

THIS MONTH'S TOPIC

The 2020 US Presidential Election: Another Close Race?

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- **President Donald Trump's performance on the US economy gives him a significant advantage over his Democratic rivals heading into the 2020 election.**
- **However, Trump has consistently polled poorly with voters on character issues including leadership, temperament and management skills. The potential fallout from the Mueller report and ongoing House investigations remain wildcards.**
- **The 2020 election could be another close call, possibly a 50-50 tossup at this stage in the election cycle.**
- **We see four potential election scenarios that could have significantly different implications for the US economy and investors.**

The 2016 Presidential election produced one of the biggest upsets in US Presidential history. It was also one of only five elections since 1788 where the winning candidate lost the popular vote, but won the Electoral College. It was just another reflection of a deeply polarized electorate. Because of the lack of a popular mandate and very high unfavorable ratings, Trump never enjoyed a honeymoon. His net approval rating has never been positive. He has consistently had high negative approval ratings for most policy issues, while his rating is deeply unfavorable for attributes such as honesty and trustworthiness.

While Trump's road to reelection remains challenging, his prospects for another term are not as bleak as might appear, based on an analysis of recent polling data and the patterns of previous elections. The market is starting to anticipate a Democratic victory, as evidenced by the recent decline in healthcare stocks over concerns about potential democratic reforms. However, it's far too early to decide on the winner.

The US Presidential elections are 18 months away. However, in this era where politics and geopolitics are having a bigger impact on financial markets, we believe it is a perfect time to preview the Presidential race.

This paper examines four hypothetical election scenarios, likely key policy initiatives associated with each one, and potential economic and market implications. The wildcard that could alter the election dynamics at any time remains the fallout from the Mueller Report and other ongoing House and State investigations.

Uphill Odds for Trump

An analysis of the political fundamentals indicates an uphill road to reelection for Trump.

- His approval rating has averaged 42% during his tenure, while his disapproval rating was 53% as of June 16, resulting in a net approval rating of -11%. Trump is the only President who has not experienced a positive net approval rating by this point during his first term.
- In a NBC/WSJ Poll conducted February 24-27, Trump lagged an unnamed candidate by 7%. He lagged front-runner Joe Biden by 8% in a Morning Consult/Politico poll (4/19-21), and lagged Bernie Sanders by 3% in an Emerson Poll (4/11-14).
- Market expectations tracked by political betting website, Predictit, gave Democrats a 57% probability of winning the election, while Trump's reelection probability was 43%, as of April 17. The trend has been stable for the last three months. Similar to the 2016 polls, this political betting website was also off the mark.

Many voters are not impressed with Trump personally. He has significant net unfavorable ratings in leadership attributes, such as temperament, trustworthiness and management skills by margins of -41%, -25% and -18%, respectively, according to a CNN poll (Mar.14-17, 2019). Overall, his unfavorable ratings outnumber his favorable ratings by a 2.1 margin.

He trailed in multiple areas, including education, healthcare, social security and the environment, according to a recent Politico/morning Consult poll (Apr.5-7, 2019). Despite Trump’s landmark achievement, the Tax Cuts and Jobs Act of 2017, he has a net disapproval rating on his handling of taxes from the Pew Poll (Mar.20-25, 2019). Recent polls suggest the Democrats have been successful at labeling the tax cuts as benefitting the wealthy.

However, Trump Has a Path

Despite Trump’s poor standing on key fundamentals, he has a path to reelection. Historically, a negative net approval rating has not necessarily been a deterrent to reelection. President Ronald Reagan was reelected with a net approval rating of -9%, not far from Trump’s current level of -11%. Conversely, a positive net approval rating has not necessarily translated to victory. President George H. Bush had a strongly positive net approval rating of +70%, but lost the election decisively to Bill Clinton. Trump’s trailing position at this early stage does not mean a loss on election day. Clinton won reelection despite trailing an unnamed GOP candidate at this point in the election cycle.

In a Quinnipiac Poll (Mar.21-25, 2019), Trump enjoyed a net favorable rating for personal fundamentals. He scored +46% and +5%, respectively for the statements, “stands up for beliefs” and “tough to handle a crisis”. In my opinion, these two factors may be important enough to offset some of the other “softer” factors where Trump rates poorly.

