MARKET UPDATE

The Final Countdown – US election primer

With less than four weeks to go until the US presidential election on November 3, Democrat Joe Biden appears to be well ahead of President Donald Trump in the polls. Will he suffer the same fate as Hillary Clinton in 2016? And if he does win, what would be the impact on the economy and markets?

Executive Summary

The election race

Joe Biden leads Donald Trump by a wide margin in opinion polls, betting odds and online prediction markets, wider than Hillary Clinton enjoyed at the same point in the 2016 campaign. However, a majority of votes nationwide does not necessarily translate into a majority in the electoral college – a swing towards Trump in a few large states could quickly change the dynamic of the race. We believe that Biden will end up in the White House but with a narrower majority than expected by markets and that the Senate might remain in Republican hands, acting as a counterweight to the Democrat's policy initiatives.

Background to the elections

The coronavirus pandemic has hit the US harder than almost any other developed economy in terms of confirmed cases and deaths. Moreover, despite exhortations from the President, restrictions on activity remain relatively high and mobility measures are well down on normal levels. The Federal Reserve acted promptly with rate cuts and asset purchases and is set to keep policy easy for years to come. After a dramatic Q2 slump, activity recovered quite rapidly initially but the pace has slowed in recent weeks. With supplementary unemployment benefits set to disappear, more fiscal stimulus is needed but negotiations in Congress have failed to make progress. A deal looks unlikely before the election.

Policy positions

Donald Trump is campaigning on his track record of tax cuts, deregulation and a preference for bilateral engagement rather than via multilateral institutions. Joe Biden's policy platform is much more detailed, as befits the challenger. He plans to reverse much of Trump's tax cuts on corporations, enhance Obamacare, raise minimum wages, boost green investment spending, R&D in technology and federal procurement from American companies, a package which would deepen deficits but boost long-term growth prospects.

Impact on the markets

Neither candidate's policy platform is likely to be positive for the US dollar, with Biden's likely to exert more downward pressure than Trump's. Biden's policies are more business-unfriendly, especially his focus on higher taxes and tighter regulation. However, full implementation of his promises is unlikely unless the Democrats win both houses in Congress. Nevertheless, equity markets tend to rise in the aftermath of elections, with the exception of the two most recent bear markets.

Bottom line

Although economic growth looks sluggish, monetary policy remains very supportive and fiscal stimulus is likely after the election, with a Biden victory ensuring a larger package. All in all, US equities remain richly valued in our view – which limits the scope for continued outperformance – but this policy mix represents a rather supportive backdrop.

The election race

Polls

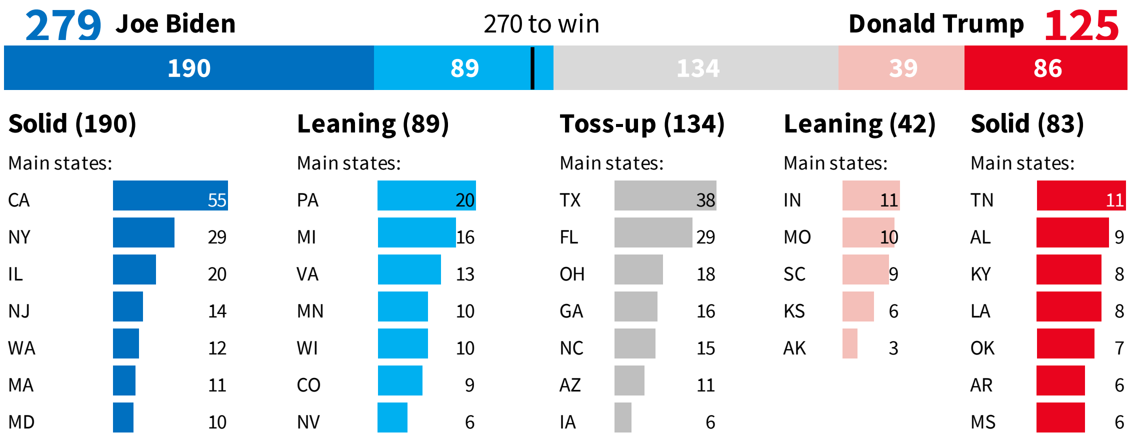
According to national opinion polls, Biden's lead over Trump has widened steadily since he became the clear front-runner in mid-April, from 4 points to 8 in August to 9 today. At the same point in the 2016 campaign, H. Clinton led by only three points (see chart 1). Moreover, her share of votes in the polls then was 47.5% whereas Biden currently polls 51.6% on average (Clinton's average vote share never rose above 50% in the polls during the last months of the 2016 campaign).

