicans and Democrats agree on the need for lower drug prices and increased protection for patients with pre-existing conditions. Republicans likely will work for lower drug prices by using Medicare’s enormous purchasing power to negotiate volume discounts on drugs. Democrats, however, want drug-price controls on the pharmaceutical companies, which likely would result in lower profits and less research-and-development spending for new life-saving medications. Democrats also want to solidify President Obama’s singular health-care achievement, the Affordable Care Act (ACA); Trump still wants to dismantle it.
- **Immigration reform** Republicans are trying to pair enhanced border security with improved immigration policies (H1-B visa reform and DACA) to supplement a cyclical trough of the organic fertility rate of 1.8 children per woman in the U.S. The latest JOLTs report, for example, detailed that we have one million more available jobs in this country than unemployed people. We need better immigration policies to staff both high-skill and low-skill jobs to keep GDP growth elevated. Democrats want to find a solution for the DACA problem and end the practice of separating young children from their families at the border, while creating a generally wider immigration gate and a pathway to citizenship.
- **Trade** Trump has engaged in a very controversial and highly visible game of chicken with our foreign trading partners (particularly China), as a means of reducing our \$600 billion balance-of-trade deficit through stronger export volume, potentially boosting GDP growth 1% annually. Democrats want oversight and approval on any new

trade agreements, with an eye toward enhancing the protections and compensation afforded labor unions. Their long-standing demand for an immediate minimum-wage increase to \$15 per hour may be leveraged here.

- **Tax reform** Trump would like to make the personal tax cuts permanent, cut middle-class tax rates another 10%, index capital gains for inflation and introduce more stringent work requirements for able-bodied food-stamp recipients. Democrats would like to raise corporate tax rates from 21% to 25%, increase personal tax rates for the highest bracket from 37% to 39.6%, eliminate the \$10,000 annual SALT deduction cap, increase estate tax rates while lowering the exemption, and increase regulations on companies. These are obviously broad disagreements that can't be bridged, but the Democrats may use the impending 2019 debt ceiling as negotiating leverage.

Entitlement reform not likely We desperately need consensus to address the unsustainable trajectory of spending on Social Security, Medicare and Medicaid. However, Trump doesn't appear to have any appetite to address entitlements and Democrats want to increase Social Security payments, which would exacerbate the problem.

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Philip Orlando, CFA

Chief Equity Market Strategist, Head of Client Portfolio Management

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Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services

produced in a country.

The Job Openings and Labor Turnover Summary (JOLTS) is conducted monthly by the U.S. Bureau of Labor Statistics.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

Federated Advisory Services Company

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Federated Investors Tower
1001 Liberty Avenue
Pittsburgh, PA 15222-3779
Telephone: 412-288-1900