Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

TRENDMACRO LIVE!

On Georgia

Wednesday, January 6, 2021

Donald Luskin

Markets should be more concerned. It will be easier for Dems to tax than to spend.

The first item on our list of developments that could derail the 2021 boom looks like it has happened – it's not fully official yet, but *both GOP Senate candidates in Georgia look like they have lost to Democratic challengers, which will give Democrats narrow control of the Senate* (see "A Boom in 2021… But What Could Make It Bust?" January 4, 2021). We knew it would be close, but this result is not what we predicted – and we think it is a surprise to markets, too. *It's an anti-growth surprise, because it opens the door to anti-growth tax, regulatory and industrial policy that a GOP majority would have blocked. Yet as of this writing, markets don't seem to be very worried.*

- Equities are higher. Treasuries are reacting a bit more strongly, with the 10-year yield making new post-lockdown highs, led by a widening of the TIPS breakeven spread also to new post-lockdown highs.
- We'll see what happens over the coming days and weeks, as markets get clues from Democrats about how they intend to use their power. But at the moment *the simplest explanation is that markets anticipate that free-spending Democrats will stimulate and reflate the economy enough to offset any negative effects of higher tax and regulatory burdens*.
- We're not so certain about that. To be sure, stocks are overdue for a correction (see "Do We Need More Stimulus?" December 14, 2020), so it gets our attention that they are not weaker this morning on what we see as a negative surprise. But as the recovery from the Covid-19 recession continues, we've expected yields and inflation expectations to back up anyway (again, see "A Boom in 2021… But What Could Make It Bust?"). Whatever markets are thinking or not thinking, we think that a 50-50 tie in the Senate (deciding vote to be cast by Vice President Kamala Harris), and only a 9- to 13-seat majority in the House, mean *it will be a lot easier for Democrats to tax and regulate than to spend*.
- Those narrow margins of control mean that Democrats will find it difficult to implement the more radical agenda items that have been bruited during the campaign – eliminating the filibuster in the Senate, packing the Supreme Court, admitting new states, and so on. The GOP will have no problem presenting a completely unified opposition to such things, while Democrats will be able to tolerate almost no defections. Moderate Democrats in purple states and

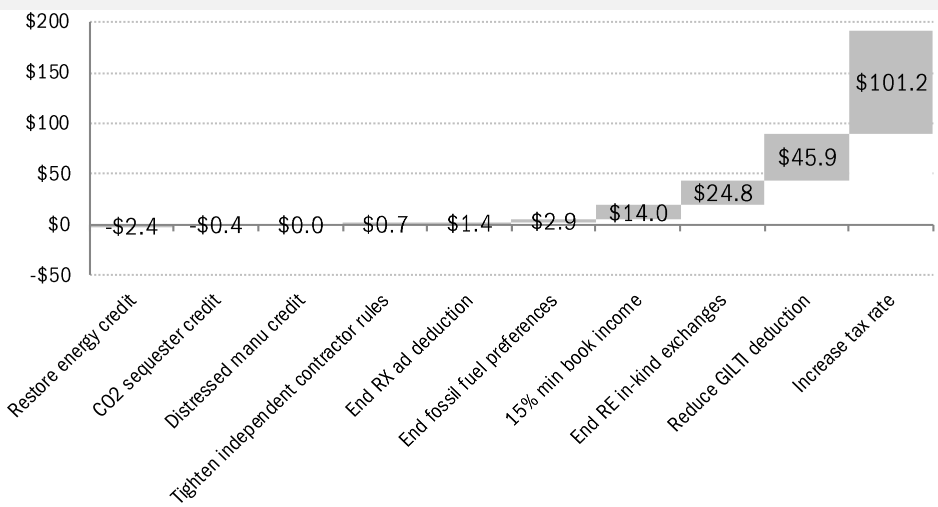
Update to strategic view

US MACRO, US STOCKS, US BONDS, OIL: It appears the both GOP Senate candidates in Georgia have lost to Democratic challengers, giving Democrats very narrow control of the Senate. Equities, due for a correction anyway, don't seem as concerned this morning as we think they should be, given the risk that the 2018 corporate tax cuts will be repealed, reducing S&P 500 earnings by more than 12% and disincentivizing CAPEX. Higher Treasury yields and TIPS breakevens might imply expectations that free-spending Democrats will do lots of "stimulus," but as recovery proceeds we were expecting a back-up anyway. We'll have to wait for clues from Democrats about how they intend to use their powers. We will be watching most carefully for possible elimination of Senate filibuster rules, because that would be the gateway to aggressive anti-growth legislation. Even then, the Democratic agenda will be constrained by its narrow margins of control, and the upcoming 2022 elections in which reapportionment makes continued Democratic control of the House tenuous.