Of course, 2016 taught us that a lead in the polls is no guarantee of victory, given that the president is appointed by the 538 members of the electoral college. Each state nominates a certain number of electors, depending on the size of its population, who are then charged with voting for the candidate who has won the majority of votes in that state. This means that the candidate who wins most votes nationally may not become president, as happened in 2000 and 2016 (when the Trump/Clinton vote split was 46.1% to 48.2% but Trump won 304 electoral college votes).

State-level polls can help estimate how the electoral college might look, taking into account the strength of each candidate's support in each state. According to Financial Times analysis, 190 votes are solidly for Biden and 86 for Trump. Another 89 are leaning in favour of the Democrat and 39 for the President, with 134 up for grabs (see chart below). However, a victory by Trump in a small number of large states could easily transform the picture – for example, gains in Texas (38 electors), Florida (29), Pennsylvania (20), Ohio (18), Georgia and Michigan (both 16) could bring him close to returning to the White House.

Who is leading the 2020 US election polls?

The latest polls suggest this outcome in the electoral college



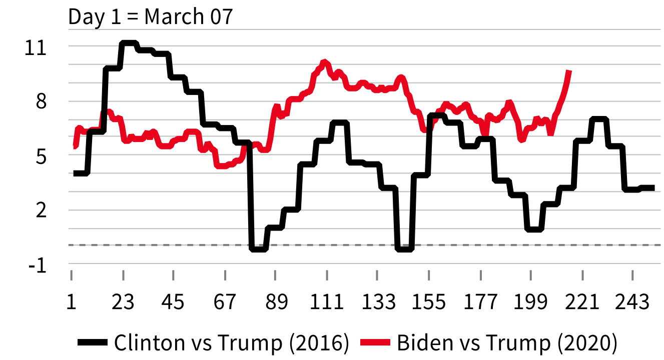
Sources: SGPB, Financial Times, data as of 08/10/2020

Alternative election barometers

Given the drawbacks in opinion polls, it is also interesting to follow alternative sources to compare them with the polls. For example, New Zealand's Predictit and the University of Iowa run online markets where investors can invest in election results. Such markets have an advantage over opinion polls – participants make actual cash investments in the result, demonstrating a level of commitment which respondents do not necessarily feel when answering a pollster.

Chart 1

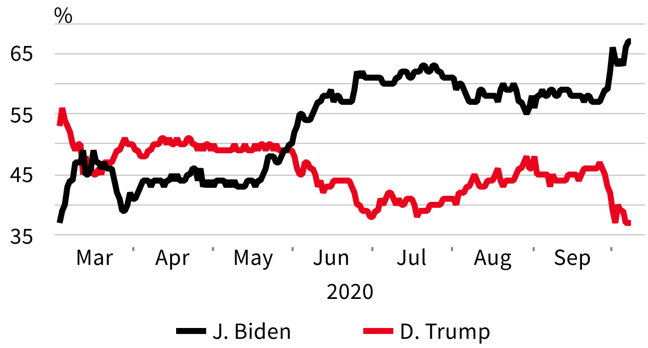
National opinion polls: 2016 compared to 2020



Sources: SGPB, Macrobnd, RCP, data as of 08/10/2020

Chart 2

Who will win according to PredictIt's online market?



Sources: SGPB, Macrobond, PredictIt, data as of 08/10/2020

Predictit currently shows a 67% probability of a Biden victory and 37% for Trump, from 59% and 45% a month ago respectively (see chart 2). And Iowa's investors agree – their winner-takes-all market currently shows 80.4% for Biden and 24% for Trump.

Another interesting barometer to follow is betting odds, which also reflect real-money wagers on the result. Real Clear Politics' betting odds service currently shows the highest skew so far in favour of Biden – 63.7% versus 35.4% for Trump.

And finally, France's Hypermind aims to harness the wisdom of crowds by following how good individual forecasters are when calculating probabilities of events occurring. For now, Hypermind shows a 69% probability of a Biden victory versus 29% for the President.

The other elections

The race for the White House is not the only election on November 3. All 435 seats in the House of Representatives will be contested as well as 35 of the Senate's 100 seats. The Democrats currently control the House with 232 representatives while 53 Republican senators control the upper chamber.

