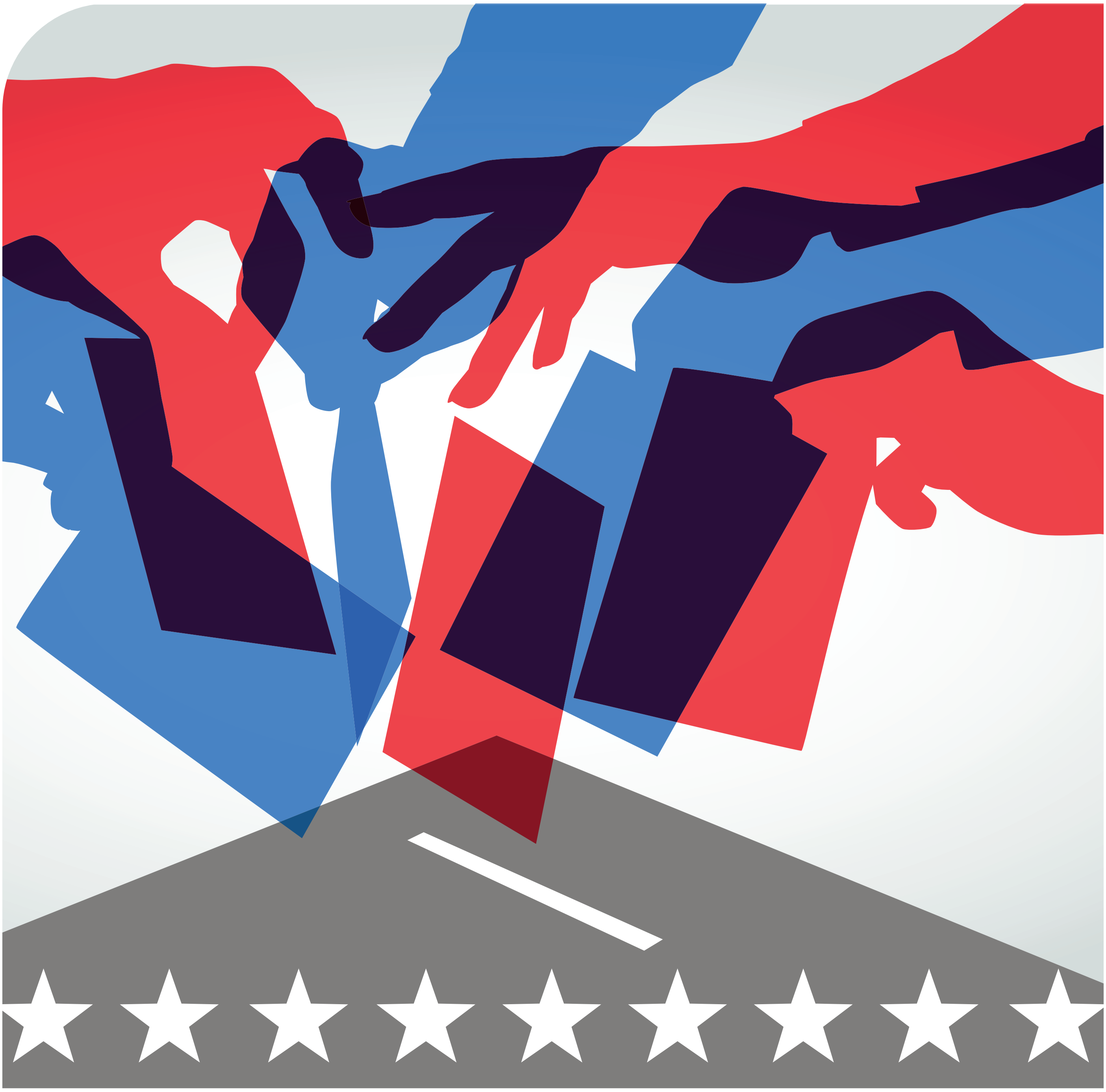
Biden vs Trump

Policies and their market implications



Rathbones
Look forward

Foreword

This is a long note. It may, therefore, seem rather odd that I'm going to start by saying that elections rarely matter for financial markets. Looking at 40 years of data, covering equities, the dollar, Treasuries and corporate bonds, we've found that presidential elections generate a little noise, but rarely any signal. Popular ideas such as Democratic presidents being worse for investment returns don't stand up to scrutiny. Even sectoral ramifications are often hard to identify. What were the two worst performing sectors during the Obama years? Financials and energy. The worst under Trump? Financials and energy. There are bigger forces at work.

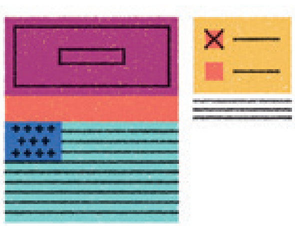
I think it's still worth reading on. Political polarisation means that the Republicans are now right-wing populists and the Democrats are touting more big government, even socialist, policies than usual. It's possible – though I wouldn't say certain – that it's different this time. At the very least, the sectoral implications are rather more stark.

Surveys of institutional investors suggest that a Democratic clean sweep could rile markets the most. Many fear Biden in the White House even with a split Congress. Yet Biden's resurgent polling numbers haven't stopped the markets from climbing. It's possible those surveys are misleading.

I think it's really important to ask if any of the four pillars supporting markets this year are likely to be undermined by the clean sweep, or any other election outcome? Those pillars are (i) hope for a timely, effective vaccine; (ii) supportive fiscal policy; (iii) supportive monetary policy; and (iv) a levelling-off of previously escalating Sino-US trade tensions. We've summed them up in the table below. It might help keep things in perspective. In most cases, there is little change, and in a Democratic clean sweep you get bigger fiscal policy and less maverick trade. Historically, a presidential candidate committing to very loose fiscal policy would have caused investors to expect tighter monetary policy. But the Federal Reserve (Fed) has committed to holding interest rates near zero until the end of 2023, even if inflation rises above 2%. As such, is it as simple as the outcome with the most stimulatory fiscal policy is the most positive for markets?

At the same time, Biden's plans are heavily redistributional. GDP may go up, but the corporate share of GDP is likely to go down, and for some companies and sub-sectors, at least, there may be a negative net effect on future returns. As we detail in the second half of the note, it's important to consider the opportunities and threats on a sector by sector basis.

Edward Smith
Head of Asset Allocation Research



Most important market drivers over the next 18 months

	Democratic sweep	Biden/split Congress	Trump/split Congress	Republican sweep
COVID vaccine	nc	nc	nc	nc
Fiscal policy	✓	nc	nc	✓
Monetary policy	nc (slight rise in inflation risk)	nc	nc	nc
Trade policy	✓ (still anti-China)	✓ (still anti-China)	x	x
Corp. share of GDP	x	x (but restrained)	nc	✓

✓ = positive for markets; x = negative for markets; nc = no change

Source: Rathbones.

What are the odds?

Since we published our outlook for the US election in our July Investment*Insights* publication, the betting markets had rethought the huge lead they had given former Vice President Joe Biden over the summer. In mid-September, Biden still had the edge, but, given the bookies' track record, the odds suggested it was really too close to call. We agreed with this view. We don't pretend to be able to predict elections outright, but we do have the tools to help us assess the spread of likely outcomes (figure 1). 'Prepare, don't predict' is always a good mantra for investors in political matters.

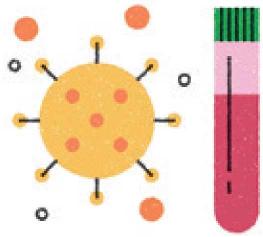
Biden had a huge lead in the national polls, but not in key swing states, where in some cases he led by less than Hillary did this time four years ago. Political science models, such as Lichtman's 'Keys to the White House' favoured Biden, but our own econometric model, which had correctly predicted every outcome since 1980, including Trump's first victory using no information from the future ('out of sample' – to use the proper jargon), suggested that President Trump still had the edge.