Trump’s Advantage: The Economy

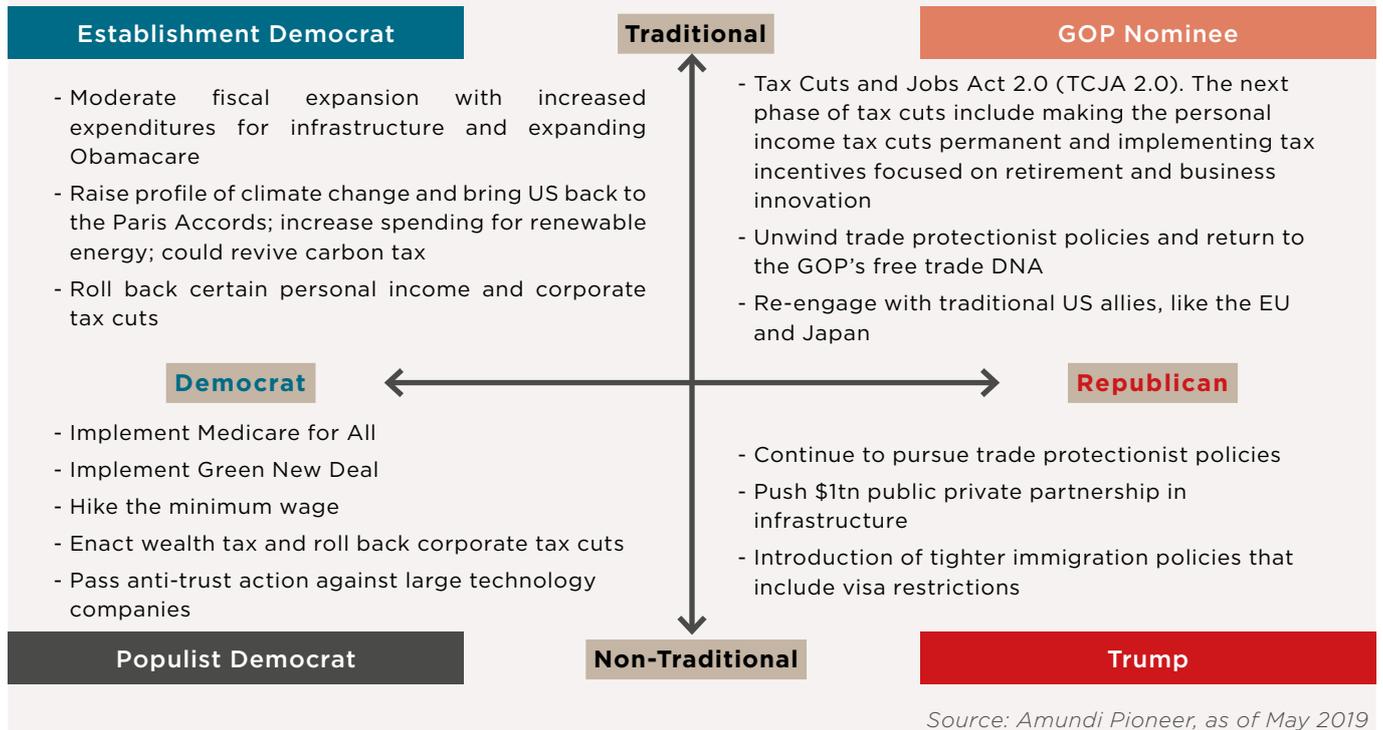
In economic fundamentals, Trump has been polling ahead of Democrats in Congress on the most critical issues likely to influence the outcome of the election, including his handling of the economy, jobs and national security. In these areas, Trump was ahead by +12%, +10% and +5%, respectively, according to a Politico/Morning Consult poll as of Apr.5-7, 2019. Of all the fundamentals that are important factors in the election, economic fundamentals will be the most critical to monitor. If the economy continues to expand and the unemployment rate remains low, then Trump’s reelection prospects improve.

US Presidential Elections: Four Scenarios

We can see four potential scenarios in the 2020 US Presidential Elections.

Potential Scenarios	Odds	Description
Trump Reelected	45%	The economy remains robust and Trump’s style of politics boosts the unfavorable ratings of his Democratic opponent – the classic “lesser of two evils” scenario (a repeat of the 2016 election).
GOP Nominee Elected	5%	In this unlikely, but not entirely implausible scenario, scandal envelops Trump, either forcing him to resign, to be forced out of office or abandon a run for reelection, the GOP is forced to find a replacement nominee.
Establishment Democrat Wins	35%	The US economy slows dramatically, Trump’s approval rating falls into the mid-30s, and broad-based disapproval of Trump’s politics & style feeds the narrative for change.
Populist Democrat Wins	15%	The economy slumps into recession, increasing voter fatigue about ongoing scandals plague Trump. Widespread disenchantment about income inequality feeds the narrative for a seismic shift for change.

US Presidential Agendas



Potential Economic Implications

	Trump	GOP Nominee	Establishment Democrat	Populist Democrat
Growth	Above Trend Growth	Trend Growth	Near Trend Growth	Below Trend Growth
CPI	Rising	Upward Pressure	Downward Pressure	Stagflation
Monetary Policy	Tightening	Upper end of Neutral	Neutral	U-Shaped Cycle

Source: Amundi Pioneer, as of May 2019

■ **Trump Reelected:** Under a reelected Trump, we believe there is greater likelihood of easier fiscal policy via lower taxes and an increase in infrastructure expenditures which, in combination, should propel US economic activity further above trend. Partly offsetting this boost to growth will be the administration's continued protectionist policies, rising interest rates and a strong US dollar. Robust economic activity would put upward pressure on inflation and wages, potentially prompting the Fed to resume its tightening cycle.