Predictit's online market for Congress shows a 68% probability of the Democratic party winning both houses and 26% for the status quo (Democrat House and Republican Senate) as shown in chart 3.

Given the number of individual contests in the House, we believe that national and state opinion polls, which are solidly in favour of Biden's party, also offer a useful pointer to the Democratic party retaining control of the House. Indeed, fivethirtyeight.com simulations suggest that the Republicans would only win back control in 7 out of 100 scenarios.

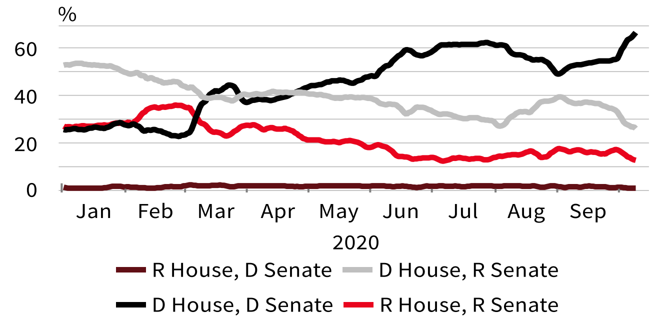
With a vastly smaller number of seats up for grabs, the Senate race is far less clear-cut. On fivethirtyeight.com's models, the average outcome is for the Democrats to control the Senate with 51 seats. This may well prove rather optimistic in our view, and we expect Congress to remain split, with the Democratic party retaining the House and Republicans the Senate.

Putting it all together

As we have seen, many different sources point towards a Biden victory on November 3. The margin in his favour is wider than Hillary Clinton's in 2016 and also wider than the +/-2% margin of error in polls. However, the last White House race showed that electors who were shy about revealing their support for Trump to pollsters were happy to express it in voting booths. The same reticence could hold sway again. Moreover, President Trump's supporters tend to be more enthusiastic, and hence likely to turn out to vote, than his rival's. In our view, a Biden victory is the most likely outcome but with a lower probability than the sources mentioned above, perhaps no more than 55%.

Chart 3

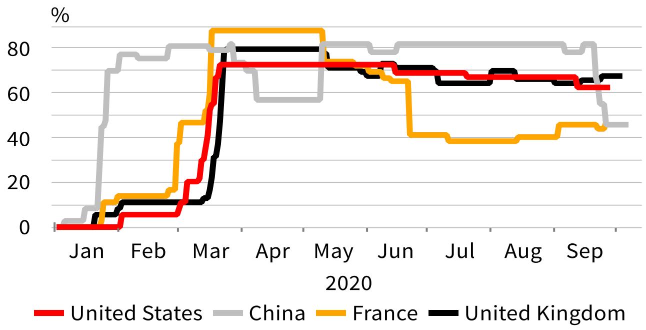
Balance of power after the 2020 US elections



Sources: SGPB, Macrobnd, data as of 08/10/2020

Chart 4

COVID-19 government response stringency index



Sources: SGPB, Macrobond, data as of 08/10/2020

Background to the elections

Pandemic

The coronavirus pandemic has hit the US harder than almost any other country with over 7.7 million confirmed cases and over 215,000 deaths according to Worldometers. Expressed as a proportion of the population, the US counts 23,300 cases and 650 deaths per million inhabitants versus 9700 and 500 in France and 8,000 and 625 in the UK. The number of new daily cases has recently begun to rise again which has led a number of state governors to maintain or indeed tighten restrictions on activity. As shown on chart 4 above, the severity of restrictions at the national level is one of the highest among major countries.

The handling of the pandemic is of course one of the hottest topics for electors in both parties. President Trump has preferred to downplay the severity of the virus and to encourage states to avoid severe lockdown restrictions while Biden has stuck to health authority guidelines with a more prudent approach. Moreover, the President's recent hospitalisation appears only to have strengthened his desire to get the country quickly back to normal despite the spread of infections.

Economy

The spring lockdown pushed the economy into recession almost overnight, with GDP falling by 9% in the second quarter compared to the first. Since restrictions began to be eased, activity has recovered, sharply at first as businesses reopened to pent-up demand and more slowly recently as businesses and consumers adjust to the possibility that COVID-19 may be with us for many quarters to come.

