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GEORGIA ON OUR MIND

Although the Senate runoff race between Jon Ossoff and David Purdue has not yet been officially called by most media outlets, it appears increasingly likely that the Democrats will win both Georgia seats. The final pre-election polls expected this outcome, but it was a bit of a surprise for many prognosticators.

Assuming Jon Ossoff ends up winning the Senate seat, Democrats will control the Senate through the tie-breaking vote of VP-elect Kamala Harris. This outcome means a different policy agenda is in now in play in Washington DC.

- Directionally, President-elect Joe Biden has proposed a range of policies that will be economically stimulative (Biden has proposed $5+ trillion in government spending), but redistributive through higher taxes, particularly on high income individuals and corporations.
- Success in passing Biden's policy agenda is not guaranteed – if a single Democratic senator breaks from the party line, like Manchin (WV) is likely to do for some of Biden's proposals, Biden will not have the majority he needs to push budget and tax changes through reconciliation.
- Timing around tax reform remains uncertain. Biden has signaled that his initial priorities are containing COVID-19 and reopening the economy. The US will also have a meaningful output gap through at least 2021. It would be unusual to raise taxes in such an environment, but we believe Democrats will also have their eye on doing something before the midterms in two years.
- The Democratic majority in the Senate also allows Biden to push through some Cabinet nominees that otherwise would have been too extreme for a Republican Senate.

Economic Implications:

- We believe 2021 is shaping up to be an inflection point: strong organic economic growth on the back of pent-up savings, a political desire for fiscal stimulus to the point of overheating, and a Fed that has said it will - in several ways - be more accommodative than it was during the last recovery. An unknown unknown could stop the train at any point, but at this point the engineers are pushing as much coal into the engine as will fit.
    - Despite the deficits that will come with these policies, a few years of "growth at any cost" might be what we need to avoid negative rates.
    - There is a productivity wild card in the works as well that could boost trend growth even further over the next 5-10 years.

Fixed Income:

- Pricing in more stimulus, the 10-year Treasury pushed past 1% for the first time since March and inflation expectations are above 2% for the next decade.
- This election outcome further **bolsters our decision to reduce duration** in taxable bond portfolios.
- Additional infrastructure spending and state-specific fiscal support will bolster the municipal bond market.

Equities:

- Despite a broad consensus that additional stimulus is good for equities, we need to watch the Fed to see how they respond to higher Treasury rates. It is likely the Fed will use yield curve control to keep the long end of the curve suppressed if needed.
- To the extent that the Fed keeps nominal rates down and lets inflation move higher, the dollar could be challenged over the next few years. Non-dollar assets, like international equities, are one of the best inflation hedges we can hold in a portfolio.

We will be covering many of these topics, including a deep dive into the municipal bond market, on our **LiveStream tomorrow, January 7th, at 10am. Please click the link below to register -** and we will make the replay available if you miss the live event.

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Please Click Here to Register for the Livestream

And, as always, we welcome any questions you have on how the current economic and investment environments may affect your portfolio in the year ahead.

Investment Strategy Team
Mill Creek Capital Advisors
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