But the betting markets have moved again. After the first debate and Trump's COVID diagnosis, the odds now present a greater chance of a Biden victory than ever (as we go to print they are giving Biden a 68% chance). Debates are red herrings: post-debate polling failed to predict Trump 2016, Obama 2012 and Bush 2004. We agree, however, that Trump's COVID diagnosis helps Biden, but not to the extent that the bookies suggest.

Figure 1: Prediction frameworks

Framework	Result
Betting odds	Biden
National polls	Biden
Swing state polls	*Too close to call*
Lichtman 'Keys' framework	Biden
Rathbones econometric model	Trump

Source: Bloomberg, realclearpolitics.com and Rathbones.



> The details surrounding Trump's diagnosis, his rapid discharge from hospital and his reckless, anti-science attitude to masks will generate endless press coverage of a topic on which Biden is likely to win.

As we wrote in part 1, our analysis of myriad opinion surveys suggests that Biden's chances are maximised if he can keep voter attention focused away from the economy and on the disease. Trump's economic track record is too strong (whether US economic strength had much to do with his policies or not is irrelevant). Typically, more Americans approve of his handling of the economy than approve of him as their president, and there is scepticism among survey respondents that the economy would get better under Biden. But between 60% and 70% of Americans are still either 'very' or 'somewhat' worried about infection from COVID, and the US's second wave impacted a disproportionate number of counties in swing states that Trump won last time. The third wave seems to be going the same way. Moreover, only 40% of independent voters, who account for about 40% of the electorate, approve of the way Trump has responded to the health crisis.

The details surrounding Trump's diagnosis, his rapid discharge from hospital and his reckless, anti-science attitude to masks will generate endless press coverage on a topic on which Biden is likely to win. The counterview tends to reference Boris Johnson's bounce in the polls after emerging from hospital. But the polls were exceptionally volatile at the time and the pop didn't last long. Boris also had a longer fight, and emerged solemn and contrite.

Macro backdrop: Politics doesn't occur in a vacuum

The rest of this note will discuss the candidates' most salient policies and the macroeconomic and market implications of the possible election outcomes. But before that it's worth summarising the state of the US economy. Politics, after all, doesn't occur in a vacuum.

The US economy has made great progress, recovering more quickly than economists expected in the early summer (including us). Judging by the spare capacity left in the Treasury and the Fed's corporate lending programmes, firms don't need extra funds, which is often a constraint early in the recovery.

But hard, soft and innovative high-frequency data suggest that the pace of growth is moderating, and there is a risk that the recovery stalls completely. That's a problem, because there is still a long way to go. Retail sales may be 5% above pre-COVID levels, but they only account for around a third of consumer spending. Moreover, they fell in July and August, while other discretionary spending remains constrained. Housing construction was another early bright spot, but new starts fell 5% in August, back to 13% below pre-COVID levels. Industrial production managed a small gain, but is still 8% below water. To be clear, key leading indicators are still consistent with expansion, and we don't expect the recovery to crash and burn. But there is a risk that it enters a stop-start phase, which could unnerve financial markets, given consensus earnings forecasts for all sectors to exceed 2019 profits in 2021, bar finance and real estate.

The remarkable thing about the recession spanning the first and second quarters was that personal incomes increased, thanks to government stimulus. That's reversing. Real disposable income (that's income after tax, adjusted for inflation) fell 3.5% in August (figure 2), as the weakest gain in compensation in four months was offset by a sharp reduction in government transfers to households. Jobs growth is needed to offset the reduction in government transfers. With employment still 10.7 million below pre-COVID levels, it's disappointing that the number of job openings fell in August.

While headline unemployment is falling, the rate excluding those registered as 'temporarily' laid off continues to rise. Counting only those who have been unemployed for between 15 and 26 weeks, the unemployment rate in August was double the rate seen in the Global Financial Crisis of 2008 to 2009 (figure 3). In September, the majority of people exiting this cohort transitioned into the next — more than 27 weeks unemployed — from which history suggests it can be difficult to ever emerge. To be sure, various surveys suggest that the economy will continue to add jobs, but there is a significant risk that it could do so at a pace that both disappoints markets and curtails consumer-driven growth.

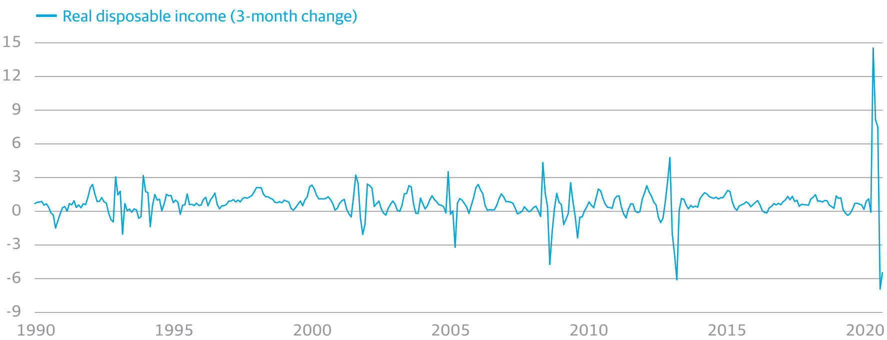
With the job market at risk of stalling, COVID cases rising for the third time, and flu season approaching, the economy has reached a critical juncture on the road to recovery. It may continue to head in the right direction alone, but its chances would increase greatly if consumer spending — the main engine of economic activity — as well as beleaguered state and local governments received more federal stimulus. Unfortunately, Trump recently tweeted: "I have instructed my representatives to stop negotiating [for a stimulus bill] until after the election when, immediately after I win, we will pass a major Stimulus Bill."

Some commentators, such as Gavekal, argue that the recovery is not threatened by this because consumers can spend the savings they accrued from the previous cheques, just as they did in August. But that assumes that all households saved, or that those that did will now offset the fall in consumption by those that didn't. We're sceptical. Consumer sentiment remains near post-COVID lows, and there isn't a particularly large spread between wealthy and less wealthy households. Moreover, a recent academic working paper found that while around 60% of the stimulus money was either saved or used to pay down debt, household behaviours differed significantly, with household income being a highly significant determinant of saving. An innovative dataset that uses debit and credit card transaction data suggests that spending by low-income households normalised quickly, while high-income households continue to be more spending-averse. Drawing all of this together, it suggests that consumer spending could be curtailed by low-income households with now falling incomes.

No news is ~~good~~ bad news — a contested result

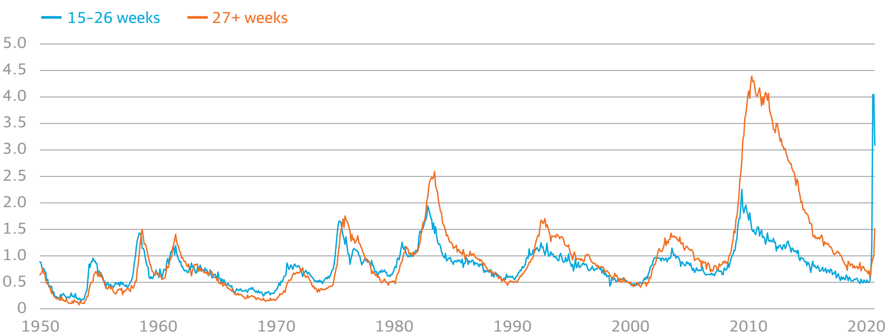
Investors suggest the worst outcome is no outcome at all. November VIX futures — the price of volatility protection — are notably elevated, more so than usual for an election month. A recent survey of 1,377 institutional investors by Citi found that 45% expect US equities to fall by more than 10% if there's no result

Figure 2: US real disposable income (%)

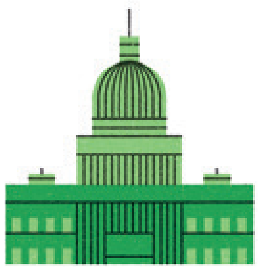


Source: Refinitiv and Rathbones.