Nationwide mobility data shows that trips are still well down from January's level and barely changed since June. Moreover, mobility in Florida – where the Republican governor has been a vocal proponent of getting back to normal – is undistinguishable from the national trend (see chart 5). In New York City, subway usage is still well below the levels registered in recent years during the holiday season. In previous years, the peak number of travellers on the subway was around 6.5 million per day – today it is below 1.9 million.

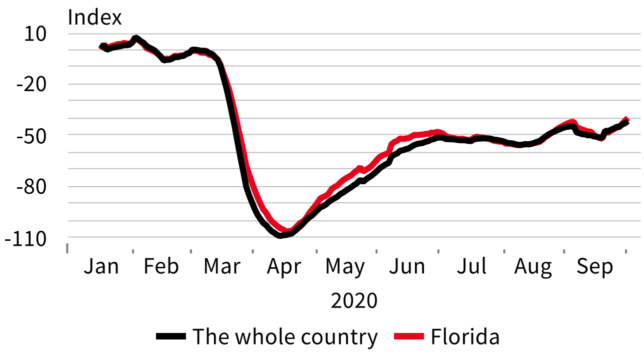
The job market adjusted rapidly to lockdown with continuing claims for unemployment benefits reaching all-time highs at almost 25 million workers (the previous record was set during the Great Recession at 6.6 million in 2009). Since the peak in May, employees have returned to work bringing the total claimant count down to 11 million, but the rate of improvement has slowed markedly in recent weeks.

Consumer spending has been shored up during the crisis thanks to federal support. The CARES act provided $650 per week in additional benefits to the unemployed until it expired at end-July. Since then, claimants have been receiving between $300 and $400 per week thanks to a Presidential executive order, but this is running out. This leaves many millions of households facing a sharp drop in income, just as the economy appears to be slowing.

Policy makers are conscious of the risks and have been locked in discussions on a fiscal stimulus plan since May, but with little progress so far. Democrats in the House of Representatives have approved a $2.2 trillion bill, but this is fiercely opposed by the Senate where many Republicans are reluctant to approve more than $1 trillion in stimulus. Hopes for a breakthrough this week were dashed when President Trump ordered his team to halt discussions, although he did go on to suggest that some targeted stimulus might be possible.

Chart 5

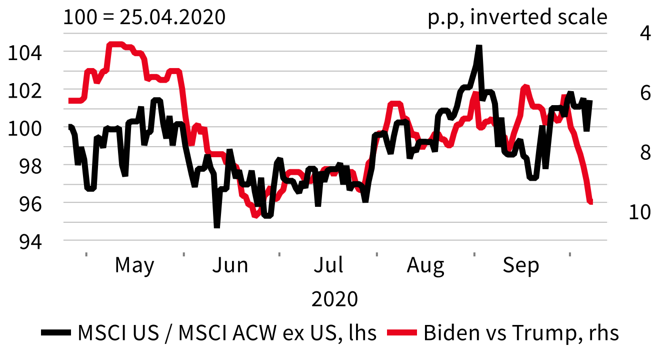
Mobility report in the US



Sources: SGPB, Macrobond, Bloomberg, data as of 08/10/2020

Chart 6

Equity market performance and US election polls



Sources: SGPB, Macrobond, data as of 08/10/2020

Past performance should not be seen as a guarantee of future returns.

Putting it all together

Despite the best efforts of (mainly Republican) politicians, households and businesses are taking a prudent approach in light of the continued spread of the pandemic. The launch of a vaccine would help, but we believe that none will be widely available before Q2 next year. Moreover, a recent Axios poll found that 60% of respondents would wait at least a few months before taking a vaccine. With the economy showing signs of slowing and unemployment still high, we believe that a substantial stimulus package is necessary. However, a deal now looks unlikely before the election.

Policy positions

What sort of economic policies will the next president pursue? As the incumbent, Donald Trump's electoral platform is rather light on detail – he clearly plans to offer continuity with his policy positions over the last 4 years. As the challenger, Joe Biden has provided a much more detailed set of policies.

Biden

Investment. The democratic candidate outlines a $2 trillion investment plan (some 9.3% of GDP) over the next 4 years. Originally, Biden had proposed $1.7 trillion over 10 years, but then updated his plan in light of the COVID-19 recession. Much of the focus in investment will be on green energy technologies, for example in transportation, electricity and construction. His aim is to achieve net zero emissions by 2050 at latest.

Taxation. Statutory corporation tax is set to rise from 21% to 28%, with an additional 10% offshoring penalty surcharge on top. In addition, a carbon adjustment tax would penalise companies which fail to meet commitments on climate and the environment. Biden also plans to increase the personal taxation rate from 37% to 39.6%, and the capital gains tax to same level on amounts over $1 million, almost doubling today's 20% rate.

