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The US Presidential Election. Is the Result in the Mail?

Our weekly macroeconomic view.

26 October 2020

2 Weeks is a Very Long Time in Politics

We are now inside the final 2 weeks of the US election campaign. Aggregated poll surveys show Biden continues to lead by between 8 and 10 points although there is evidence of tightening in the past week as Trump launches a campaign blitz.

By way of comparison, Hilary Clinton held a 6 point lead at the same point in 2016. This lead narrowed to 3 points the day before the election. Despite winning the popular vote 48% to 46%, Clinton lost the Electoral College vote 305 to 233.

Ultimately just half a dozen swing states will likely hold the key to the US Presidency. Biden continues to hold an average 4 point lead in these states and on this basis is favoured to win the election by taking 5 or possibly all 6 of these battleground states (worth 100 Electoral College votes), however, 2 weeks is a very long time in politics.

Clinton led in the swing state polls in 2016 but still lost the election, so there is still considerable trepidation around the accuracy of polling. Pollsters have attempted to learn from 2016 and have attempted to correct potential sampling biases from oversampling urban and college-educated voters. The much talked about "shy Trump voters" of 2016 remain a point of conjecture.

Exhibit 1: Biden versus Trump net polling (aggregated polls)

Biden net lead (aggregated poll)

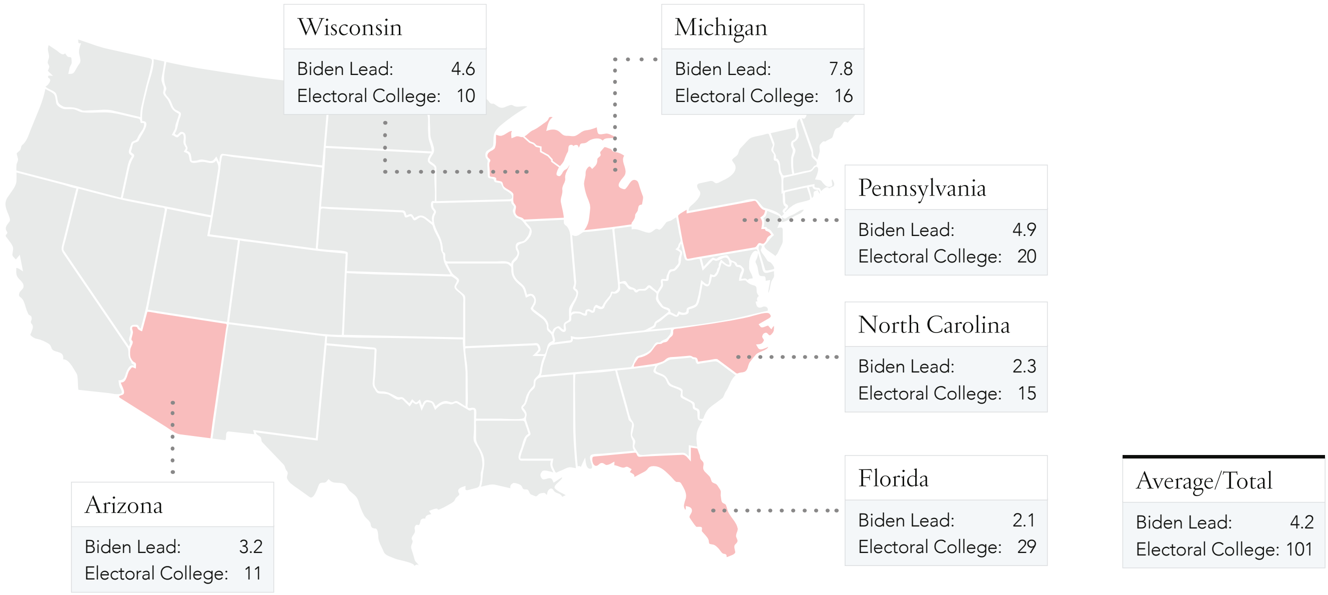
Source: Realclearpolitics.

Exhibit 2: Clinton led Trump in the polls through 2016 but by less than Biden

Clinton Trump 2016 Aggregated Polling

Source: Realclearpolitics.

Exhibit 3: Swing state polling and electoral college votes



In 2016 the undecided appeared to swing behind Trump on election-day. There appears to be a lower number of undecided voters relative to 2016, and this may act to limit a late Trump swing this time. Trump supporters also showed a higher propensity to cast a ballot in 2016 relative to a complacent Democrat base. This is unlikely to be the case this time around. The high number of voters that have already flagged an intention to vote early (around 25% of voters) may also act to limit a surprise late swing.

A Contested Election is the Risk Case for Equities

A contested election result is the scenario most feared by investors. The 2000 Bush-Gore deadlock saw the S&P 500 fall 10% in the month following the election before Gore finally conceded. A more protracted and bitterly contested outcome this time around could see even more downside in stocks, though this is a risk case rather than the most likely outcome.

Investors appear to have lowered the risk of a contested election this month given Biden's reasonably sticky lead in the polls, but a tight initial result that produces lingering uncertainty cannot be ruled out.

The potential for a confusing or contested result is heightened by the method of voting. Republicans are signalling an intention to vote in person on the day, while 47% of Democrats are suggesting they will vote by mail (compared to only 11% of Republicans). This could lead to the initial results seeming to favour either a Republican victory or a very tight initial vote, only for the result to swing in favour of the Democrats as mail-in votes are counted.

Trump has repeatedly questioned the legitimacy of mail-in ballots and could further feed market uncertainty by criticising the mail-in ballot system if the result appears close on election night.

