

Biden win brings hope for some bipartisan agreement

Stimulus should be forthcoming and trade uncertainty relieved, even if Congress remains split

Joseph Robinette Biden Jr, a centrist, establishment Democrat, has been declared the 46th President of the United States of America. The Republican Party is using the courts to challenge the validity of mail-in ballots cast by election day but received subsequently. With a new Republican appointment to the Supreme Court, and election rules in flux, it is possible the popular vote could be overturned, as we set out in more detail in our previous [InvestmentUpdate](#).

For now we are working on the assumption that Biden becomes President, but still think it makes sense to look for investments that are not dependent on specific election outcomes. The implications of a Biden administration for financial markets are highly contingent on the outcome of the Senate elections, which are also yet to be determined. However, control of the Senate has now come down to the two seats in Georgia, both of which will go to a January runoff, with no single candidate receiving the minimum 50% in the first round. Unless the Democrats win both, Mr Biden will govern with a split Congress.

Before we start thinking about the implications of the election it is important to establish a baseline and some priors – just as it is when trying to interpret any new information. One way to do this is to think about what has been driving markets over the last six months. To our mind, it has been (i) hope for a timely, effective vaccine; (ii) supportive fiscal policy; (iii) supportive monetary policy; (iv) a levelling-off of previously escalating Sino-US trade tensions. Would Biden's victory alter these four factors? We don't think so.

Indeed, while he is no dove when it comes to China and foreign policy (as we shall discuss more below) the risk of erratic policy moves of the sort that have unnerved markets over the last four years diminishes.

Another way to establish a baseline is to examine how elections have impacted financial markets in the past. Looking at over 50 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.

Split Congress: a contrarian view

Mr Biden, a former six-term Senator for Delaware and two-term Vice President in the Obama administration, campaigned on heavily re-distributional policies. If all his plans were executed, GDP is likely to go up due to larger and better-targeted fiscal stimulus, but the corporate share of GDP is likely to go down. For some companies and sectors, at least, the net effect on future returns may be a negative. But this is where the Senate race comes in. If the Republicans retain control, there is no chance that Biden could get any large increases in corporation tax, or the majority of his re-distributional agenda items (which surveys of institutional investors suggest markets will balk at the most), through Congress.

On the contrary, we think there's a strong argument to be made for a Biden presidency with a split Congress being a very market-friendly outcome over the medium term. Little changes in terms of the scale of the fiscal or monetary policy support, relative to the status quo, but foreign and trade policy uncertainty will ease significantly. The *substance* of Biden's trade policy is similar to Trump's, at least on China, but the *style* will change, and the maverick, unpredictable 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 that 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 the outperformance of US versus global equities and the long upward trend in the dollar. Uncertainty has become greater *outside* of the US than within it 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 its stock market is less cyclical than many others and less sensitive to the global trade cycle. And the dollar has benefited from its safe-haven status.

We've also looked at the stock market reaction to notable transitions from right- to left-leaning governments in

nine advanced economies over the last three decades. Again there is no discernible pattern. If the most progressive aspects of his agenda are constrained, President-elect Biden is unlikely to be different.

Addressing investors' fears

Some commentators are concerned that a split government makes additional fiscal stimulus unlikely. We disagree. After all, Congress has been split for two years and that hadn't stopped a most extraordinarily generous policy response. There is evidence from political scientists that Republicans care more about balancing the books when Democrats are in office, yet recent studies on voter attitudes clearly suggest that swing voters are firmly in favour of interventionism. For sure, we may have to wait until February when the new government is settled in Washington, which might keep market volatility elevated should the economy or the virus take a turn for the worse. When it does arrive, it is likely to be smaller than it would have been under a blue or red 'wave', but still of sufficient size to keep the US recovery, which has been world-leading so far, on track.

Surveys of institutional investors conducted in the run up to the election consistently found a net expectation that markets will fall significantly if Biden were to win. That said these surveys also signalled that markets expected Biden to win for some months, so some of that risk should have been assimilated into the price of financial assets already.

Curiously, we found no significant relationship between Biden's polling numbers or betting odds and equity market returns since April. Markets have also rallied since election day. Perhaps those institutional surveys aren't representative of broader opinion.

Perhaps, as we said in our introduction, 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.

Or perhaps there is no discernable relationship between the polls and equity performance because investors are focused on those four factors that have driven markets higher this year.

Some things both sides agree on

With the Democrats' hopes of a sweep diminishing, though not yet dead, investors should think about bipartisan issues. To our minds, there are three of them, beyond passing a new COVID-relief spending bill.

Infrastructure

Mr Trump has long-since touted a "\$1 trillion" 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.

Of course, a succession of presidential candidates and members of Congress have promised federal infrastructure investment. It's a rare bipartisan issue, though some investors question whether it will ever arrive. However, various Washington policy watchers 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 new \$1 trillion plan that focused on projects such as roads and bridges. We expect a bipartisan infrastructure bill to focus on this.

Biden also pledged to oversee \$2 trillion of spending on clean energy and green infrastructure over the course of his first term. It was 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 in the 18th century, advanced steam in the 19th, and then the advances in electrification that enabled the megafactories 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. Such policies would provide good investment opportunities in alternative energy and related technologies as well as the commercial and residential construction industries. However, we do not expect to see much progress here during a split Congress. If other economies find a green energy revolution a successful way of boosting productivity, America's long-term competitiveness may suffer. But markets rarely react to possibilities that are that far ahead.

