

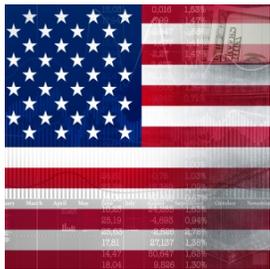


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## Election 2020: Political Uncertainty Creates Potential for Market Swings



*Because tax policies are polarizing, the winning candidate may have little chance of achieving his policy goals unless the same party controls both the Senate and the House of Representatives.*

There are clear differences between President Donald Trump and Former Vice President Joe Biden (and the political parties they represent) when it comes to tax policies, spending priorities, and overall economic strategies. For this reason, a shift in the balance of power could have wide-ranging implications for future policies and the financial prospects of individuals and businesses.

With the nation closely divided, it is difficult to forecast election outcomes based on opinion polls. It's no secret that financial markets prefer clarity and have reacted to election surprises in the past. But with an economy weakened by the pandemic, concerns about election security, and the possibility of delayed or contested results, investors are facing extra layers of uncertainty.<sup>1</sup>

As a taxpayer, you might find it helpful to follow the candidates' policy proposals. And as an investor, you may want to steel yourself for an anticipated increase in market volatility in the weeks before and after the election.

### Trump's tax cuts

The president has campaigned to preserve his signature 2017 tax legislation, the Tax Cuts and Jobs Act (TCJA). The TCJA lowered tax rates for individuals at most income levels, roughly doubled the standard deduction, and eliminated the deduction for personal exemptions — so far fewer taxpayers now itemize on their tax returns.

The federal estate and gift tax exclusion was also doubled, reaching \$11.58 million in 2020 (adjusted for inflation). This is the amount that can be transferred to heirs free of federal tax. These changes to individual tax rates and the exclusion are temporary and scheduled to revert back to pre-TCJA levels in 2026.

For businesses, the TCJA reduced corporate tax rates from a top rate of 35% to a flat rate of 21%, repealed the corporate alternative minimum tax, and enhanced deductions for capital investments.

Pass-through businesses (including many self-employed individuals) received a new deduction equal to 20% of their qualified business income. TCJA changes affecting businesses are permanent.

Regarding second-term proposals, the president has expressed support for additional middle-class tax cuts, reductions in the capital gains tax, expansion of the Opportunity Zones program, and tax credits for companies that bring jobs back from China, but few details are available.<sup>2</sup>

### Biden's pitch

Joe Biden contends that most of the TCJA's tax benefits went to big businesses and the wealthy. He has proposed tax increases for corporations and high-income households to help pay for his climate, infrastructure, R&D, health, and education plans.<sup>3</sup>

Biden would return the top personal income tax rate to 39.6% from 37%, which currently applies to income above \$518,400 for single filers and \$622,050 for joint filers. The tax benefit of itemizing deductions would also be limited for those with incomes above \$400,000. The 20% deduction for qualified business income would phase out above the same \$400,000 threshold. A TCJA provision that caps the itemized deduction for state and local taxes at \$10,000 would be repealed. Targeted tax credits would be offered to help make child care and housing more affordable for the middle class.<sup>4</sup>

Biden also wants to end the preferential tax treatment of long-term capital gains and qualified dividends for households with incomes above \$1 million. Capital gains above that threshold would be taxed as ordinary income at 39.6% instead of today's 20% rate (plus 3.8% net investment income tax). The step-up in basis for inherited capital assets might also be eliminated, making more capital gains taxable after death.<sup>5</sup>

Social Security is funded by a 12.4% payroll tax — split between employers and employees — on wage and self-employment income, up to an annual cap that is



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adjusted for inflation (\$137,700 in 2020). To address the program's growing funding deficit, Biden would also impose the payroll tax on income earned above \$400,000.<sup>6</sup> He has proposed raising the corporate tax rate from 21% to 28%, reinstating a 15% minimum tax on profits exceeding \$100 million, and increasing taxes on foreign profits.<sup>7</sup>

## Checks and balances

The executive branch has the power to shape economic policies, but any changes to tax law require congressional action. Because tax policies are polarizing, the winning candidate may have little chance of achieving his policy goals unless the same party controls both the Senate and the House of Representatives.

Many other geopolitical issues and economic variables could influence business activity and corporate profits going forward, including monetary policies set by the Federal Reserve. The Fed plays a substantial role in supporting the U.S. economy and has acted aggressively to help stabilize financial markets in 2020.

The benchmark federal funds rate was slashed to near zero (0% to 0.25% range) in March — where it's projected to stay for the next three years.<sup>8</sup> Low interest rates can boost economic activity and asset values by reducing the cost of borrowing for consumers and businesses.

The U.S. central bank acts independently of the government in pursuit of its dual monetary policy goals: maximum employment and price stability.

Budget autonomy — the ability of the Federal Reserve to fund its own operations — allows Fed officials to make decisions based on evidence and analysis, theoretically free of political interference.

## Election anxiety

Some companies and industries could be impacted for better or worse, at least in the short run, by the election. The two candidates tend to favor different policies regarding international trade, financial regulations, energy, and health care, among others.

Another economic wildcard that hinges on the outcome is the scope of fiscal stimulus that might be passed to help consumers, businesses, states, and local governments recover from the COVID-19 recession.

Emotions are running high, but it's generally unwise for long-term investors to upend their investment strategies based on election predictions or their own political biases. A well-balanced portfolio should be built to span multiple election cycles.

*All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.*

1) *The Wall Street Journal*, August 16, 2020

2-7) Tax Foundation, August 20 and 25, 2020

8) Federal Reserve, September 16, 2020

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