Paul Dietrich
Chief Investment Strategist

11/24/2020

AN UPDATE FROM PAUL DIETRICH

THE YEAR-END ECONOMY & CONTROL OF THE SENATE

Year-to-date, the S&P 500 Index is up a surprising 10.73%, and for the past year it is now up 15.02%. The tech-heavy NASDAQ Index is up 32.41% year-to-date, and it is currently up 39.45% for the past year.

Throughout this year, I have urged investors to stay fully invested in the stock market in all of my *Market Commentaries*. Despite record market volatility in 2020, investors were rewarded for not panicking and trying to time the stock market.

However, I remind investors that the stock market continues to be overvalued. According to Factset, the forward 12-month Price Earnings Ratio (P/E) for the S&P 500 Index was 21.7 as of Friday. That means the S&P 500 Index could be overvalued by more than 17% compared to the 5-year forward P/E average of 17.4.

The Economy Is Slowing And Could Stall If COVID Increases

I have warned investors over the past couple of months they should not be surprised to see a 10% or more pullback or correction from current prices in early 2021. This would be the start of a normal, healthy reversion to the stock market's long-term trend of a forward P/E ratio of 17.

What could trigger a stock market pullback in 2021? With COVID-19 cases expected to spike after the Thanksgiving and Christmas holidays, and with national hospitals expected to be overwhelmed and exceeding capacity starting in January 2021, politicians may be forced to lockdown the economy once again. Epidemiologists believe that a full lockdown is inevitable if the nation's healthcare infrastructure is at risk of collapsing.

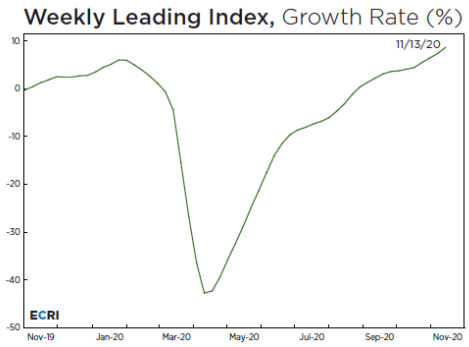
It is essential to understand that such a pullback will be an entirely normal and healthy correction because the stock market is overvalued. Sometimes the markets get ahead of themselves and then they adjust. That could happen in early 2021.

What To Expect From The Stock Market Next Year

This is not a time to panic or get out of the stock market. In the long term, the stock market will thrive in 2021. The new COVID-19 vaccines are expected to return the nation to some semblance of normal by the end of the year. The expected stimulus package and infrastructure legislation from the Biden Administration **should make 2021 an excellent year for the stock market.**

What Are The Leading Economic Indicators Telling Us?

As we take a look at the current state of the overall underlying U.S. economy, we can see from this week's ECRI Weekly Leading Index of leading economic indicators that the economy is still growing and expanding—but at a slower rate.



Leading economic indicators tend to notify investors in advance of changes in economic activity. According to the Conference Board, their index of Leading Economic Indicators (LEI) grew for the second straight month, 0.7% month over month, which is significantly lower than earlier in the recovery.

While there is optimism that a safe and effective vaccine will be widely available to all Americans by mid-2021, the next six months will likely see new record high

infections and deaths. With this comes the specter of new regional lockdowns.

Suppose a divided Congress doesn't pass a significant stimulus bill to help those small businesses and others negatively affected by the pandemic. In that case, this could be a difficult six months for the economy.

Who Will Control The U.S. Senate?

Currently, the Republicans control 50 Senate seats, and the Democrats control 48. Two Senate seats, both in Georgia, will be decided in a runoff election on January 5, 2021.

If the Democrats win both races, the Senate will be divided 50-50—something that has only happened three times in U.S. history, in 1881, 1953, and most recently after the 2000 election for a short time.

With a 50-50 Senate, Vice President Kamala Harris would cast the deciding votes, making Senator Chuck Schumer the Senate's Majority leader.

Will This Happen? Not Likely!

While President-Elect Biden won the state of Georgia, many Republican voters cast their ballots for Joe Biden as President and then voted for down-ballot Republicans for other offices. Many Georgian Republicans voted against Donald Trump, **but not against other Republicans.**

In the Senate races, all of the Democratic candidates won fewer votes than Republicans in each race. Biden received over 100,000 more votes than the Democratic Senate candidates.

According to Inside Elections, since the 1990s Democrats have only won one of seven runoffs in general or special elections.

In the past, Democrats have struggled to turn out their voters in runoff elections compared to Republicans who tend to vote in higher numbers in all elections.

It is harder for Democrats to turn out voters in non-Presidential elections, and this runoff will come shortly after the New Year amid the Coronavirus pandemic.

These elections will be flooded with money on both sides. These could be the most expensive Senate races in history.

