The Decisive Vote for Gridlock That Stocks Will Love

By Ken Fisher, November 17, 2020

In the wake of America's election, you likely fall into one of two camps: Blissful over Biden's win or terrified by Trump's (apparent) defeat. But for markets, this election has a different reality. This was a mandate for moderation—an election so close big legislation you either love or loathe stands virtually no chance of passing. However you feel about this-or-that race's outcome, for your portfolio, this election is great news.

Headed into the election, markets wobbled—partly due to election angst. Would a "Blue Wave" sweep government? Would Trump surprise again? Would an unclear result tee up a Supreme Court contest a la 2000? But even before we had clear answers to any of these questions, markets rallied. What they saw: At every governmental level this election was historically tight—defying polls and ushering in unusually early gridlock—like Christmas in July.

While the specifics may yet shift some, Joe Biden seems to have won with a far narrower margin than most expected. Election eve polls put him 7.2 points ahead of President Trump.[i] With official certification, recounts and lawsuits still pending, reality was under half that—3.4 points.[ii] And that is just the popular vote. The Electoral College determines the presidency. Key states like Arizona, Georgia and Wisconsin were all decided by under one percent. No one knows how recounts and lawsuits will change this. Perhaps not at all. Regardless, a small number of swing states decided the race by a tiny margin.

The Senate, too, remains a cliffhanger with "control" yet to be determined. But when it is determined, control will be very weak regardless. While at least nine Republican incumbents were thought to be vulnerable, only two lost. Republicans gained the Alabama seat, leaving them down a net one seat—so far. You already know that. But there remain the two Georgia runoffs. They, also, are microcosms of this tight election.

By Georgia state law Senate candidates must gain over 50% to win. If not, a runoff between the top two vote-getters proceeds. Republican Senator Kelly Loeffler, appointed to fill retired Senator Johnny Isakson's seat, suffered a "jungle" election with a fractious field of multiple Republicans and Democrats splintering the vote. She and Democrat Raphael Warnock now advance. In the other race, Republican Senator David Perdue was nicely ahead but finished just under 50%. These races will determine which party controls the Senate. But just barely.

However they end up, neither party will have a decisive edge. There are three possible outcomes: The GOP could control the Senate 52 – 48 if they keep both Georgia seats or 51 – 49, if they lose one and keep one. If the Democrats win both races, a 50 – 50 tie means presumed Vice President-elect Kamala Harris casts a tiebreaking vote, giving Democrats "control." But that small an edge requires near unanimity to pass divisive bills.

In the House, the Democrats retain "control"—but by the slightest of margins. As I type, Real Clear Politics puts the seat count at 221 Democrats versus 209 Republicans, with five seats uncalled.[iii] Of those five, four were Democratic seats in the last Congress—contributing to the party's 232 – 197 edge on Election Day.[iv] And of the five, Republicans currently lead in four. Even if they win all five remaining seats, their margin would be the smallest Democratic majority since World War II.[v] If the Republicans win the races they currently lead, the Democratic margin would be their smallest majority *since 1900*.

Too many people think one party having nominal "control" of the Senate, House and Presidency means a clear path to big legislation. No! Parties are fractious. Politicians' primary interest is always one thing: re-election. Senators representing purple or red states aren't likely to jeopardize their post by toeing the party line. Already, there is talk of Democratic Senator Joe Manchin from red-state West Virginia joining forces with GOP Sen. Susan Collins from purple-state Maine to play king or queen makers by dragging all legislation back to the middle. Swing-state senators in Michigan, Pennsylvania and Wisconsin will face similar pressure. Congresspeople are already looking to 2022's midterms now—particularly since redistricting means many of those in more balanced districts will see their district lines change before then in wildly unpredictable ways. They will avoid extremism for fear of alienating voters not in their district now. This once-in-a-decade phenomenon tied to the census is a powerful but under-recognized force of moderation in this tight House of Representatives.

No matter how you do this math, the result is the same: gridlock, and that is good for stocks. Big legislation is often about redistribution or shifting property rights between high-earners and lower, management versus workers, and so many more. In the process, it creates winners and losers. Consistent with behavioral finance theory, losers hate losing more than winners appreciate their spoils. That means robbing Peter to pay Paulette isn't zero sum—it is far less than that, even before considering the questionable efficacy of government economic plans, no matter who draws them up.

Gridlock—whether it manifests as a split government or narrow margins for one party—bullishly prevents all that. The "Green New Deal?" Not happening. Trump's promised second tax cut? Nope. Huge tax hikes, $4 trillion in stimulus, packing the Supreme Court and eliminating the filibuster? All foiled. Stocks saw this reality before almost anyone—and rallied. We normally get this gridlock effect from midterm elections, as the president's party normally loses relative clout then. This time we got it two years early—like getting Christmas in July.

It all fits perfectly with the election trend I call the "Perverse Inverse," detailed in my August column. While neither party is "good" or "bad" for stocks, many investors think otherwise, seeing the Democrats as "anti-business" tied to campaign rhetoric that usually hypes raising taxes and tightening regulation. In election years when a newly elected Democrat wins, that typically dampens returns, which average -2.8%.[vi] But in their inaugural years, stocks rebound big—averaging 21.8%—as investors' fears don't come true and relief ensues.[vii] (Vice-versa when a Republican wins.) It usually takes some time, as investors need to see sweeping change isn't coming. But this year, the golden gridlock we got should have investors seeing US political drivers point positively early on. Politics are, of course, just one factor for stocks. But after a tense election year, the long lasting relief gridlock offers makes for a forward wind in American stocks' sails.

i Source: Real Clear Politics, as of 11/11/2020. Average poll margin on 11/2/2020.
ii Ibid. Unofficial popular vote margin as of 11/11/2020.
iii Source: Real Clear Politics, as of 11/16/2020.
iv Source: US House of Representatives Press Gallery, as of 11/12/2020. The current House has five vacant seats and one Libertarian
v Source: US House of Representatives, as of 11/12/2020. Calculation based on party advantage when Congress convenes. Deaths, party affiliation changes and resignations can cause shifts thereafter.
vi Source: Global Financial Data, Inc., as of 10/4/2020. S&P 500 average total return in election years when a newly elected Democrat wins the White House, 1925 – 2019.
vii Ibid. S&P 500 average total return in newly elected Democratic presidents' inaugural years, 1925 – 2019.

About the Author

Ken Fisher is the Founder, Executive Chairman and Co-Chief Investment Officer of Fisher Investments. His prestigious *Forbes* "Portfolio Strategy" column ran from 1984 through 2016, making Ken the longest continuously running columnist in the magazine's history. He has authored 11 books, including 4 *New York Times* bestsellers. Ken writes regular columns for more than a dozen countries worldwide.