Figure 3: US unemployment rate by duration of unemployment (%)



Source: Refinitiv and Rathbones.



With the job market at risk of stalling, COVID cases rising for the third time, and flu season approaching, the economy has reached a critical juncture on the road to recovery.

by Thanksgiving (26 November), with another 30% expecting markets to fall by 5–10%. The same survey wasn't even nearly so negative on a Democratic clean sweep (figure 4).

Why are investors more fearful of this scenario than anything else? Possibly, investors believe the hyperbolic think pieces that envisage Trump ordering the army to seize ballot papers, undermining the rule of law and democracy which have an important relationship with economic development and capital market deepness. But these think pieces are rather specious, in our opinion. States run the election, not Washington, and the concession of the incumbent is not required for power to transition.

We think investors' fears are more about the stimulus lacuna. While the result is still contested, additional fiscal stimulus is unlikely to happen. As we discussed previously, this would be risky even in the absence of any other bad news, but it could be very problematic if the economy or the virus took a turn for the worse during that time. That said, while delayed stimulus increases the risk of permanent economic scarring, the long-term effect is likely to be relatively small. Moreover, while the fiscal backstop may be removed temporarily, the monetary backstop would remain operational. As such, a correction of more than 10% in the event of a delayed result could be a good buying opportunity.

A very long delay to the result is unlikely. But three key swing states — Pennsylvania, Wisconsin, and Michigan — have extended their respective deadlines for mail-in ballots to be received to 6, 9 and 19 October. These may be subject to judicial challenges, but, as it stands, a short delay has become quite likely.

We don't think it's a useful comparison, but for reference, the S&P 500 fell by 4% between election day 2000 (7 November) and 12 December, when the Supreme Court intervened to rule in Bush's favour. It underperformed the MSCI World by 0.8%. But this was at the beginning of the dot.com bust (pets.com went under on 9 November) and leading indicators were signalling the impending recession.

The Democratic 'clean sweep' — investors' second biggest fear

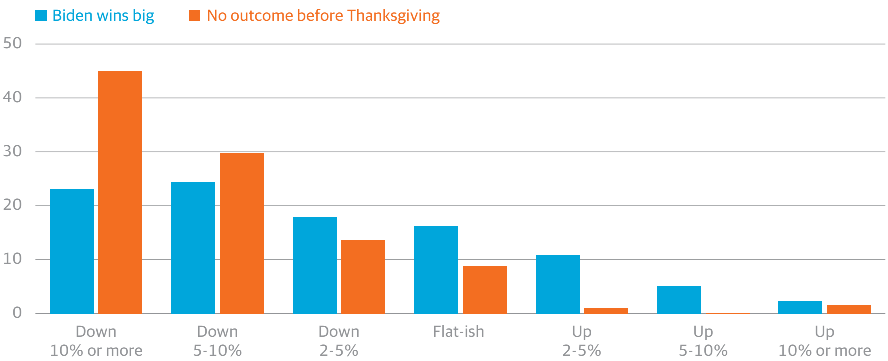
The second most adverse scenario for markets according to the Citi survey is a Democratic clean sweep — Biden in the White House, Democrats controlling both chambers in Congress. Some 23% of respondents expect US equities to fall by more than 10%, with another 25% expecting a 5–10% fall. Other investment bank surveys we've seen have returned a similar message.

Of course, there are more investors who think Biden will win than there are those who think Trump will win. According to a Deutsche Bank poll from September, 40% of investors thought Trump was either extremely or slightly likely to win compared to 46% for Biden. The Citi poll gave similar results — 41% versus 46% — as did a Goldman's poll. We expect this has risen in October, and so some of this risk will be in the price of financial assets already.

What's more, there has been no correlation between changes in Biden's polling numbers and US equity market performance, in either relative or absolute terms. The first full week in October saw a big increase in Biden's election odds/polling and a *rising* S&P 500 and Nasdaq (figure 5). Perhaps, as I said in the foreword, that's because past elections have had limited impact on the broad market. Or perhaps that's because history is on the Democrats' side in terms of the economy. In their book *Political cycles and the macroeconomy*, Nouriel Rubini and Alberto Alesina showed that the Democrats tend to preside over faster growth, lower unemployment, and stronger stock markets than Republican presidents do. Recessions are almost invariably caused by imbalances built up by Republican loosening of regulation. Nothing destroys stock returns like a financial crisis.

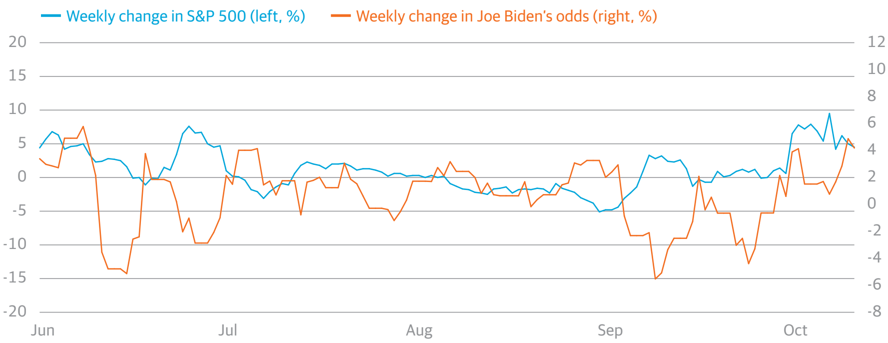
But Biden's agenda is more left-leaning than usual Democratic presidents. Perhaps the lack of

Figure 4: Outturn of Citi institutional investor poll (%)



Source: Citi and Rathbones.

Figure 5: Rounding things up — Biden only just has the edge

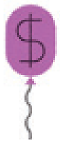


Source: Bloomberg, Refinitiv and Rathbones.

correlation is instead because investors don't interpret Biden's strengthening polling numbers as a proxy for the likelihood of the Democrats retaking the Senate. Since we first wrote about this election, we've said that it is easier for Biden to take the White House than it is for the Democrats to retake the Senate, due to the seats up for grab this year (100 Senators serve six-year terms, with a third of seats up for election every two years). Assuming the Democrats lose Alabama (a very red state that the Democrat incumbent, Doug Jones, only won last time because his opponent was "Me too'd"), they need to win back four other states.

However, Democratic challengers have started to poll increasingly well since early September. Arizona and Colorado look highly likely to flip. North Carolina and Maine are leaning that way too (since Olympia Snowe, Maine has long been the home of the Republican party's most leftward politicians), and it's really close in Iowa and Montana. The election forecaster, fivethirtyeight, run by the reputable Nate Silver, believes the Democrats are 'slightly favoured' to win the Senate, a significant change from mid-September when their simulations suggested it was too close to call. The somewhat esoteric political betting site PredictIt places a 55% chance of a Democratic clean sweep, up 45% at the end of August.

Again, despite these large moves, US equity markets appeared unperturbed. It is entirely possible, therefore, that the institutional investors surveyed aren't representative of the broader market, and that equity markets won't fall sharply on a Democratic clean sweep.



There has been no correlation between changes in Biden's polling numbers and US equity market performance, in either relative or absolute terms.

After all, what has been driving markets this year? (i) Hope for a timely, effective vaccine; (ii) supportive fiscal policy; (iii) supportive monetary policy; and (iv) a levelling-off of previously escalating Sino-US trade tensions. Are any of those four pillars likely to be undermined by a clean sweep?

A president is unlikely to alter the outlook for a vaccine.[1] Fiscal policy is likely to stay very loose under both Trump and Biden, as we'll discuss below. Its distribution will change materially but not its scale. Historically, a presidential candidate committing to very loose fiscal policy would have caused markets to expect tighter monetary policy. But the Fed has committed to holding interest rates near zero until the end of 2023, even if inflation rises above 2%. As such, is it as simple as the outcome with the most stimulatory fiscal policy is the most positive for markets? The risk of intolerably high inflation is a little greater under Biden, but over the next couple of years we expect both structural and cyclical forces to keep a lid on things (and the lacklustre inflation print in September adds evidence to our case). Biden and Trump are remarkably similar on China. But Biden is likely to be less maverick and more rules-based in his approach, which may reduce uncertainty.

