
The political party that wields the most power often introduces policies that work in their favor. As a result, the government can impact stock and bond market performance, but these shifts are often short-lived, which is a good thing because policy shouldn't define the quality of an investment.

HOW GOVERNMENT POLICIES IMPACT MARKET PERFORMANCE

Overview

The effect of policy on the market has been evident in recent years, but many of the changes that seem monumental in the moment may not have a lasting financial impact. Just look at how some current headlines could take a different turn in the months and years to come:

- Many expect the trade war with China to conclude with a favorable result for the U.S., but Jeremy Siegel, a finance professor at the Wharton School of business, says that outcome has already been factored into the markets. If negotiations fall through and result in an all-out trade war, the stock market may suffer.
- The 2017 Tax Cuts and Jobs Act (TCJA) got mixed reviews from people filing their tax returns this year, but long-term, lower taxes on corporations are expected to create higher profit margins.
- The technology sector has presented many positive opportunities for investors over the past two decades, but the Trump administration's hard stance on immigration is beginning to take a toll on the industry, along with other areas, like agriculture.

More so than politics, markets are driven by company revenues and profits, financial strength and stability, economic factors and fiscal policy, which is independently decided by the Federal Reserve's Open Market Committee (FOMC).

With that said, President Donald Trump's pro-business policies, including corporate tax cuts and deregulation, have panned out well for the stock market and the broader economy over the past two years.¹

Monetary Policy

The Federal Reserve is responsible for establishing monetary policy in this country and relies on a few points of economic data to formulate interest-rate decisions, most importantly inflation and employment.

With today's unemployment rate hovering at around 4% and inflation consistently below the Fed's target rate of 2%, the FOMC recently confirmed an interest rate hike is unlikely for the rest of 2019.

Even when the Fed does raise rates, there is no direct effect on the stock market. The impact comes from banks taking out loans at higher rates and passing on that expense to their borrowers. The extra cost cuts into a company's bottom line, which can indirectly alter stock prices.

Fiscal Policy

The federal government deploys fiscal policy to try to influence the economy, which can also impact market performance. Fiscal tools are basically those used to change government spending levels, such as altering taxes or the funding for federal and state programs.



The stock market initially responded positively immediately after the TCJA's \$1.5 trillion tax legislation was passed in December 2017:²

- Dow Jones Industrial Average: + 0.4%
- S&P 500 Index: + 0.25%
- Nasdaq Composite Index: + 0.14%

However, long-term results remain mixed. While the reform bill may have injected additional capital into the stock markets, it is projected to raise the federal deficit by as much as \$2 trillion over the next decade. The Trump administration is optimistic rising GDP growth will offset the additional deficit, but many economists remain skeptical.

Party Policy

Presidential administrations and the majority leadership in both houses of Congress tend to fluctuate in somewhat of a pattern, with neither political party dominating any one branch of the government for too long before voters swing power back in the other direction. In the two years since Donald Trump's election, the Republican party has successfully implemented parts of its pro-business agenda.

Deregulation

There is a constant struggle between private commerce and government oversight to ensure companies operate in the best interests of customers and the overall marketplace. The federal government often creates rules and regulations to force companies to comply with certain norms that promote competition and keep prices in check. However, the costs of complying with regulations can be onerous, reduce profits and thus generate less value for shareholders.

According to the Brookings Institute, the Trump administration has rolled back 36 pre-existing regulations since the beginning of 2017, most recently a rule that mandated average fuel economy standards for cars in the future. Other repealed regulations that may impact specific industries in the stock market include:³

- Oil and Gas Fracking Rule - Repealed the requirement to disclose chemicals and other details of fracking operations
- Arbitration Rule - Nullified the rule that allowed class action lawsuits against banks and credit card companies to resolve financial disputes
- Stream Protection Rule - Eliminated the rule that minimized adverse effects of coal mining on streams and other water sources

Health Care

If the current court case deliberating the Patient Protection and Affordable Care Act rules the bill unconstitutional, approximately 20 million Americans will lose their health insurance. According to the Urban Institute, this loss of coverage is projected to increase the cost of uncompensated care by 82 percent, to the tune of \$50.2 billion. In addition to creating a higher burden at the state level, many hospital systems are likely to lose revenues, insurance companies will have fewer participants in insurance pools and the overall health care sector could experience significant volatility as it struggles to adjust.⁴