With stimulus deals, infrastructure legislation, healthcare measures, judicial nominees, and tax and spending policies all on the line, these Senate races may be the most important in modern American history.

In terms of policy, both of the Democratic Senate candidates represent the far left of the Progressive Democrats. Longtime Georgia Democratic operatives grudgingly agree that their campaign messages will have a hard time attracting Republicans and moderate Democrats.

Right now most analysts and pollsters give both Republicans significant odds to win.

But Just For The Sake Of Argument, What If The Democrats Win?

It will still be very difficult to get anything controversial through a 50-50 Senate with Vice President Kamala Harris as the tiebreaker.

Investors forget that there are still a few conservative Democrats like Senator Joe Manchin of West Virginia and Senator Kyrsten Sinema of Arizona who occasionally vote with the Republicans.

Whether the Senate is narrowly controlled by Senator McConnell or Senator Schumer, the center of power will shift to several individual conservative Democrats and moderate Republicans, like Romney of Utah, Sasse of Nebraska, Collins of Maine, and Murkowski of Alaska, who will hold as much power as McConnell or Schumer.

It will only take one or two of these Senators to swing a vote one way or another. Every individual Senator will have more power in a narrowly divided Senate than they did before.

Assuming The Republicans Win, What Can Investors Expect?

Investors love divided government!

Ian Bremmer, CEO of the Eurasia Group, recently outlined all the **things that will not happen if the Republicans keep the Senate**.

"There will be no voter rights act, no redo of the census, obviously no potential for ending the filibuster, no making Washington DC or Puerto Rico a state and adding to the Senate, no "packing" the Supreme Court. Cabinet appointments have to be confirmed by the (Republican) Senate, which means some positions (Department of Labor, for example) may stand with acting posts, State/Treasury and other key positions will go to centrists. Biden's broader social democratic policy agenda, attempting to align centrist Democrats with the more progressive wing of the party, is effectively stillborn—no nationwide increase of the minimum wage, no healthcare redo, no dramatic legislative agenda on sustainability, and no tax increases to pay for increased outlays (while Republicans in Congress immediately shift to concerns about the deficit and fiscal responsibility).

All of which creates an interesting dynamic. Overall, Biden's orientation on domestic policy is radically different from that of President Trump, but he's likely to be far more constrained in implementing it. While the Biden administration will be less constrained in their foreign policy... but there the agendas and orientations are actually more aligned with those of the Trump administration.

On domestic policy, it's going to be rule by executive order (also reined in by a more conservative judiciary, at every level)... with Biden as quick to undo Trump's orders as Trump was in undoing Obama's. That will mean a significant reassertion of the administrative state and heavier regulatory oversight in every area of the U.S. economy, most particularly around environment and big industry."

Where Do We Go From Here?

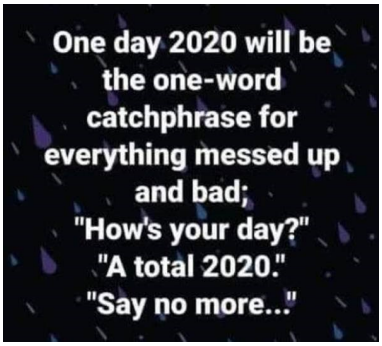
If America can get through the next six months without a nationwide lockdown, the economy and the stock market should have investors celebrating a good 2021.

We will also have a safe and effective vaccine that could return the world to some semblance of pre-2020 normalcy by the end of 2021.

Everything investors were worried about in a Biden Administration will not happen with a Republican or closely divided 50-50 Senate:

- No higher taxes that would slow down the economic recovery.
- No Medicare for All.
- No court-packing.
- No Green New Deal.
- No anti-Second Amendment gun legislation.
- No defunding the police.
- No getting rid of coal, oil, natural gas or fracking.

All-in-all, I am looking forward to a relatively normal and boring 2021. After 2020, normal and boring seems pretty good!



Paul Dietrich, *Chief Investment Strategist,* B. Riley Wealth Management

Paul Dietrich is focused on managing investments for private investors, retirement funds and private institutions throughout the United States. He also serves as a frequent on-air commentator and regularly contributes market analysis to business and financial media including *CNBC, Fox Business, Bloomberg TV, CNN, The Wall Street Journal, Yahoo! Finance, Reuters* and *The Washington Post.*

IMPORTANT DISCLOSURES:

Information and opinions herein are for general use; are not unbiased/impartial; are current at publication date, subject to change; may be from third parties; and may not be accurate or complete. Past performance is not indicative of future results. This is not a research report or solicitation or recommendation to buy/sell any securities. B. Riley Wealth Management is not engaged in rendering legal, accounting or tax-preparation services. Opinions are the Author's and do not necessarily reflect those of B. Riley Wealth Management or its affiliates. Investment factors are not fully addressed herein. For important disclosure information, please visit https://brileyfin.com/disclosures#wealth-management-disclosures