Market Implications – Market Will likely Rally on a Clear Result

The consensus even a couple of months ago was that the status quo of a Trump second term would be the more positive outcome for the US equity market; however, Wall Street appears to have become more comfortable with the prospect of a Biden victory. The US equity market is up 4.7% over the past month. This may be a function of investors lowering the risk of a contested election, but it is also likely to reflect an emerging view that a Biden victory would come with a balance of positives and negatives for the US market.

Higher taxes (particularly the proposed corporate tax hike from 21% to 28%) and higher regulation have been the most commonly discussed negatives around a Biden victory. Still, the market is increasingly looking to a large additional stimulus package post-election as a significant offset. Geopolitical tensions with China are unlikely to disappear completely, but Biden is likely to pursue a more conventional and multilateral approach to China which would on balance be positive for equities.

Overall, we judge that a clear Biden victory would see at least a relief rally from US stocks (relief that a contested election scenario was avoided) despite the negative impact of some of his stated policies. Likewise, a surprise Trump victory (if clear) would also see equities trade higher. The longer-term performance of US stocks will likely come down to the ability of US and global economic activity to recover to more normal levels, rather than to the specifics of either policy platform.

Potential Sector and Style Impacts

From a sector rotation perspective, a Biden victory would likely favour some style rotation from value into growth due to the impact on growth from a large fiscal stimulus package. An extended rotation to value would likely require some supportive news on the vaccine front in the next few months.

In terms of US sector performance, the most likely policy impacts from a change of President would be in healthcare and energy, with some potential, but less certain, impacts in financials and tech.

In healthcare, Biden is expected to expand public insurance programs (expand Obamacare). This is a negative for big pharma as they would likely face price caps on drug prices; however, the general expansion of the public health system and greater amount of dollars spent under Biden would likely result in stock-specific winners in healthcare.

Biden has an explicit target to pivot the US economy toward clean energy with an ambitious net zero emissions target by 2050. This would be a structural negative for the traditional energy sector, and positive for clean energy plays, albeit the oil price could receive support from a more positive view of US and global growth. In contrast, Trump has had little to say on climate policy and has vowed to expand oil and gas drilling zones.

Financials are likely to be subject to some degree of increased regulation (a position backed by Democratic heavyweight Elizabeth Warren) with enhanced consumer protection laws and greater personal bankruptcy protections being touted. However, Biden himself has not been particularly clear on his plans.

Exhibit 4: ALPS Clean Energy ETF relative to S&P 500

Source: Refinitiv.

Technology is likely to face further regulatory oversight under either a Trump or Biden Presidency. US mega-cap tech is already in the sights of legislators as evidenced by recent anti-trust actions. Whether the Democrats would step up the intensity is difficult to say given they have a close relationship with Silicon Valley. We think the risks for healthcare (big pharma) and energy under a Biden presidency are clearer. Tech is likely to see a heightened degree of regulation under either a Biden or Trump Presidency.

Both sides are pledging a step up in infrastructure spending, though Biden's policy guidance appears to be for a larger program (see exhibit 5). It will also be spread between traditional infrastructure and clean energy infrastructure initiatives, as well as social housing and public school spending.

Looking Beyond US Stocks – Biden Win More Positive for Rest of World Equities

It is likely a Biden victory would be well-received by equity markets outside the US due to the positive impact of further fiscal stimulus on US growth (and hence global demand), the expectation of reduced global geopolitical tensions, and a renewed focus on multilateral trade agreements.

US bond yields are likely to rise moderately on a Biden victory (an even larger US deficit than under Trump is likely). The US$ is likely to ease, which would be positive for emerging markets, and the performance of the A$ will be interesting in election week. The US election is set to occur only a couple of days after the RBA meeting at which we expect more easing.

Control of the Senate and the Ability to Execute Policy

Aside from the race for the Presidency, the control of the Senate is also critical for either side to execute their policy platform. The Democrats are favoured to complete a clean sweep by taking the Presidency and also narrowly gaining control of the Senate 52 to 48 (they already have control of the lower house). This would make the execution of their agenda much easier. If they fail to control the Senate, it is not necessarily a major negative for US equities (particularly on a multi-year view) as it would limit the extent of policy change. The failure of the democrats to take the Senate would make the passage of a sizeable stimulus in the new year more difficult, causing the market to worry about 2021 growth prospects.

Exhibit 5: Biden and Trump policy platforms

	Biden	Trump
Corporate taxes	• Raise corporate tax rate from 21% to 28%. • Impose 15% corporate minimum tax on book income. • Double tax rate on global intangible low tax income (GILTI) to 21%.	• No changes to tax rates. • Made in America" tax credit incentives for Industries who return their operations to the US.
Personal taxes	• Apply social security payroll tax of 12.4% to earnings >$400k. • Tax capital gains and dividends at 39.6% on earnings $1m+. • Restore 39.6% rate on individual earnings over $400k.	• No changes to tax rates. • Look to make 2017 tax cuts permanent.
Healthcare	• Expand Affordable Care Act (Obamacare). • The 10-year static budget cost of the proposed changes to the healthcare system approx US$1.7trn.	• Continue to unwind Obamacare.
Energy	• Move towards 100% clean energy by 2050. • Clean energy subsidies and EV support.	• No renewables focus. • Expand oil and gas drilling.
Infrastructure	• 4-year US$2.4trn plan, includes increases for traditional transport infrastructure and clean energy infrastructure, R&D innovation.	• Looking at US$1trn bill to aid the recovery. • Focus on traditional infrastructure (roads and bridges), water, and 5G wireless.
International relations/trade	• Less aggressive with China than Trump. • Re-engage on mutlilateral trade agreements. • Return to Paris Climate Agreement.	• Tough on China. • Maintain America First Policy.
Tech/anti trust	• Increase regulation of tech and big pharma.	• Pursue tech on anti trust grounds.

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