By this logic (figure 6), we think the US market could find support below anything more than a 10% correction, although particular sectors and stocks may be hit harder by Biden's redistributional agenda.

Biden White House, split Congress — arguably the best outcome?

Institutional investor surveys suggest this outcome is also likely to cause markets to fall, although by a smaller amount than if the Democrats win big or the result is contested. Interestingly, the Citi survey cited earlier found fewer investors believing markets would rise under this scenario than in the event of a Democratic clean sweep.

Contrarily, we think there's a strong argument to be made for this being a very market-friendly outcome over the medium term. Revisiting figure 6, there are few changes on the fiscal or monetary policy fronts, while there is no chance that Biden could get any large increases in corporation tax through Congress, or any of his most redistributional agenda items that markets fear the most.

But foreign and trade policy uncertainty will ease significantly. As we discuss below, the *substance* of Biden's trade policy is similar to Trump's, at least on China, but the *style* will change, and the erratic approach will likely be replaced with more measured, rules-based tactics that cooperate once again with the international institutions that have presided over decades of strong corporate profitability.

This change may benefit non-US equity markets more than US markets. We're *global*, multi-asset investors and from a *global* perspective this election is about whether global policy uncertainty will continue its dramatic ascent in recent years. Huge increases in uncertainty, particularly around what American protectionism/unilateralism means for foreign export-oriented economies, have augmented US equity outperformance (figure 7) and the long upward trend in the dollar (figure 8), which we discuss more below). Uncertainty has become greater

Figure 6: Most important market drivers over the next 18 months

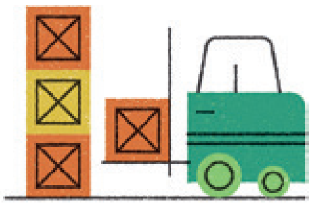
	Democratic sweep	Biden/split Congress	Trump/split Congress	Republican sweep
COVID vaccine	nc	nc	nc	nc
Fiscal policy	✓	nc	nc	✓
Monetary policy	nc (slight rise in inflation risk)	nc	nc	nc
Trade policy	✓ (still anti-China)	✓ (still anti-China)	x	x
Corp. share of GDP	x	x (but restrained)	nc	✓

✓ = positive for markets; x = negative for markets; nc = no change

Source: Rathbones.

[1] Sure, a president could lean on or perhaps usurp the FDA and bring to market a vaccine before due process. But SARS-CoV-2 has an R0 between 1.8 and 3.6, which means that between 40% and 70% of the population need to take this (likely two-dose) vaccine to achieve herd immunity. Any question marks over its safety will be seized upon by the media, likely rendering it dead on arrival.

If Trump is elected, uncertainty will likely spike again – hamstrung by a split Congress he would focus more on trade, where he doesn't need Congressional approval, just as he did around the midterm Congressional elections where the Republicans suffered a heavy loss. This would likely support US equities, relative to the rest of the world.



outside of the US than within it (as the blue line on the charts show), because the US is a more insular economy, with a lower ratio of trade to GDP. In our view, that's benefited US assets relative to non-US assets because it's stock market is less cyclical than many others and less sensitive to the global trade cycle, and the dollar is a safe-haven currency.

If Trump is re-elected, uncertainty will likely spike again – hamstrung by a split Congress he would focus more on trade, where he doesn't need Congressional approval, just as he did around the midterm Congressional elections where the Republicans suffered a heavy loss. This would likely support US equities, relative to the rest of the world.

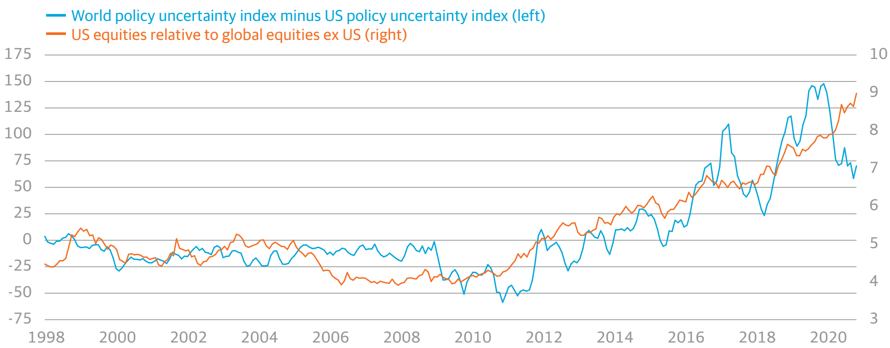
Biden vs Trump: fiscal policy

What about the policy differences and sector implications? The Biden campaign is armed with a huge array of policy items. As I write, there are 48 'plans' and 'agendas' on his campaign website. Yet where they overlap is unclear, and some key details are missing, so assessing the full impact is difficult. Not nearly as difficult as assessing the impact of a second term for President Trump, though, because Trump's campaign website lists no formal policy items at all. Literally, voters don't know what they are voting for. It simply states all of the things he has done in his first term. He did detail a few priorities on the eve of the Republican National Convention, and we can piece together some information from various interviews.

We can be quite sure that both candidates love deficit spending. Various reputable think tanks, economic consultancies and bipartisan institutions estimate Biden's tax plans will raise almost $4 trillion over 10 years (split 50-50 between firms and households earning more than $400,000 a year – figure 9), with spending plans tallying from $6–7 trillion. The net effect is a big boost, and explains why most non-partisan economics teams, such as Oxford Economics, assess US GDP to be larger if Biden's plans are enacted. Of course, Biden's plans are heavily redistributional (on tax, on minimum wages and on making it easier to unionise). The size of the economy is likely to increase – because regular households have a higher propensity to spend than the ultra-rich and corporations – but capital's share in the economy will go down, and there is a risk that, for some firms, at least, the net long-term effect will be a post-tax reduction on their return on capital.

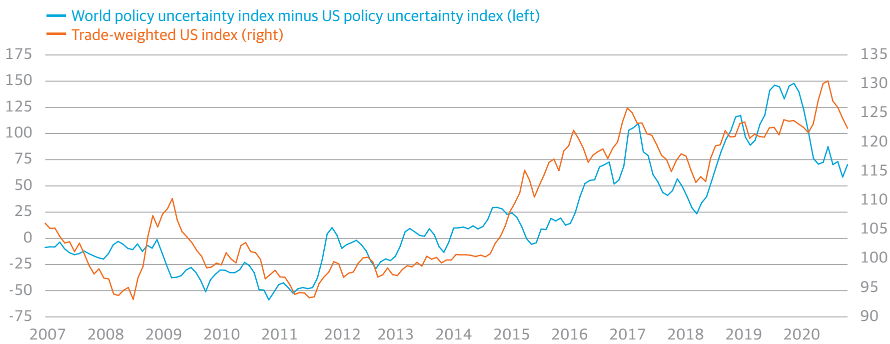
Trump is likely to extend the individual income tax cuts of the Tax Cuts & Jobs Act (TCJA) past 2025, at a cost of $1.4 trillion over 10 years (50% of the benefit accrues to the top 1% of earners, 30% to the top 0.1%). He has suggested permanently cutting the employee side of the payroll tax for workers who earn less than $8,000 per month. That would increase the deficit by almost $5 trillion over 10 years. There isn't enough spending that a re-elected President Trump could realistically cut to neutralise it, although he has proposed reductions to Medicare/aid, and less spending on nutrition and assistance programmes for low-income families (which would have a significant negative

Figure 7: Economic policy uncertainty and equity markets



Source: Refinitiv and Rathbones.

Figure 8: Economic policy uncertainty and USD



Source: Refinitiv and Rathbones.

multiplier on economic growth). He has also suggested cutting capital gains tax from 20% to 15%, and making permanent some of the expensing provisions and tax credits from the TCJA that begin to expire from 2022.

