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COMMENTARY

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Both the Economy and the Biden Administration Face Tougher Challenges Ahead

- The economic recovery remains intact through the first 100 days of the Biden administration
- Tougher challenges lie ahead.
- In uncertain times, your financial professional can help you stay focused on your long-term goals

As 2021 progresses, we continually monitor the recovery and the new administration's policies and agenda. While we have said in the past that presidential administrations have some impact on the economy and markets, there are larger forces at play like global trade and monetary policy. However, presidential administrations do have some impacts so we are watching it closely for clues on what may lie ahead. So far, the new administration has benefited from the current economic cycle/post-recession recovery, which has been front-end loaded, and has seen a surge in good news on nearly all points – from key consumer metrics like sentiment and retail sales to many important business metrics. And let's not forget the labor market is improving nearly every week. Looking ahead, however, the economy faces some headwinds as it is showing signs of transitioning from its current early cycle recovery to a mid-cycle one facing tougher year-over-year comparisons. Let's also not forget rising inflationary pressures, China reducing its stimulus, and the potential of higher taxes, which we discuss below, may also impact this recovery.

This economic cycle that we are in now is very similar to the first 100 days of the Biden administration as they have both been front-loaded with positive news. The Biden administration also started quickly with the passing of the $1.9 trillion American Rescue Plan. Unlike most bills, this was swiftly passed in Congress with relative ease. Like the economic cycle progressing and facing a difficult road ahead, Biden's next attempt at stimulus, the Infrastructure Bill, faces big headwinds such as a lack of bi-partisan support and concerns around how to pay for it that will create challenges.

Similarly, the doses of vaccines being administered accelerated at a robust pace. By early April, more than 3 million Americans were vaccinated daily, exceeding vaccination targets. Lately, however, there has been a clear slowing of vaccinations/doses being administered that seemed to have peaked right at the time that the Johnson & Johnson vaccine was temporarily taken off the market. With concerns around blood clots, apprehension, especially among the under-65 age group, of vaccines is rising. Positively, more than half of adults in the U.S. have received at least one COVID-19 vaccine dose and more than a third of adults have been fully vaccinated. On the other hand, it is estimated that around 75% of the population will need to be vaccinated for herd immunity to take effect.

Recently, the Biden Administration surprised the financial markets with a proposal to raise the capital gains tax rate for people that earn $1 million or more in income. However, was this really a surprise? During his campaign, he telegraphed his plans to raise taxes on the top 1% of income earners and this announcement is consistent with that message. According to the Federal Reserve, households in the top 1 percentile of income own about 45% of all U.S. corporate equities and mutual fund shares. That concentration is why a tax applied to a very narrow slice of U.S. households led to the recent abrupt market selloff. The positive market move that ensued is likely investors realizing this was not a surprise, given Biden's campaign, and, more importantly, raising the capital gains tax rate faces a long and uncertain path through Congress. At this time, this tax change will not likely pass in its current form for three reasons: 1) this is a large increase and will likely be lowered 2) Republicans will not go along with it and even some Democrats may not be on board, though they could be persuaded if the tax change includes a removal of the SALT tax cap 3) though the economic recovery is broadening, this could hurt the delicate balance.

Lastly, speaking of the financial markets, investors reacted positively to Biden's announcements and stimulus bill in the first part of the year. Equities rallied and bond yields surged in anticipation of good times ahead. Lately, this has not been the case. After the first quarter rally in economically sensitive asset classes and sectors like value, small cap, financials, industrials and materials, there has been a sharp reversal lately as growth and technology have taken the lead as investors begin to question economic growth and focus on the economic cycle shift from early recovery to mid-recovery. Similarly, bond yields surged in the first quarter. However, slowing growth prospects have begun to pressure yields.

Going forward, new agenda items will likely require the Biden administration to compromise with a deeply divided Congress. Biden's campaign promise to unite the country may prove to be his most difficult promise to fulfill. In these times, your financial professional can help you stay focused on your long-term risk and return goals and help you with your personalized investment objectives.

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