Drug pricing

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 outright, and permitting Medicare to negotiate prices. This last point is significant because Medicare's drug spending is equivalent to c.45% of Big Pharma's total sales (according to the investment consultants BCA), and therefore carries the clout to push down prices substantially. Trump signed four Executive Orders on drug pricing in July, with remarkably similar aims as Biden's policies. This is a rare bipartisan issue, and we may get some movement even if Congress remains split.

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. Innovations come at a cost, and high drug prices are required to fund all of the research and development necessary to find them. 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.

Same trade policy, different style

As we said in our introduction, the style of American trade policy will change under the Biden, but not necessarily its substance – at least in regard to China.

Biden has plans for a new offshoring tax penalty of 10% on the profits of any product from a US company overseas that is sold back to the US. He also has 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.

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; their share prices appear to be moving in line with Biden’s polling numbers, suggesting a perception among investors that a Biden victory would be good for China. We think this might be a mistake.

Biden has pledged to honour multinational agreements, and the World Trade Organisation 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. 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. This could be timely: 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 anymore, in case it goes into lockdown. The Biden campaign is open to the possibility of restarting the Trans-Pacific Partnership, which would be relatively positive for those included (Australia, Japan, Malaysia, New Zealand, Singapore, Vietnam). Biden would also 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 European assets.

A level (green) playing field

Biden has spoken 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 if Biden aims to make America carbon-neutral. In July, the European Commission also launched a public consultation on energy taxation, with a particular focus on border-adjustment mechanisms. Such taxes are likely to become more common at some point in the next decade.

Environmental policies such as these are rarely popular with Republicans, but this dovetails with an anti-China stance

on trade. We think it has an outside chance of being agreed upon by a split Congress in the next two years, most likely by way of compromise.

Minimum wage versus reality

The Republicans have recently refused to consider Democrat bills proposing to raise the minimum wage. During the campaign, Biden pledged to increase the federal minimum wage from \$7.25 to \$15 an hour, although he didn’t indicate over what time period. Yet an interesting development in Florida alerts us to an outside possibility that we may see some movement in the federal minimum wage, which hasn’t risen since 2009.

Voters in a down ballot, direct democracy initiative in the sunshine state voted overwhelmingly to raise the state minimum wage to \$15 an hour by 2026, from just over \$8.50 today. So in a state that Trump won convincingly, voters also came out for a key Democrat policy pledge. As we discussed earlier, swing voters want more intervention, not freer markets.

If Congress does agree to raise the federal minimum wage, we do not anticipate it having all that much effect on aggregate profits. Many states and cities have already raised their 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 for minimum wage workers was \$11.80 in 2019. That’s already 63% above the federal minimum wage.

Is big tech safe?

With the Trump administration filing a monopoly suit against Google, and the House Democrats issuing a 449-page report calling for the breakup of US technology giants, many commentators are speculating that regulation of this sector or even enforced break-ups will become a bipartisan issue. With big pharma and big oil in his sights, and big

plans for green energy and addressing low incomes, we are sceptical that Biden is going to prioritise big tech in his first four-year term. He didn't make it a policy plank in the way that Bernie Sanders or Elizabeth Warren did in the race for the Democratic nomination. Back then, Biden instead said it would be premature to break up big tech without formal investigations. 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". Meanwhile, Republicans on the House judiciary committee issued an alternative report that asserted that break-ups were a non-starter for conservatives.

Regulation

With Congress split, Biden is likely to make use of executive orders to regulate markets and increase consumer and environmental protections. This may dent animal spirits a little, particularly among small business owners who have historically cited 'red tape' as a reason for pessimism, but we are sanguine about its overall impact on equity markets.

Trump regularly lauds 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.

Downhill from here for the dollar?

As we always say, we are highly sceptical of anyone who claims they can predict the *short*-run movements of currencies. Currencies just don't have a consistent enough short-term relationship 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 (which looks at relative trade prices, relative productivity, relative savings), and others.

Over the next few years large monetised fiscal deficits (government borrowing funded by central bank bond purchases), large current-account deficits (trade and investment income) and low savings rates could push down the dollar (creating more demand for foreign currencies to fund these deficits). This would be more likely if the Democrats had control of both houses of Congress. If US inflation-adjusted interest rates remain entrenched deep in negative territory, and the current account deficit widens further, the dollar may continue to weaken. In particular, a relaxing of tariffs would contribute further to a widening in the current-account deficit.

It should go without saying that for the dollar to lose its position as the preeminent global 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 could ever achieve such status.

'Blue wave' fears relieved

If the predicted Democratic 'blue wave' doesn't materialise, a split Congress will constrain the most progressive elements of President-elect Biden's agenda. And if a bi-partisan agreement on stimulus is also reached, this could be a very market friendly result.

Large scale fiscal or monetary policy support is likely to continue, while foreign and trade policy uncertainty ease significantly. A maverick, unpredictable approach to trade should give way to rules-based cooperation with allies and international institutions. Such a change may benefit non-US equity markets more than US markets. But as global, multi-asset investors we can contend with that.

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