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Investment Institute

Market Commentary

Weekly perspective on current market sentiment January 13, 2021

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Last Week's S&P 500 Index: -0.3%

# Now what?

## Key takeaways

- The result of the Georgia U.S. Senate runoffs allows Democrats to largely control the legislative agenda.
- Additional meaningful government stimulus spending in the months ahead is more likely now, and the stock market is responding positively.

With the Georgia U.S. Senate runoffs behind us and the Democrats taking both seats, a new Congress is in session. One party is in control of the presidency and both houses of Congress if one considers Vice President-elect Harris's ability to break the 50-50 tie in the Senate. The stock market has continued to hover near all-time record highs despite President-elect Biden's campaign promises to hike a variety of taxes, including those on the incomes of high-earning individuals and corporations. The incoming administration also made it clear on the campaign trail that many of the regulations removed by the Trump administration will be brought back, likely sooner rather than later.

Historically, the stock market's initial reaction to the possibility of higher taxes and more regulation has oftentimes been negative. We would argue that over just the last couple of months the major stock indexes experienced some upside pressure based on the belief that a divided Congress (the consensus expectation) would not be able to successfully pass tax increases. But as the polls coming into the Senate runoffs on January 5 tightened, the market realized that Democratic control would greatly increase the probability that substantial additional stimulus would be approved by Congress. And many market participants consider tax increases to be more of a late 2021/very early 2022 story rather than something that could happen right away as the economy is clearly still trying to recover from the pandemic. As we pointed out fairly recently in this weekly publication, the equity market sometimes shifts into "immediate gratification" mode and moves any issues that won't likely be impactful in the near term to the backburner. Higher taxes and more regulation appear to be those issues at the moment.

With a narrow majority in the House and a split Senate that has a number of what we consider to be moderate Democrats, enacting a number of the campaign proposals President-elect Biden touted will not be downhill sledding. The makeup of the new Congress will likely require compromise between the parties to get things done.

The good news is our current outlook on the economy and equity markets would likely be helped by additional stimulus spending in addition to the recovery in consumer spending that we are projecting over the course of the final three quarters of 2021. We want to position portfolios for an improvement in the economy by having meaningful exposure to the segments of the market that we feel will benefit the most.

So, for now, we continue to favor U.S. large- and mid-cap stocks over international equities. Technology, Consumer Discretionary, and Communication Services are among the sectors we favor. We also favor the Materials sector given the prospects for increased government spending and global economic recovery. The Health Care sector is also favored and should benefit from increased federal spending. Stay invested. We will continue to look for opportunities in markets that will benefit from economic improvement.

**Risks Considerations**

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks.

**Sector Risks**

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. **Communication** services companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the communication services sector may also be affected by rapid technology changes; pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players; reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market.

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