Wages. The minimum wage would increase to $15 per hour from today's effective level of $11.80. This would benefit around 42% of Americans who earn less than the new minimum today but raise wage costs by around 5% for employers.

"Buy American". Biden plans a $400bn federal procurement programme over 4 years.

Trade. Biden is likely to adopt a less confrontational stance with allies like the EU and Japan and seek to build a coalition to keep pressure on China.

Healthcare. Biden's platform aims to improve the Affordable Care Act, one of Obama's key legacies. He would limit drug price increases under Medicare to the rate of inflation and also allow households to buy prescription drugs from abroad.

Technology. More regulation on technology majors is planned to "level the playing field". Biden would repeal the law which exonerates social media platforms from liability for what users post. On the other hand, he plans $300bn over 4 years in new research and development spending in strategic sectors such as 5G and Artificial Intelligence.

Defence. No significant reduction in defence expenditure.

Finance. Biden plans to tighten regulations on banks, reversing much of Trump's efforts to reduce restrictions on the industry

Trump

Investment. The president plans the "world's greatest infrastructure system" investing $1 trillion over 10 years.

Taxation. President Trump will offer tax credits to businesses in exchange for repatriating jobs from China.

Jobs. Create 10 million jobs in 10 months.

Healthcare. Trump plans to cut prescription drug prices, and lower healthcare insurance premia, while reversing much of Obamacare provisions.

Technology. Trump also plans to repeal legislation exonerating social media from liability for users' posts.

Impact on markets

Since Joe Biden won Bernie Sanders' endorsement and became front-runner for candidate in mid-April, he has maintained a lead in national polls over Donald Trump which has fluctuated over time. When we compare the changes in his lead with the relative performance of US stocks to global stocks ex-US, it appears that surges in his support have coincided with bouts of underperformance by US equities (see chart 6 above).

This may be because investors view his policy priorities – higher taxes, tighter regulation etc. – as market-unfriendly. However, those periods of underperformance also coincided with problems for the US economy – such as the second surge in coronavirus infections – which could be blamed on the incumbent. Moreover, Biden's platform is strongly pro-growth – although it may hit market confidence in the near term, it is likely to boost US GDP in the mid to long term. It is too early to say if a Biden presidency would be negative for markets.

The balance of power

In order to assess how much of a candidate's economic programme might be implemented, it is key to look at how the balance of power between the Administration and Congress might look. There are 4 main scenarios:

1. Biden president, Democrats retain the House and Republicans the Senate. This would make policy implementation difficult, keeping Trump's tax cuts in place. Such a period of stalemate would not be bad for markets, but it could hamper chances of near-term fiscal stimulus.

2. Biden president, Democrats retain the House and win the Senate. This would allow the Democrats to push ahead with implementing policy priorities, at least until the 2022 mid-term elections. We would expect substantial fiscal stimulus, boosting growth prospects. The increased spending in the near term would help mitigate the hit from higher taxes.

3. Trump president, Democrats retain the House and Republicans the Senate. The status quo would not be bad for markets, but it could hamper chances of near-term fiscal stimulus.

4. Trump president, Republicans win the House and retain the Senate. This scenario would confirm the shift in US politics towards the Trump doctrines of small government, low taxes and a preference for bilateral deals over multilateral institutions like the World Trade Organisation. It would also allow for some fiscal stimulus, but probably more modest than under a Biden presidency.

Over the last 11 presidencies, only two presidents – J. Carter in 1976 and G.W. Bush in 2000 – won a clean sweep in Congress and kept it for the whole four years. So, history suggests that if the next President wins both houses in Congress, he will only have 2 years to push through flagship policy initiatives.

Impact on USD

We expect the dollar to weaken in the medium term, irrespective of who ends up in the White House. This view is based on a number of factors. First, the outlook for the US twin deficits – low taxes from Trump or higher fiscal spending from Biden would prevent any meaningful improvement in the budget deficit while the US looks set to continue to run large current account deficits given that low savings means sizeable inward capital investment needs. In addition, the support for the dollar from interest rate differentials has disappeared with the fixing of key rates at the zero bound. Thirdly, the dollar is richly valued in terms of purchasing power parity or real exchange rates.

