

Control of the Senate: The Elephant and Donkey in the Room



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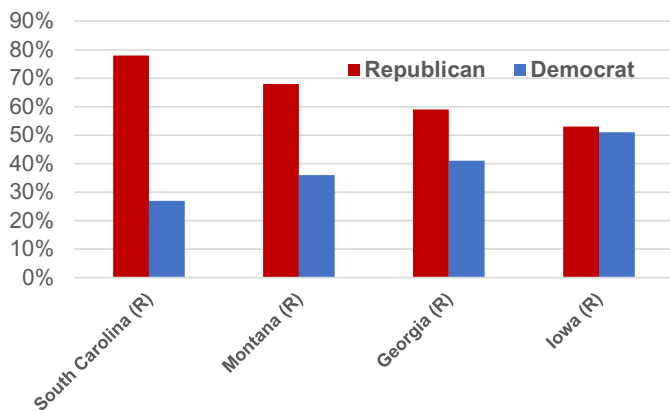
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Pre-election, the Senate make-up is effectively a Republican majority of 53-47. Closely contested Senate races include those in South Carolina, Montana, Georgia, Iowa, Maine, Arizona, Michigan, and North Carolina. The accompanying charts separate these races into those led by Republican candidates and those led by Democratic candidates based on “odds” in a well-known betting market. (The party designation next to the state indicates which party currently holds the seat.)

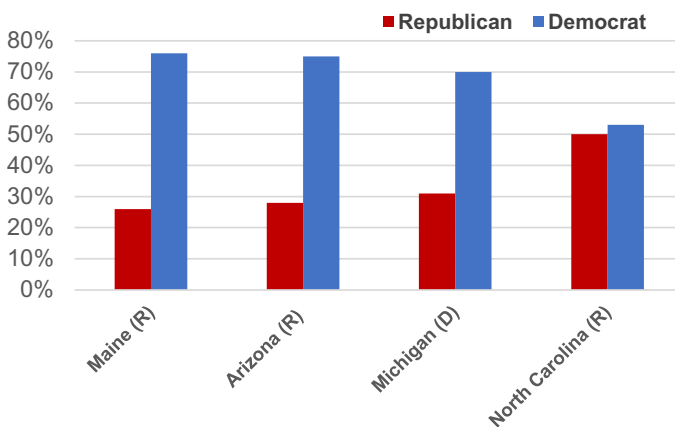
In close races, the track record of prediction markets is not stellar, but if somehow each Senate race ends up going to the odds-on candidate the Senate would be split 50-50 Republicans and Democrats. While

**Prediction Markets:
Republican/Democratic Outcome Probabilities in Key Senate Races**



Source: Predictit.org as of 10/28/2020

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effective control of the Senate would then be conferred based upon a Vice Presidential tie-break vote, this “control” would be tenuous as a single moderate vote across party lines would scrap a bill’s passage (recall that 3 Republican senators, including John McCain, voted against the skinny-repeal of Obamacare).

Given the eight reasonably contested Senate races listed above, the final post-election breakdown could be anywhere from 54-46 Republican to 54-46 Democratic control. The implications of these scenarios are all very different, especially under a Biden presidency should he be elected. In addition to proposing a massive \$5 trillion of additional fiscal spending over 10 years, Biden has proposed large increases to corporate, personal (on those making over \$400k/year), and capital gains taxes. We expect such hikes would be anathema to a Republican Senate that held even a single vote majority. And, more immediately, the scope of fiscal stimulus to combat the COVID downturn will also be impacted by the election outcomes.

In simple terms, we expect that equity markets will focus on the net effect of fiscal stimulus (positive for risk assets) and corporate tax increases (negative for risk assets). But, netting these out requires detailed expectations for each scenario. On current COVID-related fiscal stimulus, for example, there is a wide pre-election chasm between the roughly \$500 billion that the Republican Senate is comfortable approving and the \$2+ trillion that the Democratic House passed in the May “Heroes Act.” Thus, the most frugal stimulus package would likely be seen under a Biden presidency along with a Republican majority Senate. Conversely, a Democratic sweep with a larger Senate majority may blow past that \$2 trillion figure.

On the other side of the ledger, outcomes that lead toward an expectation of higher corporate taxes could result in a period of digestion for U.S. equity markets. Should Biden win, we expect he would require an additional vote or two cushion in the Senate to increase taxes to close to the degree proposed. Should the Senate be 50-50, only modest tax increases would likely be feasible. If Trump wins re-election taxes would not increase, and he could probably cajole even a Republican Senate to COVID-related fiscal stimulus amounts much higher than those currently approved.

In sum, while the Presidential election is a binary outcome, Senate results present more of a continuum with different investment implications. Potentially complicating matters, the two closest Senate races based on prediction market odds, Iowa and North Carolina, allow for mail-in ballots to be received after election day. And, the crucial presidential swing state of Pennsylvania is reportedly already sitting on a pile of over 2 million mail-in ballots that it cannot start processing until November 3rd – a process which could take days. We may have clarity on November 4th, and we may not.

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