November 7, 2020

15 min

MARKET UPDATE: US ELECTION

BIDEN US PRESIDENT-ELECT

WHAT HAS HAPPENED?

Joseph R. Biden is on track to becoming the 46th president of the United States, with the latest results indicating he has exceeded the 270 Electoral College vote threshold according to the Associated Press as of 11:30 a.m. EST. In congressional elections, the Democratic Party was poised to keep control of the House of Representatives, though with a smaller-than-expected majority. The Republicans seem likely to maintain a thin Senate majority. However, that outcome will depend on two Senate races in Georgia to be decided by a January run-off poll after no candidate secured an absolute majority, as per that state's rules.

President Donald Trump has pledged to mount legal challenges to results in some states, including Pennsylvania and Wisconsin, so uncertainty about the final result may last for several weeks. But assuming that the current results hold, here are our thoughts on the implications from the 2020 election.

President-elect Biden may struggle to execute his policy agenda with Republicans still in control of the Senate. Aggressive fiscal stimulus to combat the effects of the pandemic will likely continue but could face ongoing political roadblocks. Biden may find it difficult to reverse corporate tax cuts enacted by the Trump administration.

MARKET REACTION

Global markets have rallied this past week in reaction to the US election results. The S&P 500 Index rose by 7.4%, while the MSCI All-Country World Index was up 7.6%. MSCI Europe advanced by 9% and MSCI Japan was up 6.4%.

So why have stocks advanced since Wednesday?

+ Healthcare and tech stocks have rallied, possibly because of fading concerns that a "blue wave" Democratic sweep—which didn't happen—would have spurred heavier regulation in these sectors.
+ With a Republican Senate, corporate tax hikes that would have reduced earnings are much less likely.
+ The election uncertainty had been weighing on sentiment, and many investors were using this as a reason not to shift into equities.
+ Many market participants believe that some level of gridlock in Washington, DC is good for stocks. This view might normally be correct, but we don't think that's the case when action and stimulus are desperately needed.

We don't think investors should extrapolate too much from the past three days of market moves, which might also be influenced by portfolio repositioning and the unwinding of hedges put in place before the election.

ECONOMIC POLICY OUTLOOK

Our economists have been preparing for various post-election scenarios and will be considering the potential impact of the current results on US fiscal and monetary policy as well as on the economic growth outlook.

Fiscal stimulus is likely to top the agenda of the new administration. Biden will probably seek more stimulus spending, although he could face further opposition from the Republican-controlled Senate, and the size and shape of any near-term package remain highly uncertain.

Biden's platform has promised tax increases for companies and individuals. However, plans for tax hikes are likely to be thwarted by a divided government.

Even if tax hikes face political opposition, we expect the business climate could change dramatically under a Biden administration. While revoking executive orders and implementing new policies is more of a process than an event, we expect executive orders around climate change policy would be among the first changes—and the most impactful. Biden's platform also earmarks $2 trillion in "accelerated" infrastructure spending, with a tilt to net-zero emission goals.

Biden's call to more than double the national minimum wage would be felt most by low-margin restaurants and retail, though the retail sector would benefit from more trade certainty, and restaurants would be buoyed by fiscal expansion and a larger labor force, given relaxed immigration policies.

We don't expect a near-term change in the low interest-rate environment and the US Federal Reserve's easy money policy under the new administration.

EVALUATING POLITICS IN PORTFOLIOS

Across asset classes, our portfolio managers generally do not take positions in stocks or bonds based on political considerations. However, when evaluating holdings and investment candidates, our research analysts assess how policy decisions could affect the fundamental outlook for companies and issuers. Our investment teams will study the election results and evaluate the potential policy impact on individual holdings.

FIVE THINGS FOR INVESTORS TO THINK ABOUT

1. **Focus on Quality in Equity Allocations:** In the past, long-term US stock market returns haven't been much different under Republican or Democratic presidents. This time may be different, because of several major long-term trends that have been developing over decades. Still, we don't think investors should build an equity strategy based on the election outcome, because it's very difficult to predict how policy will play out in practice. Instead, we think they should focus on high-quality stocks and thematic portfolios based on companies well-positioned to surmount the challenges of COVID-19 and thrive through the pandemic in a low-growth world.
2. **Healthcare Regulation Won't Hurt All Companies:** During the campaign, Biden pledged to restore the Affordable Care Act's individual mandate, which required all US residents to have a health insurance plan and was scrapped by Trump. Biden also promised to take action to lower prices of prescription drugs. Expectations that Biden will push through new regulation for the sector, which could have hurt some healthcare companies, have been dampened by the Senate result. With or without new regulation, we believe select healthcare companies have strong business drivers and are relatively immune to potential regulatory change, in areas such as gene sequencing, robotic surgery and the digitization of medical services.
3. **Demand for US Municipal Bonds May Increase:** If tax hikes are successfully pushed through, which would be challenging with a Republican Senate, demand for US municipal bonds could increase, especially among wealthier earners, in our view. Higher demand could make munis more attractive relative to taxable bonds, which in turn would increase muni prices. In the current low-yield environment, however, we believe initial price changes would be minimal. Higher corporate taxes could also drive up muni demand, especially among banks and property and casualty insurers.
4. **Climate Change Policies to Shift:** Stronger climate change policies would be good for the planet but could hurt energy and basic material earnings. A renewed focus on climate change would help promote energy efficiency and is likely to boost renewable energy firms. But exploration and production would be most negatively impacted with more regulation, a potential carbon tax and higher federal leasing rates that would impact production and increase costs. A potential fracking ban on federal lands is a more remote possibility. Lower exploration and production levels would lead to lower oil-field services revenue, though the only direct hit to oil-field service companies would come from higher taxes. Oil refiners would see higher renewable biofuel costs and—eventually—the pinch of tighter efficiency standards for cars. Energy pipelines may be impacted by shifts toward greener energy sources and potential litigation.
5. **International Reengagement:** Despite the congressional outcome, the Biden presidency is likely to pursue US reengagement with multilateral institutions like the World Trade Organization. Greater trade certainty, which is also likely under a Biden administration, could aid several sectors. The boost could be particularly notable for autos, chemicals, tobacco and technology, all of which sell globally.

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