swing districts understand that this was no "blue wave" election conferring a "progressive" mandate, and a couple of Senate squeaker wins in Georgia don't suddenly make it so. They know what happens historically in mid-terms when the governing party colors outside the lines. That's an especially salient concern in the House, where thanks to the 2020 census and the subsequent congressional district reapportionment, there will be a flip of between 10 and 12 districts from blue states to red states in time for the 2022 elections, and GOP legislatures and governors will be in charge of the gerrymandering (see "How Will Biden Govern?" November 20, 2020).

- *Of those radical agenda items, the one that most concerns us would be the elimination of the filibuster in the Senate. It's the one we'll be listening most attentively for in the coming weeks, because it is the gateway to all the other items*.
- We draw comfort from conservative Democrat Joe Manchin (D-WV) having gone on the record in November saying he won't vote to abolish the filibuster. And he said it with the Georgia races in mind. One Democratic defection is enough to end the matter, and it shows how fragile Democratic control really is.
- The filibuster is already gone for Supreme Court and other federal appointment confirmations, including cabinet or Federal Reserve nominees.
- Only legislation moved under "reconciliation" rules can be passed with just 50 Democratic votes plus the vice president, no filibusters allowed. Reconciliation applies to budget bills, so tax hikes can easily be passed. Abolishing the Tax Cuts and Jobs Act of 2018 that sharply lowered corporate taxes could be accomplished, and doing so is not seen by Democrats as especially controversial. Candidate Joseph R. Biden campaigned on it explicitly, even while distancing himself from "progressive" initiates such as "Medicare for all." *We remain concerned that this should be a major worry that equities seem to be ignoring – it would cut after-tax S&P 500 earnings by more than 12%, and punish future earnings growth by*

Corporate income tax burden: Biden plan 2022 change versus current law USD billions



Source: Tax Policy Institute, TrendMacro calculations

Contact TrendMacro

On the web at trendmacro.com

Follow us on Twitter at twitter.com/TweetMacro

Donald Luskin
Dallas TX
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

[About us]

disincentivizing CAPEX (please see the chart on the previous page and again, see [“A Boom in 2021… But What Could Make It Bust?”] January).

- The filibuster is not much of a blocker to Biden’s restarting the Iran nuclear deal, and lifting sanctions against Iran – which would flood an already glutted crude oil market with an additional 2 million barrels per day of Iranian production (see “Shale Survives, and May Soon Thrive” December 8, 2020). We say that because the GOP Senate didn’t approve the deal in 2015 when it was first put in place, despite a seemingly clear Constitutional requirement that the Senate must approve treaties.
- *But without abolishing the filibuster, Biden’s legislative and regulatory agenda will be on a short leash. Even with its abolition, the Democrats’ narrow margins of control act as a natural constraint. On the one hand that would rule out the more radical anti-growth items, but on the other hand would also likely rule out the kind of “stimulus” that the markets are arguably expecting, or at least wishing for.*

Bottom line

It appears both GOP Senate candidates in Georgia have lost to Democratic challengers, giving Democrats very narrow control of the Senate. Equities, due for a correction anyway, don’t seem as concerned this morning as we think they should be, given the risk that the 2018 corporate tax cuts will be repealed, reducing S&P 500 earnings by more than 12% and disincentivizing CAPEX. Higher Treasury yields and TIPS breakevens might imply expectations that free-spending Democrats will do lots of “stimulus,” but as recovery proceeds we were expecting a back-up anyway. We’ll have to wait for clues from Democrats about how they intend to use their powers. We will be watching most carefully for possible elimination of Senate filibuster rules, because that would be the gateway to aggressive anti-growth legislation. Even then, the Democratic agenda will be constrained by its narrow margins of control, and the upcoming 2022 elections in which reapportionment makes continued Democratic control of the House tenuous.