

As we get closer to November, investors are likely to become increasingly preoccupied with a new source of uncertainty: the US presidential election. The coming months represent a period in which opinion polls could have an outsized influence on market sentiment, making it even more important for investors to focus on the bigger picture and the key issues that matter.

Financial markets and the US election

Thinking strategically about the US presidential election: a starting place

We're roughly three months away from the US presidential election, which is both near enough to merit careful monitoring, but also awkwardly far out enough to make it impossible to have any meaningful visibility into likely outcomes. The fact that it's taking place amid an unprecedented health crisis introduces even more uncertainty into the financial markets. That said, we've identified three themes that we believe investors should consider.

1. A Biden win and/or a Democratic sweep, which markets are beginning to price in,¹ may not necessarily be negative for risk assets.
2. The less obvious policy changes associated with a new administration may be the most important for the medium- and longer-term investment view in the event of a Biden win and/or a Democratic sweep.
3. A few key economic policies will continue to be dominant drivers of the 2021/2022 economic/market outlook regardless of the outcome of the election.

Theme 1: fears that a Democratic sweep will be market negative are probably overblown

There's no shortage of financial news analysis—such as [this article](#) in the *New York Times*—

suggesting that markets are focused on one particular election outcome: a Biden win and Democratic control of both the House and the Senate also known as a Democratic sweep. While the popular perception is that a Democratic sweep would be broadly market negative, we'd caution that we believe such fears are likely exaggerated.

A quick analysis of how different asset classes have responded to the change in opinion polls, which had been moving in Mr. Biden's favor in the past month,² shows that a positive correlation exists between the S&P 500 Index, the US dollar, and the prospect of a Biden win and a Democratic sweep.

A Democratic sweep doesn't equate to carte blanche implementation of sweeping reforms

Congress plays an important role in the policymaking process in the United States, and this is an important reason why it isn't always easy for newly elected presidents to fulfill the policy pledges that they've made while on the campaign trail. While political pundits will highlight that there's a path for the Democrats to gain a simple majority in the Senate, from a mathematical perspective, it's unlikely that the Democrats can reach a 60-seat majority that will allow it to end debates on proposed bills and prevent minority parties from mounting filibusters that could block the passage of legislation. In other words, even in the event of a Democratic sweep, without a 60-seat majority, barriers to passing major legislation will remain—and this will apply to many of Mr. Biden's proposed policies, including his plan to raise corporate tax.

The need to support the economy in a post-COVID-19 environment will likely hijack most other policy proposals

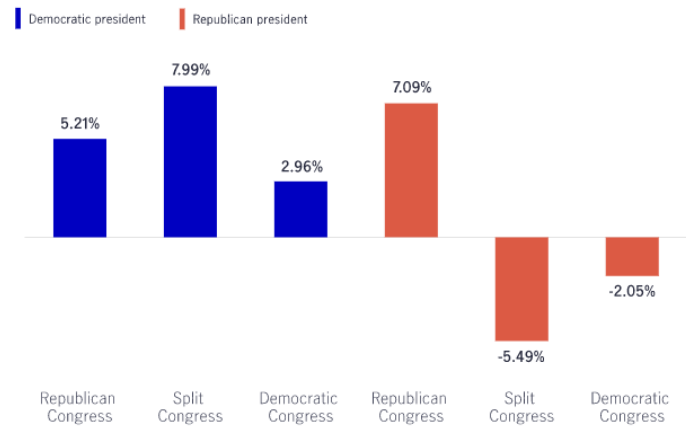
In our view, 2021 will be an exceptionally challenging year for the economy as it faces elevated levels of unemployment, rising inflationary pressures, and an ongoing health crisis. It isn't likely to be an environment that can plausibly absorb higher tax rates on either the corporate or individual level. Rather, it will be an environment that necessitates large-scale, continuous stimulus, such as the extension of various relief measures in the CARES Act.

In our view, should the probability of a Democratic sweep continue to rise and investors begin to take a more considered view of the challenges that could face the new administration, they'll likely:

- Gradually price in a *higher* likelihood of additional large-scale stimulus
- *Reduce* their expectations of a hike in corporate and individual taxes, particularly in 2021 and 2022
- *Reduce* their expectations for new policy proposals to be introduced in 2021 (at least), with healthcare being the one possible exception

Chart 1: US markets don't consistently sell off under Democratic sweeps

Dow Jones Industrial Average—historical returns under different governments
Average % gain per year (since 1900 based on monthly data)

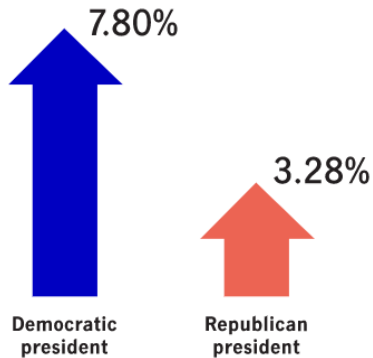


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From an economic/academic perspective, there can be no doubt that the COVID-19 outbreak has made it rather difficult to make historical comparisons with the current economic environment—we're certainly in uncharted territory here; however, we believe it's important for investors to note that Democratic sweeps don't, on average, lead to market losses. Historically, the Dow Jones Industrial Average has risen twice as much when a Democrat was elected president than when a Republican was elected president.³

Chart 2: Dow Jones Industrial Average — average performance (since 1900 based on daily data)

Dow Jones Industrial Average—average performance (since 1900 based on daily data)



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We certainly aren't suggesting that markets will perform better under certain *types* of government—the real world is much more complex than that—but it's useful to note that the often-cited view that Democrats may be market negative isn't historically accurate.