Biden's COVID-related stimulus proposals may be more effective in the short-term. Trump wants to focus on tax cuts and payment holidays, but these would be regressive – accruing more to people with a high propensity to save – and a recent working paper has found a low propensity to consume from COVID-stimulus – just 40%, and lower for some wealthy households.

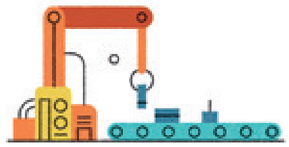
Over the long term, a Democratic or an improbable Republican clean sweep would likely see a substantial fiscal injection. We don't see much changing relative to today's status quo if Congress is split. A 2017 paper by political scientist Dr Lee Drutman shows how unlikely it is that Republicans flip votes with a very free-market, austerity-minded budget policy. Interventionism is here to stay.

Trump's deficit spending could be the one with more inflation risks, as it appears less targeted at boosting investment and the supply side of the economy. But in the short term, before supply-side boosters kick in, the Democrats' plan risks higher inflation. Still, we believe cyclical forces, on top of longer-term structural forces, such as digitalisation, are likely to exert pronounced disinflationary effects over the next year at least.

Biden vs Trump: corporation tax

Biden plans to increase corporation tax to 28%, from 21% today. In an interview with CNN in September, the Democratic candidate said he would do this on "day one". But there are two more important changes to corporation tax. A 15% minimum tax on book income for firms with income of more than $100 million (book income is pre-tax profits reported to shareholders, rather than the profits reported to the IRS, which differ due to accounting conventions), and a doubling of the minimum tax on foreign income (known by the amusing acronym GILTI) to 21%, from 10.5% today. Under the TCJA, the effective tax rate on GILTI is scheduled to increase to 13.125% in 2026.

According to the Congressional Budget Office, corporate income taxes are currently projected to raise $3.2 trillion over the next decade. Projections by various estimators such as the Tax



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Foundation or the Urban-Brookings Tax Policy Center suggest Biden's changes to corporation tax will raise an additional $1.6–1.9 trillion. That's a significant step up.

Still, it's important not to get carried away here: 28% is still well below the 35% tax rate in place when Trump took over, and indeed the statutory rate hadn't been below 30% since the 1950s. Although Biden's tax plans are far from small, it's important to remember the starting point. The Trump administration has slashed the broad tax take to 16% of GDP, the lowest revenue share in half a century. Under Biden, the revenue share would return to around 19%, still below the average during Bill Clinton's second term – a period of strong economic growth – and less than the 21% of GDP recommended by the National Commission on Fiscal Responsibility and Reform in 2010, which was co-chaired by Republican and Democratic congressmen. It's also low by international standards.

Together, BCA (an independent provider of global investment research) estimates that these tax measures would reduce S&P 500 earnings per share (EPS) by 9–10%. HSBC also estimates a 10% hit (it estimates 2017's TCJA added 12%). UBS concurs. It calculates that retail, consumer staples, financials and healthcare equipment & services are most exposed to the increase in the headline tax rate. But pharmaceuticals, technology and communications services are most exposed to the GILTI. Investors must keep an eye on which parts of his tax plan Biden prioritises. As we said above, these measures won't pass if Congress is split.

There are international tax implications of a Democratic sweep too. Earlier this month, the Organisation for Economic Cooperation and Development (OECD) revealed a long-

Figure 9: Tax analysis

Estimated effect of Biden's tax plan on tax revenues ($ bn).

	Fiscal year				
Individuals	**2021**	**2022**	**2023**	**2024**	**2021–2030**
Income/payroll taxes on earnings above $400,000	101	153	165	178	1394
Tax capital gains and dividends at same rate as ordinary income above $1 million of income and tax unrealised capital gains at death	5	34	47	49	448
Other tax increases and reductions	-6	-12	-12	-13	68
Total for individuals	**100**	**175**	**200**	**215**	**1910**
Businesses					
Increase corporate income tax rate to 28%	49	101	124	134	1300
Reduce the global intangible low-tax income deduction from 50% to 25%	27	46	48	49	309
Impose 15% minimum tax on global book income	8	14	14	15	166
Eliminate certain tax preferences for the real estate industry	14	25	26	28	294
Other corporate tax changes	2	2	2	2	14
Total for business taxes	**100**	**188**	**214**	**228**	**2084**
Total revenue effect of plan	*200*	*364*	*414*	*443*	*3994*
...as a % of GDP	*1*	*2*	*2*	*2*	*2*

Source: Tax Foundation, 29 April 2020; Tax Policy Center, 5 March 2020; and Rathbones.

awaited blueprint for an international tax treaty. It has two pillars: (i) to ensure firms pay taxes where their customers are located, even if they sell remotely; and (ii) an effective minimum corporate tax rate that every multinational would have to pay, regardless of where they were headquartered. If a company was based in a tax haven with low corporate rates, other countries would have the right to collect taxes up to the global minimum, removing the incentive to shift profits to low-tax jurisdictions. The OECD estimates this could raise an extra $100 billion (2.5% of the MSCI World's 2019 operating earnings). Unless the Democrats control the Senate, America is highly unlikely to agree to it, and other countries would likely follow America's lead. But even with the Democrats in charge, it is not certain to pass globally. After all, the OECD and the G20 major economies have been trying to reach agreement on this matter for the best part of a decade, and getting 135 governments to put this into law is no small matter. I'm sceptical.

Trump hasn't discussed corporate tax policies in any detail. From 2022, businesses will no longer be allowed to deduct research and development (R&D) expenditures immediately and instead phase them over five years. Deduction of net interest expenses will be further limited. In 2023, full expensing for short-lived business investment will also begin phasing out. It is likely Trump will extend these.

Finally, where Trump once spoke of a "border-adjustment tax", or a Reciprocal Trade Act, Biden speaks openly of a carbon-border tax: "The Biden Administration will impose carbon adjustment fees or quotas on carbon-intensive goods from countries that are failing to meet their climate and environmental obligations."

Carbon-border taxes are essential to ensure that domestic manufacturing doesn't lose out to cheaper, 'dirtier' processes of markets with less stringent environmental policies. In July, the European Commission launched a public consultation on energy taxation, with a particular focus on border-adjustment mechanisms, as it too accelerates plans to reduce carbon emissions.

And here's the important point about US tax. While the statutory rate has hovered around 35% since the late 80s, the *effective* tax rate — what US companies actually paid — has trended down substantially (figure 10). This is due to the use of tax havens, offshoring, and an increasing number of tax credits and deductions. It's not as simple as looking at the headline rate, and investors must scrutinise exactly what any new plans mean for individual companies.

Biden vs Trump: infrastructure, green energy and fossil fuels

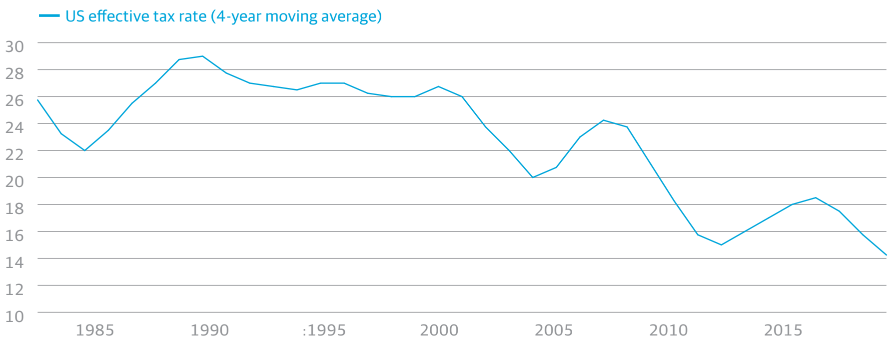
President Trump has long-since touted a "$1 trillion" infrastructure plan, but that has meant just $200 billion of federal government money over 10 years, with $200 billion from state and local governments, and the rest from the private sector. Biden on the other hand has tabled $1.3 trillion of *federal* spending on infrastructure, matched by another $5 trillion from state and local governments and the private sector. Trump makes their scale sound similar, but they are quite different, although it is unlikely Biden could find enough shovel-ready projects in his first term. Since July, Biden has also referred to plans to oversee $2 trillion of spending on clean energy and infrastructure over the course of his first term. It's unclear how these plans interact.