In the event of a Biden presidency, dollar weakness could accelerate. It would mean more fiscal spending and less business-friendly policies. In addition, diplomatic and trade policy would become more EU-friendly, a potential positive for the single currency.

Impact on equity markets

US equity markets tend to react positively to presidential elections, irrespective of the party which wins power or of which parties control Congress. As shown in the table below, US equities were higher after 3 and 6 months with only two major exceptions in the last 40 years – the tech stock bear market in 2000 and the subprime bear market in 2008.

US equity market performance after presidential elections

MSCI USA, 3-month and 6-month performance after the election

House	Senate	President	Date	3-month Performance	6-month Performance
D	R	R	04.11.1980	-0,4%	0,6%
D	R	R	06.11.1984	6,2%	6,0%
D	D	R	08.11.1988	8,4%	10,5%
D	D	D	03.11.1992	6,2%	5,2%
R	R	D	05.11.1996	9,5%	16,8%
R	R	R	07.11.2000	-7,2%	-12,3%
R	R	R	02.11.2004	5,7%	3,2%
D	D	D	04.11.2008	-16,9%	-9,2%
R	D	D	06.11.2012	6,0%	13,4%
R	R	R	08.11.2016	7,3%	12,1%

R= Republican, D= Democrat

Sources: SGPB, Macrobond, data as of 08/10/2020

If Donald Trump returns to the White House next January, we would not expect any major impact on equity markets. Corporate taxes would remain low, regulations would be kept light and trade policy would stay adversarial. So far, that combination has not proved an impediment to rising equity markets.

If Joe Biden wins, some of his flagship policies may negatively impact markets, notably on taxation and regulations.

Higher taxes

Biden plans a partial reversal of the president's December 2017 statutory rate cut from 35% to 21%, taking the headline rate back to 28%. However, the effective rate (how much tax companies actually paid) fell from 26% to 17% when Trump cut taxes – Biden's hike would raise the effective rate to 20-22%, cutting 2021 EPS by around 4-5%. The brunt of the increase would fall on sectors with more domestic earnings (Utilities, Communications) rather than on more international earners such as Technology, Healthcare and Energy.

Moreover, some other policies could represent an additional drag on earnings – the offshoring penalty surtax, the global intangible low-taxed income tax and the hike in the minimum wage (which would hit sectors which rely on cheap labour, such as Retail and Hospitality) might add up to a further 10% cut. However, there would be mitigating factors – for example, full implementation of Biden's fiscal stimulus plans could add around 5% to earnings, leaving a drag of -10%.

Of course, these tax hikes would be unlikely if there is no clean sweep by the Democrats in Congress and so this should be viewed as a worst-case scenario. In addition, the tax hikes would be a one-off whereas fiscal stimulus would continue to boost growth in the medium term, perhaps triggering a shift from Growth stocks to Value and cyclicals.

Regulation

Two sectors are particularly vulnerable according to Biden's policy platform – Technology and Banking. In addition to repealing the law on social media liability for users' posts, the Democrat may push ahead with antitrust legislation based on the recent Congressional report on abuse of market power by megacap technology and internet stocks such as Alphabet, Facebook, Amazon and Apple.

Putting it all together

The table below summarises which sectors might fare best and worse under Trump or Biden presidencies:

D. Trump	J. Biden
Traditional Energy Financials Defense Small caps Infrastructure	Clean Energy Utilities Construction (renovation, infrastructure) Overseas earners
Companies with sizeable exposure to China US dollar	Healthcare Domestic stocks (hospitality, communications) Megacap tech stocks US dollar

Bottom line.

The weeks running up to the election are likely to see volatility in equity markets remain at relatively high levels. Investor nervousness could then be exacerbated if the election results are closer than forecast in the polls. That may provoke calls for recounts, which could take days if not weeks (in 2000, the recount lasted 5 weeks before the Supreme Court ruled in favour of G.W. Bush), further adding to market tensions.

In the end, we expect Joe Biden to win the election but by a narrower margin than suggested by polls. If that proves to be the case, the Republicans may hold on to majority control in the Senate, thereby acting as a counterweight to policy initiatives from the Biden White House, making substantial tax hikes more difficult to implement. Further fiscal stimulus would likely be forthcoming, especially given the recent slowing in the pace of recovery. And the Federal Reserve recently indicated that it expects to keep key rates at zero until 2023. US equities remain richly valued in our view – which limits the scope for continued outperformance – but this policy mix represents a rather supportive backdrop.

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