Theme 2: the less obvious policy initiatives may be the most market relevant

Mr. Biden's proposal to reverse some of the Tax Cut and Jobs Act and gradually raise the US corporate tax rate from 21% to 28%⁴ has attracted a lot of interest—and caused concern—among market watchers. Certainly, when taken in isolation, higher corporate taxes will be tough on risk assets, but, as mentioned earlier, we think the probability of this being a near-term policy priority is low.

Instead, we think investors should focus on policies associated with a change of government that have so far received less attention—three issues in particular, in our view, have important implications:

- **Minimum wage increases**

Mr. Biden's labor agenda includes plans to raise the minimum wage to \$15 per hour and a proposal to index the minimum wage to median

wage growth. There are also initiatives to introduce regulatory changes that would facilitate the unionization of workplaces and impose higher penalties on businesses for workplace violations.⁵ In our view, these proposals may have a higher chance of becoming policies amid the health crisis as lawmakers try to protect workers. However, should these initiatives make it through Congress, it could hurt corporate earnings and translate into inflationary pressures in the broader economy.

- **Increase regulation for tech firm**

Details on this subject are actually somewhat sparse on Mr. Biden's campaign website as of this writing, but it's worth highlighting that the presumptive Democratic presidential nominee has referenced the need to ensure that big tech firms are competing fairly and behaving appropriately,⁶ and he's called on Congress to revoke Section 230 of the Communications Decency Act, which shields social network firms from being liable for what their users post. He has also said that the United States "should be setting standards not unlike the Europeans are doing relative to (data) privacy."⁷ While these may not be game changers from a growth/inflation perspective, with technology stocks now making up 27% of the S&P 500 Index,¹ regulatory changes in this space are clearly market relevant.

- **More government involvement in healthcare**

Mass unemployment as a result of the COVID-19 outbreak invariably means that fewer Americans have health coverage at a time when more will need healthcare. This is likely to create a larger appetite to implement changes among lawmakers to protect their voters: Many of Mr. Biden's proposals seek to reduce healthcare costs *and* the cost of prescription drugs, a sector that has seen some of the highest inflation. Changes in this area will have important implications for the healthcare sector, and any limit placed on drug prices could also offset expected disinflationary pressures.

Theme 3: focusing on what's unlikely to change, regardless of election outcomes

To have a fuller picture of the market environment we're likely to be in after November's election, investors shouldn't focus only on factors that *could* change—it's just as important to pay attention to macro issues and developments that are likely to continue to shape future policies regardless of election outcomes.

Note that this is a *starting* place for discussion as we attempt to map out how financial markets are likely to respond to the upcoming election. The markets' perspective on the election will likely evolve in the coming three months as new events occur and existing developments play out. Other dynamics that investors should consider could include how the election is contributing to a weaker

US dollar, the implications of a continued decoupling of the US and Chinese economies, and what a second term for the Trump administration could mean for investors. Given the known unknowns, it's too early to make any form of definitive judgment.

1 Bloomberg, as of July 21, 2020. 2 RealClear Politics, as of July 21, 2020. 3 Ned Davis Research, Manulife Investment Management, as of July 21, 2020. 4 ["Biden tells donors: I'm going to get rid of most of Trump's tax cuts and 'a lot of you may not like that,'"](#) cnbc.com, June 29, 2020. 5 ["The Biden plan for strengthening worker organizing, collective bargaining, and unions,"](#) joe Biden.com, as of July 21, 2020. 6 ["I think Amazon should start paying taxes. Joe Biden says,"](#) cnbc.com, May 22, 2020. 7 ["Biden calls for revoking key online legal protection,"](#) thehill.com, January 17, 2020.

Key theme	Details	Market implications
US-China decoupling continues	<p>Mr. Biden is generally considered quite hawkish when it comes to US-China relations.</p> <p>We believe he'll demand equal market access and might also choose to focus on human rights-related issues in his negotiations with China.</p> <p>So far, there doesn't appear to be any indication that he plans to roll back existing tariffs on Chinese imports.</p>	<ul style="list-style-type: none"> • Global trade flows will likely remain suppressed • The US dollar could strengthen at the margin • Mild to moderate inflationary pressures
Large-scale infrastructure spending	<p>There's cross-party support for significant infrastructure spending, which we believe will continue regardless of the election outcome.</p> <p>However, a Democratic package would likely be larger than a Republican package and contain more climate-related initiatives.</p>	<ul style="list-style-type: none"> • Higher productivity • Higher potential growth • Mild to moderate inflationary pressure • A steeper US yield curve
Pressure on corporate share buybacks	<p>Corporate share buyback programs have been receiving increasing scrutiny in recent years. In some ways, the COVID-19 outbreak—during which the US Federal Reserve stipulated that firms receiving federal support wouldn't be allowed to use the money they received to fund share buybacks—provided policymakers with an opportunity to emphasize their concerns.</p> <p>We believe the volume of share buybacks is likely to trend lower in the coming years, regardless of the outcome of the election.</p>	<ul style="list-style-type: none"> • Higher level of volatility in the equity market as fewer issuers would be able to head into the market to snap up their own shares when prices fall • This could have a negative impact on earnings per share growth

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