Of course, a succession of presidential candidates and congressmen and women have promised federal infrastructure investment. It's an increasingly rare bipartisan issue, and some investors question whether it will ever arrive. But various Washington policywatchers have said that an infrastructure bill was ready to be signed into law last year: Trump torpedoed it in retaliation to the House Democrats' gimcrack impeachment trial. In June, the Department of Transportation outlined a $1 trillion plan that focused on projects such as roads and bridges. I would expect this to come to fruition whoever is chosen as the next president.

Biden's green infrastructure push would require a Democratic clean sweep. It's designed to bring the US to net zero emissions by 2050, and by 2035 in the electricity sector. Designed correctly, such a bold target could boost the economy. For starters, energy revolutions have preceded the great productivity revolutions of the modern era (coal

"The Biden Administration will impose carbon adjustment fees or quotas on carbon-intensive goods from countries that are failing to meet their climate and environmental obligations."

Figure 10: US *effective* corporate tax rate (%)



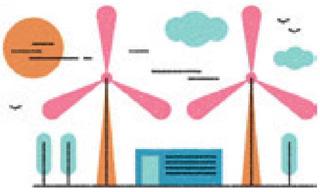
Source: Refinitiv and Rathbones.

in the 18th century, advanced steam in the 19th, and then the advances in electrification that enabled the mega-factories of the early 20th). Economists at Citi, using Oxford Economics' model, find that a global green-oriented policy strategy could improve growth and debt trajectories while also reducing carbon emissions, as long as carbon tax proceeds are redistributed in a way that reduces income taxes.

Electric vehicles are prominent in Biden's plans: he envisages a cross-country network of 500,000 charging stations. He proposes rebates and incentives to swap older, fuel-inefficient vehicles for new, clean models (so long as they are American-made, of course – see below), and would offer the auto industry various other subsidies and investment credits. He plans to restore the full electric vehicle tax credit and modify it to target middle-class consumers. Conversely, Trump plans to *remove* the plug-in electric vehicle credit.

The construction sector could also get a boost from Biden's pledges. He has called for 2 million homes to be weatherised and 4 million buildings to be upgraded to higher efficiency standards. He will restore the tax credit for residential energy-efficiency improvements. US housing subsidies currently make up 25% of domestic private investment in housing, according to BCA, and Biden's government would roll out a significant expansion of these programmes. Construction would get a further multi-year boost from public spending on transit, and affordable housing. Trump talks little of

If private and public entities outside of the US focus more and more on decarbonising consumption and investment, an American loosening of climate standards could constrain the competitiveness of US exports, particularly energy-intensive ones.



house-building, but did discuss cutting regulation around permitting in 2019.

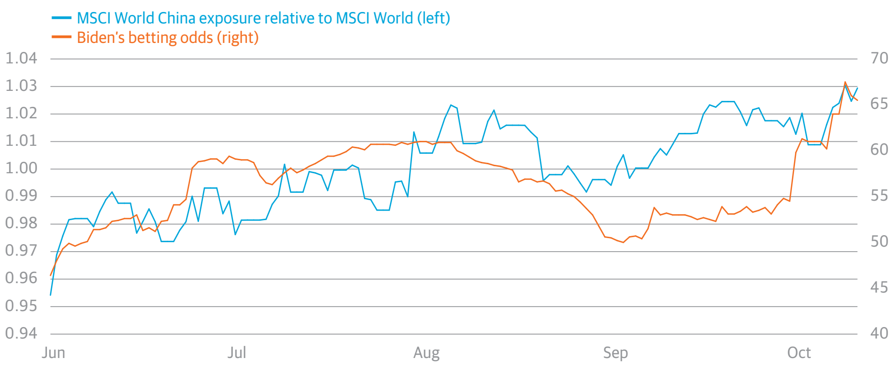
Biden wants to use the tax code to promote alternative energy. He proposes permanently extending the investment tax credit for residential solar energy, deductions for emissions-reducing investments, and creating new incentives to encourage the development of a low-carbon manufacturing sector. He will also allow development of renewables on federal lands and waters, with the goal of doubling offshore wind by 2030.

Needless to say, fossil fuel producers won't be treated kindly. Biden will repeal certain tax incentives that the industry enjoys. But we note that a plank of the Democratic party platform calling specifically for eliminating *all* such provisions was deleted before ratification at the Democratic National Convention. Biden advocates limits on new fossil fuels production, especially on federal lands and waters. But, again, these are limits not outright bans, and he recognises the sizable contribution to jobs and the economy from the sector. Biden's position papers never mention fracking. At a recent CNN town hall in Pennsylvania, he said that fracking will continue as the US transitions to net zero by 2050, and banning fracking would cost too many jobs. We could expect much more stringent reporting and penalties for methane emissions and a zero tolerance for flaring, which could mean higher costs and possibly shut-in oil production in the short term, particularly in the Permian Basin. Of course, it will take time for the US to wean itself off oil. If Biden's policies will increase the cost of US oil at the margin, driving up household fuel bills, the flipside may be a more lenient, Obama-like stance on Iran, which could increase the supply of oil and ease those extra costs a little.

Conversely Trump has stated "the golden era of American [fossil fuel] energy is now underway". His budget blueprints for fiscal years 2019, 2020 and 2021 all called for repealing prominent alternative energy tax incentives, including accelerated depreciation for renewable energy property (although qualifying property would remain eligible for the bonus depreciation allowance included in TCJA), the energy investment tax credit, the credit for residential energy-efficient property, and the income exclusion for utility conservation subsidies. He has already repealed many Obama-era regulations on coal.

If private and public entities outside of the US focus more and more on decarbonising consumption and investment, an American loosening of climate standards could constrain the competitiveness of US exports, particularly energy-intensive ones. As global investment managers increasingly incorporate ESG criteria into their investment strategies, US companies' cost of capital may also rise. Some of Trump's plans upend decades of investment strategies by US companies, for example those of auto companies to meet the Corporate Average Fuel

Figure 11: DM stocks exposed to China vs Biden's betting odds



Source: Bloomberg, Refinitiv and Rathbones.

Trump regularly touts his deregulating agenda. Yet outside of the energy sector – where deregulation started under Obama – there is little evidence that Trump's programme has boosted investment spending, competition, or economic growth more broadly.

Economy (CAFE) standards. With an eye towards the global marketplace and to their long-sunk costs, some US companies have already pushed back on Trump's relaxations. Over the long-term, this could compromise US productivity relative to the rest of the world and push down the dollar. But it's a long-term risk and not one likely to move markets over the next year or two.

Biden vs Trump: trade policy

It is telling that Biden chose to give one of his most important speeches on economic policy in Warren, Michigan, an industrial suburb of Detroit. He unveiled a new offshoring tax penalty of 10% on the profits of any product by a US company overseas for sales back to the US, as well as a new proposal for a 'Made in America' tax credit, available to companies that make investments for purposes such as revitalising closed or closing factories, bringing jobs from overseas to the US, expanding or broadening domestic facilities, and expanding manufacturing payroll in general. These are policies that Trump touted, but never actually implemented.

Indeed, the Republican National Convention saw a scramble to match Biden. Proposals included: enacting 'Made in America' tax credits; enacting new tax credits "for companies that bring back jobs from China"; and permitting 100% expensing "for essential industries like pharmaceuticals and robotics who bring their manufacturing back to the United States".

