

A Conversation Between Alissa and Peter

August 20, 2024

Peter: Alissa, I hope you're not going downtown this week.

Alissa: I won't have to go until Sunday for the Sky game. So I will be safe from the mayhem around the DNC.

Peter: I'm glad to hear that. So I have to tell you that I'm pretty worried about a Black Swan event. As you know, Kamala Harris's ratings have improved quite a bit. What I think people don't understand is that there's a chance that Harris could win the White House, and the Democrats could win the House and the Senate.

Alissa: So I do think that would be a true Black Swan, meaning a very low probability outcome. Joe Manchin is retiring in West Virginia, which gives the Republicans a pretty sure seat. That would even the Senate at 50-50. The Democrats are also up for 23 of the 33 available Senate seats, which gives the Republicans more chances to gain seats. So I think we are more likely to see gridlock than a Democratic sweep.

Peter: So you've been here at our firm for six years.

Alissa: Yes.

Peter: And in the six years you've been here, a potential Democratic sweep is the most concerning Black Swan I've considered.

Alissa: Really? Wow. So tell me which of Harris's policies concern you the most.

Peter: It's not her policies themselves that concern me. It's the possibility that she can enact them with a Democratic-controlled Congress. Markets like gridlock. Just on Friday, Harris announced her first economic plans, which included price controls, rental caps, and some debt forgiveness. In addition, it seems pretty clear to me if Harris is in the White House and the Democrats control both the House and the Senate that we're going to have higher business and personal tax rates. As well as the potential for a tax on unrealized capital gains for those who are super wealthy. So overall, I'm pretty worried that if the Democrats take control, it could be a really bad scenario for the markets.

Alissa: We last had a Democratic majority in both chambers when Obama was elected in 2008. I had just started freshman year of high school.

Peter: Boy I feel old.

Alissa: And under Obama the market performed well, didn't it?

Peter: That was a different environment. Obama's economic policies were not comparable.

Alissa: So let's talk about Harris's policies. Did you listen to her speech in North Carolina?

Peter: No, I just read the headlines and parts of news stories about it.

Alissa: Aha. OK. So the phrase “price controls” is getting thrown around a lot in the news. But what Harris actually said was much more vague. She said she would put a federal ban on price gouging on food.

Peter: That sounds like a price control.

Alissa: I think it could be interpreted many ways. She put on her attorney general hat and talked about disciplining companies for illegal practices, anti-competitive practices. For example, when it comes to housing, she wants to pass a bill that would prevent landlords from using price-fixing algorithms to increase rents. You can disagree with the policy, but I still think it's a long way from rent controls.

Peter: You're lucky Stuart isn't here. He thinks that law was a terrible idea in San Francisco. At last night's DNC, James Clyburn of South Carolina said, "We are the sum of our experiences." And our experiences -- the world's -- has not been a good one with price controls. But I think what I'm ultimately most concerned about is rising tax rates: corporate, personal, and inheritance.

Alissa: I think Harris might raise the corporate tax rate to 28% (up from 21%).

Peter: If not more. She proposed 35% when she ran for president in 2019. And I think Trump's tax cut in 2017, which lowered the corporate tax rate from 35% to 21%, was a really big tailwind for the markets.

Alissa: I agree that a higher corporate tax rate would weigh on corporate earnings in the first year it's enacted. But then it's done. Corporate tax rates were 35% in the US for a long time, and the market performed very well. So I think higher taxes could be a one-time hit. You might see the market sell off 10 or even 20%.

Peter: Actually, I'm worried about an even bigger sell-off. Also: what do you think is the probability of a Democratic sweep?

Alissa: That of course changes as polling numbers change, but I've seen a recent estimates ranging from 10-15%. If you multiply that by a possible 20% selloff, it would imply an expected loss of 2-3%. That's minimal for a long term investor. Of course, we never want to see losses in our portfolios, but it's important we put it into context.

Peter: There's also the issue of regulations. Late last week, small business optimism hit a two or three year high. I'm worried that small businesses are going to get quite concerned with the higher regulations and higher tax rates.

Alissa: That could be.

Peter: So I don't know if you know, but we're now approaching the two year anniversary for the bull market. Now, it's mostly been a "Magnificent Seven" rally. But what's interesting is that we've had this rally in a period of higher interest rates. You usually have a big rally when interest rates are falling.

Alissa: So now that the Fed is about to start lowering rates, it might offset some of the negative impact of economic policies from the new administration -- whichever one we end up with.

Peter: Could be. Now, for my last question: Angel Reese or Caitlin Clark as Rookie of the Year?

Alissa: That might end up being a closer race than the one for the President of the United States.

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