Immigration

While making immigration laws more stringent continues to be a top policy priority for the current administration, there may be long-term repercussions for the economy and the markets. Pew Research Center estimates about 11.3 million immigrants currently living in the U.S. do not have legal status, but the majority work and pay income taxes. Illegal immigrants comprise about 5% of America's labor force, with large numbers working jobs underserved by U.S. citizens (construction, farmworkers, fast food and domestic help).

These workers have become a mainstay in many industries. For example, if new immigration policies cut the number of foreign-born workers in half, more than 3,500 U.S. dairy farms would be forced to close. This would lead to a substantial drop in milk production and increase prices by as much as 30 percent. If immigrant labor were eliminated, milk prices would rise by 90 percent, with similar risks to the U.S. fruit, vegetable and meat industries. Naturally, the disruption in the food industry would impact not just consumers, but shareholders as well.⁵

Foreign Policy

In recent years, trade-policy concerns have become a major source of U.S. stock market volatility, particularly given today's global economy. Multi-national corporations have significant interests abroad, including production facilities and supply chains as well as extensive distribution networks in foreign economies. Any changes to trade agreements puts these commercial interests at risk and could potentially reduce company equity value on the U.S. stock market.

Recent research analysis by the Wall Street Journal found that only seven of 1,103 large market moves from 1900 to 2017 could be primarily attributed to news about trade policy. In contrast, trade-policy news was largely responsible for three of the nine large market fluctuations in 2018.⁶

Final Thoughts

For the sake of clarity, Luigi Zingales, a prominent economist associated with the National Bureau of Economic Research, the Center for Economic Policy Research and the European Corporate Governance Institute, points out the difference between pro-business and pro-market policies. While pro-business policies tend to protect specific business sectors and domestic companies, pro-market policies are designed to support market conditions for all types of industries, promote international competition and investment, and ensure laws are universally applied.⁷

As such, longer-term, pro-market policies tend to have a more positive impact on a well-diversified portfolio. In a highly concentrated portfolio, specific pro-business policies can certainly help an industry sector and its underlying businesses thrive.



¹ Matthew Hazel. CNBC. April 11, 2019. "Wharton's Jeremy Siegel on Trump, China and risk of recession." <https://www.cnbc.com/2019/04/11/wharton-jeremy-siegel-on-trump-china-and-risk-of-recession.html>. Accessed April 15, 2019.

² Leslie Kramer. Investopedia. April 7, 2019. "What Is Fiscal Policy?" <https://www.investopedia.com/insights/what-is-fiscal-policy/>. Accessed April 15, 2019.

³ Brookings Institution. April 12, 2019. "Tracking deregulation in the Trump era." <https://www.brookings.edu/interactives/tracking-deregulation-in-the-trump-era/>. Accessed April 15, 2019.

⁴ Les Masterson. Healthcare Dive. March 27, 2019. "Killing ACA would lead to huge spikes in uncompensated care." <https://www.healthcarediver.com/news/killing-aca-would-lead-to-huge-spikes-in-uncompensated-care/551355/>. Accessed April 15, 2019.

⁵ Mary Jo Dudley. CBS News. Jan. 10, 2019. "These U.S. industries can't work without illegal immigrants." <https://www.cbsnews.com/news/illegal-immigrants-us-jobs-economy-farm-workers-taxes/>. Accessed April 15, 2019.

⁶ Steven J. Davis. Chicago Booth Review. March 18, 2019. "Trade policy is upending markets—but not investment." <http://review.chicagobooth.edu/economics/2019/article/trade-policy-upending-markets-not-investment>. Accessed April 15, 2019.

⁷ Luigi Zingales. University of Chicago-Booth School of Business. Jan. 12, 2017. "Donald Trump's Economic Policies: Pro-Business, Not Pro-Market." <https://promarket.org/donald-trumps-economic-policy-pro-business-not-pro-market/>. Accessed April 15, 2019.

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