Market Strategy
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Strategas Washington Research Analyst Jeannette Lowe breaks down the policy landscape in DC as we begin the new year. She addresses the faltering Build Back Better agenda, the fading fiscal stimulus, and how stocks perform during midterm election years.

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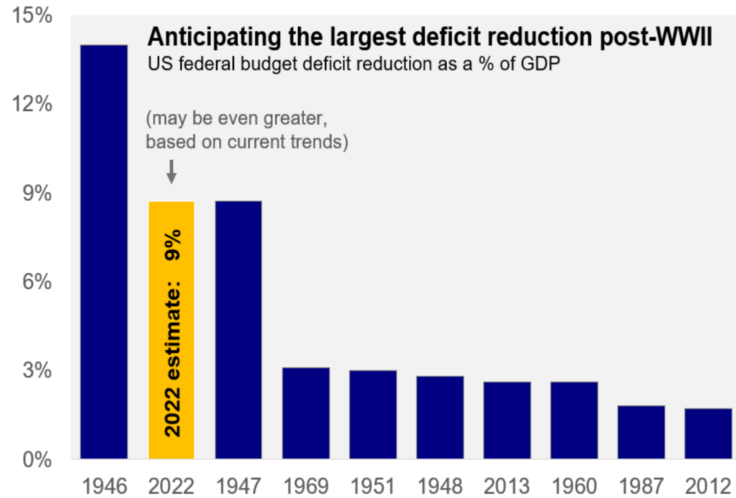
BBB ON HOLD, INFLATION KEY | FEDERAL VS. STATE | MID-TERM VOLATILITY

ROSS MAYFIELD: Let's begin with your update on the stalled Build Back Better (BBB) legislation and where it stands today.

JEANNETTE LOWE: The House passed a version of BBB in November, but ultimately Senator Manchin (D-WV) said he couldn't support the package in its current form and cited inflation as a reason. So he'll try to cut the package down which will mean focusing on just a few priorities—we think it'll be climate and green energy spending, funding to continue expansion of the Affordable Care Act, and maybe universal pre-K. But inflation is going to remain a headwind, and if we still have high readings in February and March, that could impact the timing of the bill's passage. What's critical about that is that further delay chips away at the likelihood that tax changes such as the small businesses tax and the wealth surtax will be retroactive to January 2022. Same thing on the corporate side, where some potential 2023 taxes might get pushed to 2024.

ROSS: You mentioned inflation, and it's obviously a key issue right now. It seems inevitable that we'll see tighter monetary policy this year (in addition to tighter fiscal policy) and that seems like a lot for the market to digest—what are your thoughts?

JEANNETTE: We had historic policy support for the US economy in 2020 and 2021. That's rolling off now, but the economy is still in great shape. One of the implications of that is strong tax revenues: **this year, we'll see the US budget deficit come down by ~9% of GDP, which we haven't seen since the 1940s.** So that'll have a big impact. And then of course, the Fed is looking to raise rates. So all in all, way less federal stimulus in 2022. The other side of this story is that states are benefiting from both strong tax revenues and the federal government paying many pandemic expenses via Covid-relief programs. So states are flush with cash, and you could see is governors (most of whom are up for reelection in 2022) looking to cut taxes or create new spending programs. So you might see this dichotomy—tightening at the federal level but perhaps more stimulative at the state level.



ROSS: That's a great point, so maybe a little fiscal support after all. Ok let's end here—it's a midterm election year. Could you talk about what a midterm year looks like for the stock market versus years 1, 3, and 4 of a presidential term?

JEANNETTE: We generally see much more volatility in a midterm election year. The average S&P 500 intra-year decline in a midterm year is -19% vs. -13% in a non-midterm year (more on that here). Even though we might see more volatility, stocks have historically been up in the year after the bottom, by an average of 32%. In fact, **we haven't seen the S&P 500 decline in the 12 months following a midterm election since 1946.** So we should see some buying opportunities amid the volatility.

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