WINTHROP WEALTH

JANUARY 2021 CLIENT QUESTION OF THE MONTH: POTENTIAL IMPACT OF DEMOCRATIC CONTROL

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Now that we know the outcome of the Georgia Senate runoff elections, the Democrats will secure the White House and a narrow majority in both the House and Senate. The majority in Congress is razor-thin with the House currently at 222-to-211 and the Senate at 50-50 with Vice President-elect Kamala Harris serving as the tiebreaker. Going into the election, many investors were concerned about the implications of a "blue wave" scenario, and while the narrow majorities in Congress means the outcome is not quite a wave (maybe a "blue ripple" is more accurate), Democrats have control nonetheless. As we discussed in our **Presidential Election piece from October**, making emotionally driven portfolio changes (market timing) based on political concerns is a major financial mistake. This latest period is more proof of that as the stock market (S&P 500) is at a new all-time high after returning +18.4% in 2020.

Over the last few days, we have received several questions regarding our thoughts on the Democrats gaining control of the Senate. This piece will outline the implications, including potential tax policy, based on what we know so far.

» Reconciliation and Rise of the Moderates

The Senate requires a simple majority to pass a bill, however, a procedural step known as the cloture rule, requires 60 votes to end debate and move to a vote. If a measure does not have the support of at least 60 Senators, that means it has been filibustered. However, some bills are not subject to the filibuster and can pass with 51 votes, the most notable is through a process called reconciliation. In 1974, the Senate adopted a budget reconciliation process that allows for one bill per year related to certain tax, spending, and debt limit legislation to pass with a simple majority vote. The Biden administration would likely use the reconciliation process to advance a tax and spending package without needing any Republican votes. Republicans used the reconciliation process to pass the Tax Cuts and Jobs Act (TJCA) in 2017.

Given that Democrats will need Republican support to pass most bills, and that they cannot afford to lose one vote from their own party in the reconciliation process, the voice of the moderate becomes incredibly important. Moderate Democratic Senators, including, Joe Manchin (West Virginia), Kyrsten Sinema (Arizona), and Jon Tester (Montana) will become several of the most powerful politicians in the world. Senator Manchin has already gone on record stating that he will not support ending the filibuster, packing the court, or the Green New Deal.

» Schumer Sets the Schedule

Senator Chuck Schumer (New York) looks set to become the next Senate majority leader. Senator Schumer has been the minority leader since 2017. The majority leader is important as the position controls the legislative agenda, thereby effectively deciding which measures can be considered for a vote.

» More Stimulus, More Payments

President-elect Biden introduced his $1.9 trillion Coronavirus Recovery Plan on January 14th. The plan includes $1,400 in direct payments (bringing the total to $2,000), increased federal unemployment benefits, raising the federal minimum wage to $15 per hour, aid to state and local governments, and funding for vaccine distribution. Biden stated his preference is to pass the bill with bipartisan support, but it will likely need to undergo several changes before a final agreement.

Taxes

As expected, we have received the most questions on potential tax changes, and unfortunately right now the best anyone can do is guess. We do know that President-elect Biden campaigned on increasing the corporate tax rate from 21% to 28%, raising the top individual rate from 37% back to 39.6%, and taxing capital gains and dividends in line with personal income for those with taxable income over $1 million, and eliminating the step-up in basis on inherited assets. However, these were largely only campaign talking points. According to Deloitte, "very little detail is currently available on many of the proposals President-elect Biden has put forward. Over the course of the campaign, he did not release detailed tax policy papers to the public or deliver a substantial, tax-focused economic address. Biden's proposals are gleaned largely from statements on his campaign website, as well as from comments made during Democratic primary debates, rallies, campaign speeches, and briefings to reporters." We will also point out that most of these proposals were introduced pre-Covid when the economy was healthy. Given the current economic weakness, policies that promote job growth are likely to be prioritized over others that could dampen the recovery.

We will receive more details on President-elect Biden's tax proposals when his administration submits their budget to Congress. Federal law requires the budget proposal to be submitted by February 1, 2021. However, a new president frequently submits their first budget a few months after the deadline (month of first budget submission – Clinton: April, Bush: April, Obama: May, Trump: May). The next twelve months are critical to pass any tax legislation as by next year the focus will turn to the 2022 midterm elections. We would advise taking a wait-and-see approach regarding potential tax changes rather than guessing. We have already seen forecasts from several Wall Street analysts that range from no changes to major reform. We strongly caution against put too much stock into one person's estimate.

We also want to remind everyone that taxes were already going up. Most of the individual and estate tax provisions as part of the Tax Cuts and Jobs Act (TJCA) of 2017 are set to expire after 2025. Individual tax rates are scheduled to effectively return to where they were pre-TCJA. Keep in mind that the tax code evolves – there have been plenty of tax changes in the past and there will be more in the future.

As part of our comprehensive financial planning process, we provide tax analysis and minimization strategies as well as cash flow management. We will analyze your past tax returns and help estimate your current year tax situation so that we can proactively introduce and implement strategies that best fit your unique circumstances. Most importantly, we will make sure that we have funds set aside for your short-term cash flows while investing the rest of the assets in a globally diversified portfolio. As always, we caution against making significant portfolio changes based on political views or potential tax changes. We know that **Dire Market Predictions** are quite common and often wrong.

At Winthrop Wealth, we apply a total net worth approach to wealth management that combines both comprehensive financial planning and investment management. Our investment philosophy is based on providing actively managed, well-diversified portfolios, with a long-term focus. We continue to believe this is the optimal approach for helping our clients ultimately reach their goals and objectives. Please see our **December 2020 Client Question of the Month** for several charts that support our investment philosophy by demonstrating that: the stock market goes up over time, market declines are common, the value of time, and the benefit of portfolio diversification.

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The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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