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JANUARY 2021

Election Special Bulletin

GEORGIA SENATE RUNOFFS AND ELECTORAL COLLEGE CERTIFICATION

Overview

There has been significant focus on political events this week, including both a pair of senate runoff elections in Georgia and the certification of the Electoral College results. The unrest we have seen in Washington this week is disturbing, a jarring moment and truly embarrassing blemish on our great nation. Fortunately, there are better days ahead. From an investment perspective, it is important to understand that, despite the short-term news flow, markets are forward looking. We continue to expect the pandemic to ease in mid-2021 and the transfer of power in Washington to go forward, leading ultimately to a reduction of COVID related restrictions, increased economic growth, and rising corporate profits. With Democrats holding unified control of government for the first time since 2010, some changes in policy direction can be expected and we are monitoring this to assess any need to adjust our GDP, interest rate and corporate profit forecasts, as well as our approach to tax management. However, because the thinness of Democrat congressional majorities will likely restrain their agenda, we are maintaining our forecasts and asset class recommendations for now, and continue to believe our portfolios properly positioned for the current market environment.

Economic Implications

- **Major drivers of near-term growth:** While policy changes can have an impact on growth, we continue to expect the path of the economic recovery to be driven largely by the combined effects of the COVID-19 pandemic and the monetary and fiscal policy response. Congress has already agreed to a new stimulus package worth $900 billion, and we expect vaccines to lead to a mid-2021 normalization of activity.

- **No significant change to policy expectations:** While the Georgia runoffs have given Democrats control of Congress, the narrow margin in the senate and the thinner majority in the House of Representatives limit the scope of potential policy changes.

- **Potential for increased stimulus spending:** In addition to the recent passage of a $900 billion stimulus package, there is potential for further spending, such as increased direct payments to tax payers to aid recovery and infrastructure investment. It is unlikely that such decisions will come immediately, but we believe they would be supportive of near-term economic growth.

- **No significant change to the economic outlook:** The pace of economic growth is unlikely to change meaningfully as a result of the election, as the recovery's path will be shaped largely by the combined effects of the pandemic and ongoing fiscal and monetary support. We continue to expect a more entrenched and durable recovery developing in the second half of 2021 as vaccinations become widespread.

Equities

- **Moderate returns expected, regardless of election outcome:** With relatively high equity valuations and low long-term economic growth expectations, we continue to believe that investors should expect moderate returns going forward. While policy initiatives will likely change with a change in control in Washington, history has shown that after an initial adjustment period in stock prices the market does well regardless of the composition of the U.S. government, as there are other are critical differentiators that are impactful in corporate earnings growth and stock returns.

- **Policy impact to market expected to be modest:** While a modest increase in the corporate tax rate is possible and would likely negatively impact corporate profits, other policy changes, such as increased fiscal spending, investment in infrastructure, and incentives for R&D in certain areas could boost growth and, in turn, support profits. We believe the net impact of these policies in aggregate is modest, and we continue to favor U.S. equities relative to global peers due to a range of factors beyond public policy, as outlined with our 4Ps framework.[1]

- **Certain industries are likely to be impacted differently:** The technology sector could be more negatively impacted by higher tax rates, and increased regulatory scrutiny and potentially onerous antitrust approaches could hurt the largest tech stocks. The health care sector would benefit from increased subsidies for the Affordable Care Act and an expansion of coverage, though pricing power might come under pressure for some companies. The consumer discretionary sector could benefit from minimum wage increases, which support consumer spending. The financial sector would likely see increased regulations related to consumer protections, and traditional energy companies could be hurt by increased regulations, while renewable energy-focused companies could see growth increase. Industrial companies could be helped by increased fiscal spending and investments in green energy but hurt by increased regulations on the oil and gas industry.

- **Rigorous fundamental analysis is key:** Given the variety of potential policy changes, it is critical to carefully assess each company's business model to understand the potential policy impact. Tax and regulatory approaches can vary widely on a company-by-company basis, highlighting the importance of active management for investors.

Fixed Income

- **Low short-term interest rates, modest support for long-term rates:** While monetary policy is expected to keep short-term interest rates low for years, the increased spending expected under the new administration could lead to modestly higher growth and inflation expectations and put upward pressure on long-term rates. The net impact is continued low levels of investment income from fixed income and potential downside risk to longer duration segments of the bond market.

- **Environment favors opportunistic fixed income:** Increased fiscal spending would be supportive of economic growth and, in turn, the outlook for corporate credit broadly, and the potential for increased long-term interest rates favors a focus on the high yield segment of the bond market, which tends to be less sensitive to interest rate movements. Further, amid continued low interest rates, the search for yield will continue to support opportunistic fixed income segments.

- **Policies relatively supportive of municipal fixed income:** Near-term fiscal spending is expected to include support for state and local governments, improving the credit outlook for municipals. Additionally, the potential for increased personal income taxes on higher wage earners is expected to make tax-exempt bonds relatively more attractive for taxable investors. Both of these factors could support the return outlook for municipals in the near-term.

[1]The 4P analysis is a proprietary framework for global equity allocation. Country rankings are derived from a subjective metrics system that combines the economic data for such countries with other factors including fiscal policies, demographics, innovative growth and corporate growth. These rankings are subjective and may be derived from data that contain inherent limitations.