The American voter has never been convinced of the benefits of free trade, and the latest Pew survey in late July shows 73% of US respondents having an unfavourable view of China, the highest since the survey began in 2005. Anti-China trade policies have become a bipartisan issue. Indeed, they have been for quite some time. Biden is the culmination of the Democrats' anti-China shift. Global and US companies with large revenue exposure to China have done well this year and appear to correlate with Biden's polling (figure 11). We think this is a mistake.

But Biden has pledged to honour multinational agreements, and the WTO in mid-September judged that Trump's tariffs on China violated its rules. We may see greater use of non-tariff barriers, tax incentives for re-shoring, and carbon-border taxes, as discussed above, under Biden. Various studies have shown that Trump's tariffs have had a negative impact on growth, an effect accentuated by the financial market channel, with global exporters' margins and cost of capital suffering.

Biden may also return to Obama's 'Pivot to Asia' policy, which was about countering China with a reoriented globalisation. We've discussed before how a more diversified form of globalisation is the rational reaction to COVID – you don't want to source all of your widgets from one country any more, in case it goes into lockdown. The Biden campaign is open to the possibility of restarting the Trans-Pacific Partnership (TPP), which would be relatively positive for those included (Australia, Japan, Malaysia, New Zealand, Singapore and Vietnam).

Biden would be more likely to work with other major powers to combat China's bid for economic hegemony, and in this regard may well present more of a threat to China and China-related investments. While we expect Western stocks geared into China to continue to underperform, the major beneficiary from Biden's trade policy may be Europe and the euro. Trump carries a threat of European- and Japan-focused tariffs, particularly if Europe begins to use a carbon-border tax.

The most dangerous outcome for trade-related assets is a Trump presidency with a split Congress.

Biden vs Trump: regulation vs deregulation

Trump regularly touts his deregulating agenda. Yet outside of the energy sector – where deregulation started under Obama – there is little evidence that Trump's programme has boosted investment spending, competition, or economic growth more broadly. That may be because he exaggerates just how much red tape he has cut. Although the number of *new* economically material regulations each year has fallen considerably, the number of pages in the Code of Federal Regulations has barely budged since Trump took office. Or, more likely, it is because the relationship between regulation and growth is extremely complex. There is good regulation and there is bad regulation. The former corrects for market failures and bad equilibria, the latter stymies competition, discourages investment or makes it easier for vested interests to extract abnormal returns to the detriment of social welfare . Often politicians are very poor at distinguishing between the two. That's why the historical evidence from previous periods of deregulation is mixed at best. Ronald Reagan's first term offers one of the most pronounced case studies: both productivity and labour force growth declined during the early 1980s and, while productivity growth soon picked up again, it failed to break out from its previous trend.

Biden vs Trump: minimum wages and labour policy

Biden proposes to increase the federal minimum wage from $7.25 to $15 an hour, although he hasn't indicated over what time period. The federal minimum wage hasn't increased since 2009, so it is long overdue an increase. But many states and cities have been introducing higher minimum wages over the last five years or so. As a result, nine out of 10 workers who earn the minimum wage earn more than the federal minimum wage already, according to Evercore ISI economist Ernie Tedeschi, who calculates that the average wage of a minimum wage worker was $11.80 in 2019. That's already 63% above the federal minimum wage.

Therefore, if we assume that Biden's

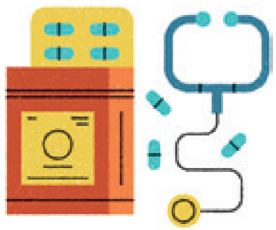
$15 proposal is a 10-year target, it may not actually have much of an impact on labour costs in his first term, even with some front-loading. There may be some sector implications, however, as Biden has proposed extending the minimum wage to farm workers and domestic carers, and eliminating the concept of the "tipped minimum wage" used in the hospitality sector.

If Biden does proceed more aggressively, our analysis of the literature suggests it should be a net positive for growth. The Dube report compiled for the UK Treasury found a rather muted effect of minimum wages on employment when reviewing 48 instances from various countries. It found a slight loss of employment for groups of workers directly affected by the minimum wage, but for the economy as a whole the effect is statistically indistinguishable from zero. Even for those affected workers, the rise in wages more than offset any effect on jobs. A 2019 paper in the prestigious *Quarterly Journal of Economics* studied 138 instances of US increases in city and state minimum wages and again found little or no negative impact in employment.

That may be because the historic examples almost invariably start from a relatively low base. Theoretically, there must be a point beyond which higher minimum wages lower employment – but that point is unknown. The higher the wage rises, the greater the risk of things going wrong. Still, when Mr Dube considered the evidence collected from very large increases in the minimum wage (which included the UK's recent past), the employment effects were not very different from the broader evidence base. A recent study published by the Federal Reserve Board estimated that a $1 increase in the minimum wage raises the income of a minimum-wage earning household by $250 per quarter and spending by $750 per quarter, with higher outlay financed by debt collateralised against durables (usually a car), so there may be very large spending multipliers.

The Dube report suggests that firms passing on higher wage costs through higher prices play a considerable role in the adjustment. Therefore firms with strong pricing power and/or geared to lower-middle income consumers should benefit.

Biden's healthcare policy takes aim at drug pricing. But so too did Trump's, and Obama's, and not much has happened.



One of the longer pages on Biden's campaign website is headed, 'The Biden plan for strengthening worker organizing, collective bargaining, and unions'. He is very strongly in favour of increasing workers' bargaining power. In particular, he would prevent states from using 'right to work' laws that give workers more freedoms to eschew labour unions. That said, it is unclear if such a move would require a super-majority in the Senate (60 votes). If it does, he won't get it. On the other hand, Biden may follow in Trump's footsteps and be aggressive in using executive orders to implement a pro-labour agenda, going further than Clinton or Obama attempted.

Under Trump, minimum wage increases are unlikely. Republicans flat out refused to consider the Raise the Wage Act tabled by Senate Democrats in 2019.

Biden vs Trump: pharmaceuticals

Biden's healthcare policy takes aim at drug pricing. But so too did Trump's, and Obama's, and not much has happened. Biden's plan includes benchmarking against an International Pricing Index and imposing penalties for exceeding it, capping drug price increases, and permitting Medicare to negotiate drug prices. This last point is significant because Medicare's drug spending is equivalent to almost 45% of Big Pharma's total sales (according to BCA), and therefore carries the clout to push down prices substantially.

Biden also wants to end the tax deduction for direct-to-consumer advertising expenses of pharmaceutical companies.

Trump signed four Executive Orders on drug pricing in July (unlikely to be acted upon before November), so he may get serious about it in the event of a second term. These took aim at (i) replacing pharmacy benefit management (middlemen) rebates in Medicare; (ii) implementing an international pricing index for Medicare drugs; (iii) allowing importation of certain drugs by individuals and states; and (iv) in certain contexts mandating passing on insulin and injectable epinephrine discounts to low-income citizens. He has also spoken about increasing competition in the pricing of generic drugs. At face value, at least, Biden's and Trump's plans on pharma are very similar.

It is important to note that we are living through a golden age of medical innovation. Huge strides have been made in treating old-age ailments and so-called orphan diseases. These innovations come at a cost, and high drug prices are required to fund all of the experiments that fail. Slashing prices on innovative drugs jeopardises future innovations. While there are undoubtedly some instances of price gouging, we do not expect presidential initiatives to target the most innovative companies.

Biden vs Trump: big tech — who's more likely to break things up?

The markets in which the Big Tech firms operate are highly concentrated on the standard measures used by the Department of Justice and the Federal Trade Commission. They consider markets with a reading on what's known as the Herfindahl-Hirschman Index (HHI) of above 2,500 to be 'highly concentrated'. Internet retailing has a HHI of 5,300 (the index ranges from 0 to 10,000), according to Goldman Sachs, and interactive media and services (i.e. Google and Facebook's industry) 4,600. They are ripe for breakup.

