JANUARY 2022 WEBINAR

# What Matters Most to the Markets

FinDec℠ welcomed back Washington-based political analyst, Michael Townsend, who serves as Charles Schwab's Managing Director of Legislative and Regulatory Affairs. This fulsome discussion outlined the current issues and developments on Capitol Hill and how they are affecting markets. Townsend interpreted the latest legislation and its potential impact on the economy, taxes and retirement savings. He also gave us his insight on geopolitical developments, his predictions on policymakers' next steps and explained how the political configuration of Washington has historically affected markets.

FinDec℠ Chief Investment Officer, Tolen Teigen, hosted the session that encompassed covered topics from green investments and cryptocurrency to midterm elections and the debt ceiling crisis. Extracting key market-influencing information from the Washington noise, Townsend shared valuable information for consumers and investors. Below is a recap.

There's never a dull moment in our nation's capital, and as we begin a midterm election year, the overpowering political noise makes it difficult to focus on the key issues that could potentially impact the markets. Townsend said the market is watching the following issues:

## CONGRESS

### 1. Bipartisan Infrastructure Bill

This was a big win for the president when it was signed into law in November. States will begin road construction, bridge repairs and other projects that will span over the next few years. There were no tax increases associated with this bill. Infrastructure is popular with voters who are already beginning to see improvement projects in their communities.

### 2. Build Back Better Act

While the Infrastructure Bill was a triumph for the administration, the Build Back Better Act is still up in the air and causing more angst and political division with every iteration. With major objections from Joe Manchin (D-WV) and others, this will most likely end up as a slimmed-down version, and how it will be funded is yet to be determined.

Many items in the original version had some investors, specifically the wealthiest filers, nervous as they anticipated changes in capital gains laws beginning in January. It didn't pass, and now the original proposals, which would have had a sweeping effect on everyone, are now relatively narrow in scope. The crackdown on "Mega IRAs" will most likely be revisited this year and will most likely affect those with large retirement accounts.

Questions have surfaced as to whether the final version could include legislation that would be retroactive, but Townsend believes that the longer it takes for it to get passed, the less likely it is that any of the items in it will be retroactive. The markets will continue to watch closely to see the implications the final version will have on such things as the SALT deduction cap, retirement revisions, tax on stock buybacks, and the corporate minimum tax – all designed to offset the cost of the programs associated with the act (social services, climate change, etc.). The markets are keeping a close pulse on this.

### 3. SECURE Act 2.0

A candidate for Congressional action in 2022, the SECURE Act 2.0 has been floating around Congress for the better part of 2021. It is a reference to the SECURE Act that raised the Required Minimum Distribution (RMD) age to 72 a few years ago. The 2.0 version will raise RMD to 75. There is a lot of support on both sides of the Hill, and Townsend believes it may get some traction early this year. This would increase catch-up contributions to $10,000 and help small businesses offer a plan to employees. It is seen as a positive, with support from both sides, but the question is, "Where is SECURE Act 2.0 on the priority list?"

### 4. Debt Ceiling Crisis

The debt ceiling is an artificial cap on the total amount of debt the government can accumulate so it doesn't default on its debts, and when you start talking doubt potentially defaulting, markets tend to get a little anxious. In December, Congress "kicked this can" down the road by raising the ceiling enough to take the issue off the table until early 2023. Neither party wants this to be on the table during elections. Raising the debt ceiling does nothing to address the debt, it just gives the government permission to accumulate more debt. The market, says Townsend, likes the certainty that comes with a particular timeline.

### 5. Looming Government Shutdown

Congress has not passed any of the 12 appropriations bills it is supposed to pass each year to fund federal programs/agencies. It passed a series of short-term extensions to operate at last year's rates through February 18, 2022. Congress is working on a bill that would allow all the appropriations bills to pass before February 18, and if they can't come to an agreement, Townsend says the result will be to buy time by extending funding for a few more weeks. The markets are keeping an eye on it but are not super worried about it.

## SECURITIES AND EXCHANGE COMMISSION

This is a midterm election year, and you will see a slowdown in legislation on Capitol Hill because neither party wants to give the other side any advantage. It's very common in the second year of a presidency to have a big regulatory agenda because those whom the president appointed have had time set settle into their new jobs and are prepared with their agendas.

It will be a big year in the SEC space, says Townsend, so be on the lookout for changes in market operations, but remember, the regulatory process is slow, and it may take a while for things to happen.

1. **Meme Stock**
   The notion that social media can influence stock prices was brought to life with Game Stop and AMC Entertainment last year. The SEC will examine how our markets work in different ways, and we will see significant proposals on market operations this year.

2. **"Gamification" of stock trading**
   Has it become too easy to have inexperienced investors using their phone to make a trade? Expect to see some rules that will require more upfront education for new investors before they can make certain kinds of trades.