What's more, Big Tech is already facing multiple federal, congressional and state antitrust probes. There are two ways US antitrust law can call foul: (i) by identifying practises detrimental to consumer welfare (difficult when most Big Tech products are free); and (ii) by identifying practises that disadvantage startups even if the incumbents offer cheap or free services. Indeed, it was the latter that was used against Microsoft in 2001, arguably paving the way for Google and Facebook.

Last week, the Democrat-led House Judiciary Committee released a 449-page report condemning anti-competitive practices of online giants such as Amazon, Apple, Facebook and Google. Choice quotes include: "By controlling the infrastructure of the digital age, they have surveilled other businesses to identify potential rivals, and have ultimately bought out, copied, or cut off their competitive threats." And: "Whether through self-preferencing, predatory pricing, or exclusionary conduct, the dominant platforms have exploited their power in order to become even more dominant."

There were eight policy recommendations, topped by structural separations of platforms and business units that use them, prohibitions on self-preferencing, and requiring more open architecture to increase interoperability and, importantly, data portability.

Neither Biden nor Trump discuss Big Tech on their campaign websites. For Trump, it's personal, as Facebook and Twitter increasingly factcheck and, lately, censor his misleading statements. Attorney General William Barr, one of Trump's most loyal allies, is about to file a monopoly suit against Google, according to Bloomberg. But an alternative report to the House Judiciary Committee's official release drafted by the Republican minority on the committee described some of the recommendations as non-starters for conservatives, such as the enforced break-up of platforms such as Amazon.

Cynically, America is the land of vested interests *par excellence*, and Biden and the Democrats receive a lot of donations from Silicon Valley (Kamala Harris is the junior senator for California, after all). We also note two conspicuous members of Biden's transition and advisory teams: Jessica Hertz, former associate general counsel at Facebook, and Cynthia Hogan, the senior lobbyist for Apple.

With Big Pharma and Big Oil in his sights, and big plans for green energy and low-income labour, is Biden really going to prioritise Big Tech in his first four-year term? He hasn't made it a policy plank in the way that Bernie Sanders or Elizabeth Warren did in the primaries. Back then, Biden instead said it would be premature to break up Big Tech without formal investigations (although with the publication of the House report, we have just had one). Over the summer, Biden and former rival for the Democratic nomination Bernie Sanders set up a policy task force on the issue, which recommended breaking up companies only "as a last resort".

Regardless of who's president, we assign a low risk to government intervention in the market of a sort that would be hugely detrimental to share prices. (For more information, read our series of articles on the historic use of anti-trust law in America published in several recent editions of Investment*Insights*).

Biden's plan to increase taxes on overseas profits would hit tech companies disproportionately hard since the tech sector derives over half its revenue from outside the United States.

Biden vs Trump: financials

Historically, investors worry about financials when Democrats take control. But times have changed. We already live in a very regulated world, and that regulation is set more by global institutions – such as the G20's Financial Stability Board – than by national ones. Recent speeches by Fed Governors Brainard or Clarida, who have oversight of financial stability, make it quite clear that we should expect more regulation not less – at least for the so-called SIFIs (systemically important financial institutions) – regardless of who's in the White House.

Financials are unlikely to be moved by politics. The interest rate environment is far more important (a big reason why financials underperformed in both the Trump and Obama eras). Stronger stimulus-induced growth would allow banks to release some of the provisions against bad loans built up this year, and in this regard a clean Democratic sweep would be favourable.

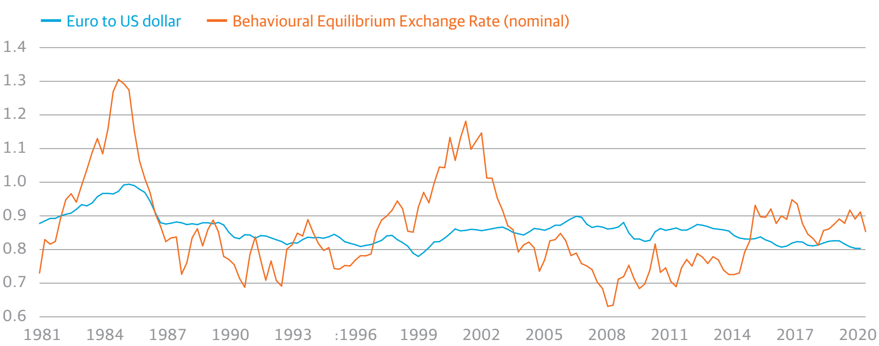
There was little mention of banks at the Democratic National Convention. But there is a risk that regulatory stress tests become more stringent and capital requirements increase under a Democratic Treasury Secretary, particularly if Elizabeth Warren is appointed, as rumoured.

The dollar

As we always say, anyone who claims they can predict the *short*-run movements of currencies is a snake-oil salesman. Currencies just don't have consistent enough short-term relationships with common variables. And that includes around elections. On a long-term basis, the dollar is overvalued against most major currencies on a variety of frameworks, such as purchasing power parity, our own Behavioural Equilibrium framework (relative trade prices, relative productivity, relative savings) (figure 12), or the IMF's external balance assessment framework.

We should separate the forces that

Figure 12: Euro to USD rate vs Behavioural Equilibrium Exchange Rate



Source: Refinitiv and Rathbones.

may weaken the dollar's value over the next few years from the very long-term factors that could result in the dollar's demise as the world's major reserve currency. These factors include large monetised fiscal deficits (i.e. funded by the creation of money) large current-account deficits (trade and investment income) with low savings rates (highly likely under both Biden and Trump, but more so under Biden); and episodes of risk-on sentiment in financial markets (again this could occur under both outcomes, but more likely under Trump). If US inflation-adjusted interest rates remain entrenched deep in negative territory, while the current account deficit widens further on the back of strong domestic demand, the dollar may continue to weaken, particularly if tariffs are relaxed.

It should go without saying that for the dollar to lose its position as a major reserve currency, there will have to be an alternative to supplant it. There is not yet a clear alternative. China has a lot of radical — and possibly painful — reform to undertake before the renminbi achieves such status. The euro is the obvious contender, but we don't think it's had a 'Hamiltonian moment' this summer with its Recovery Fund, as we've written before, and there are plenty of eurosceptics that would rather continue to hold the dollar. But if the US continues to weaponise its currency, using it to impose sanctions against both rivals and allies, its days may ultimately be numbered. And that's more likely under Trump.

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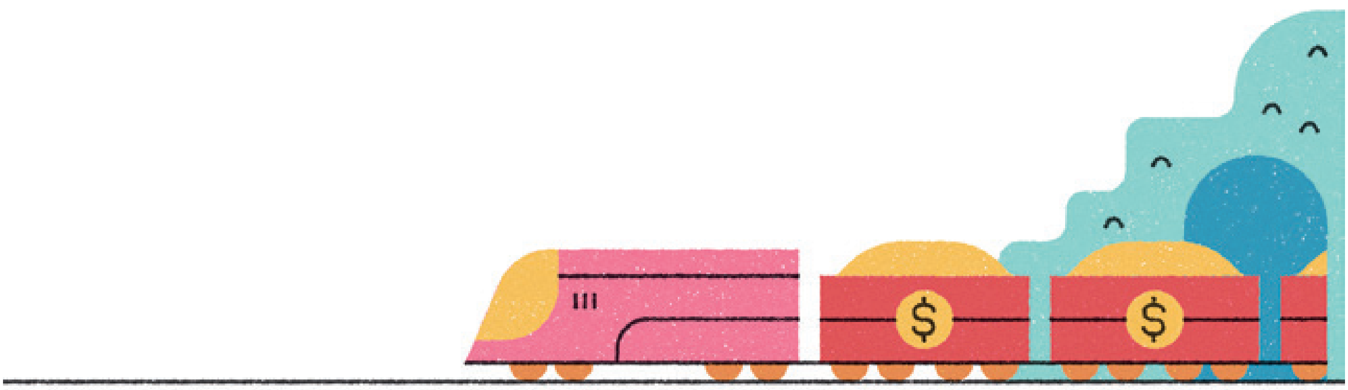

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