3. **Market plumbing**
   What happens when you push "trade" on your app? Who touches your money along the way? Are there conflicts of interest? How has the money changed hands? What is the flow? The interworking of mobile trading will be explored this year.

4. **Public company disclosure**
   Anticipate some rules that will improve climate risk disclosure. The rules were written more than a decade ago, and investors are more interested than ever before in the ESG, or "green" investment space. Look for more standardization of fund names and parameters around using terms such as "green" or "sustainable" investments, making it easier for investors to compare them. While it does seem like this administration will have a greener agenda, the push for renewable energy, says Townsend, is not going to deplete the oil and gas markets. "There's room for both because you may have the ability to collect a lot of solar energy in Arizona, but it takes fuel to get that energy to the east coast," he said.

5. **Cryptocurrency**
   Look for some regulatory framework around digital or virtual currency.

## SOCIAL SECURITY

When we approach the early 2030s, the government will no longer be able to fully pay out Social Security benefits. It is eight years away, says Townsend, which is light years to a member of Congress, who has a two-year term. "That's like four political lifetimes away," he said, "so it's hard for them to prioritize this. All of the options are bad – cut benefits, raise taxes, raise the retirement age – and no one wants to vote for those any time, and especially in a midterm election year." Don't anticipate any movement on this for a while.

## CHANGES IN THE FEDERAL RESERVE BOARD

It could be an historic year for the Federal Reserve Board. Three of the seven seats are open, and if the nominees are confirmed, there will be, for the first time, more women than men on the board. In addition, the first female black governor will be sitting on the committee. This new, diverse group will get dropped in at one of the most crucial times in history, as there is pressure to address inflation that will ultimately lead to rate hikes. Townsend believes none of the nominees are expected to be outspoken nor will any push the Fed in another direction. As far as the rate hikes, he says to expect at least three throughout 2023, but for consumers to keep in mind that even with three hikes, interest rates will end up at about .075% at the end of the year. It's not going to be a huge shock to the system, but historically it has been closer to zero. There will be continued monitoring of the discussions concerning rate hikes, as they will impact the economy. It will be a big issue in the elections this fall.

## MIDTERM ELECTIONS

With every House seat up for re-election, an historic precedence that the president's party will not win the majority of the seats in the House or Senate, it is highly unlikely that there will be any sweeping legislation passed in 2022, according to Townsend. Here are some interesting stats:

- There are 222 Democrats and 212 Republicans in the House of Representatives. All 435 House seats are up for election in November.
- In the Senate, which is evenly split with 50 senators representing each party, 34 are up for election in November.
- The president's party has lost an average of 25 seats in the House and 3 seats in the Senate in 17 of the last 19 midterms.
- Historically, presidents with a less than 50% approval rating in the first midterm election lose an average of 47 seats in the House. President Biden has a 42.5% approval rating, which, if history repeats itself, would mean a sweeping change in power of the House.
- In addition, with the states' reapportionment, eight states have lost seats in Congress. Texas gained two seats and four states gained one seat.

Add to this the 2022 retirements (26 Democrats and 13 Republicans), and it is not looking optimistic for the Democrats. If Republicans gain control, Townsend predicts they will bring an agenda that is likely to be focused more on score-settling than passing legislation.

The Senate race is most likely going to come down to the same six states that were close in the 2020 Presidential Election, Georgia, Nevada, Arizona, Wisconsin, North Carolina and Pennsylvania).

Do the markets care about the midterms? No matter the configuration of Congress, the market does well when there is a Democratic White House, and remember, the president holds the veto pen.

## CONCLUSION

The tension between the parties is creating a lot of noise in Washington. Townsend says what's most important to the markets is what Congress accomplishes, not who is in the majority. Don't let the noise distract you from the key legislation that can have a much bigger impact on the markets, the economy and your investments.

## GUEST SPEAKER: MICHAEL TOWNSEND

**Managing Director, Legislative and Regulatory Affairs at Charles Schwab & Co., Inc.**

As Managing Director of Legislative and Regulatory Affairs, Michael is Charles Schwab's Washington-based political analyst. With more than 27 years of Washington experience, he analyzes legislative, regulatory and political developments to determine how they would affect individual investors, retirement plan participants and investment advisers. Michael is the host of Schwab's WashingtonWise Investor podcast. He is a featured speaker at dozens of employee, client, adviser and industry events each year, where he discusses the impact of the political and policy environment in Washington on investors and the capital markets. Prior to joining Schwab in 2000, Michael worked at Powell Tate, Inc., a Washington, D.C., public affairs firm, and previously worked for two U.S. senators from Maine. Education M.A., English, George Mason University; B.A., English, Bowdoin College.

## NEXT WEBINAR

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**with guest Dorthea Silva, CPA**

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