■ **GOP Nominee:** Moderate fiscal stimulus, lower and permanent taxes and a reduction in trade tensions could support trend economic growth. The tightening labor market could add to moderate wage pressures. The Fed may need to fine tune monetary policy, especially if wages rise.

■ **Establishment Democrat:** In this scenario, softer growth has led to reelection of Democratic candidate. In this case, modest fiscal stimulus, a weaker US dollar and removal of tariffs could help boost GDP growth. The soft growth could keep inflation in check, while drug price controls could pull prices lower. The Fed would likely maintain a neutral monetary policy.

■ **Populist Democrat:** Under this scenario, a US recession results in the election of a populist Democrat. A populist Democratic administration is more likely than not to maintain many of Trump's protectionist tendencies. A populist agenda could lead to much easier fiscal policy aimed at stimulating the economy. The recession would dampen inflation, but a likely weaker US dollar, along with implementation of a carbon tax and tariffs, raise stagflation concerns. Finally, the Fed might initially lower rates in response to the recession, but rising inflationary pressures could force the Fed to hike.

Financial Market Implications

	Trump	GOP Nominee	Establishment Democrat	Populist Democrat
Growth	Above Trend Growth	Trend Growth	Near Trend Growth	Below Trend Growth
Equities	Positive Equities	Positive Equities	Neutral Equities	Negative Equities
Rates	Rising Rates	Stable Rates	Stable Rates	Falling Rates
USD	Strong USD	Stable USD	Weak USD	Weak USD

Source: Amundi Pioneer, as of May 2019

- Trump reelected:** The equity markets benefit from a strong economy, higher corporate earnings and lower taxes. The infrastructure and defense sectors are potential winners in this environment. Interest rates would rise due to strong growth and rising inflation, keeping the Fed on tightening cycle. The resumption of the Fed's tightening cycle would keep global interest rate differentials in favor of a strong US dollar.
- GOP Nominee Wins:** Healthy growth, permanent tax cuts, capital gains indexing and reduced trade tensions could support equity prices. A neutral Fed policy would likely keep interest rates consolidated in a wide range. While stable interest rate differentials mean a stable US dollar, the US dollar is more likely to be influenced by developments overseas.
- Establishment Democrat Wins:** In this scenario, it is assumed a Democratic president takes over in a weak economy. The stock market would likely be largely stable, but experience a cyclical rebound as growth improves. The tech, pharmaceutical and healthcare sectors could underperform due to Democratic reforms. The global convergence in growth and monetary policy drive the US dollar lower.
- Populist Democrat Wins:** This scenario assumes the economy is in a recession. Below-trend growth and an aggressive populist Democratic agenda lead to a negative environment for equities. In particular, tech, pharmaceutical, defense and healthcare sectors underperform, while construction and resource stocks outperform. Interest rates could rally as the Fed eases policy, but if concerns about stagflation emerge the yield curve may steepen as long rates rise. The negative outlook on US asset prices and narrowing interest rate differentials could lead to depreciation in the US dollar.

Key Determinants for the 2020 Presidential Elections

- The Economy/Jobs** – this is one of the few areas where Trump has polled consistently well so far in his first term. Arguably, it is probably the most important as well. Voters trust Trump over the Democrats in Congress on the handling of the economy by 52% versus 40%, according to the Politico/Morning Consult poll (Apr.5-7, 2019). The economy has averaged a strong 2.8% growth rate so far in Trump's first term through the first quarter of 2019. This is the strongest growth rate since Clinton's 3.3% in his first term. If the economy continues to grow above trend and the unemployment rate remains at or near 4%, voters may overlook Trump's poor approval and favorable ratings and vote to reelect.
- Potential Fallout from Trump Investigations** – According to the NBC/WSJ poll from Mar. 23-27, 40% of Americans believe the Mueller Report has not exonerated Trump, while 29% believe it has. Impeachment did not have broad-based support, according to a Washington Post poll taken Mar.26-29, in which 41% supported, and 54% did not. There remains a lot of uncertainty over the ongoing House Democratic investigations and, probably more importantly, local state investigations that may have legal repercussions. It could take a revelation of criminal action or resounding conclusive unethical behavior to affect Trump's reelection prospects.
- Democratic Opponent** – Trump's Democratic opponent will have a big impact on the prospects of his reelection. An establishment Democratic candidate would have a better chance of defeating Trump than a populist one, based on several polls consistently showing an establishment Democrat like Biden defeating Trump by larger margins compared with populist candidates like Sanders and Warren. There is a divide within the Democratic Party between candidates embracing left wing policies like Medicare-for-all and those calling for more moderate incremental changes to policies like healthcare. Trump has been exposing this divide by raising fears that Democrats are embracing Socialism. According to a Harris/Hill TV poll taken on Jul. 21-22, 2018, 76% of Americans would not vote for a Socialist, while 24% would. It would probably take a US recession or profound social upheaval for Americans to elect a populist Democratic candidate.

Financial Market Implications

Financial markets are already reacting to the start of the 2020 Presidential election campaigns. The market perception of an early edge by the Democrats is leading to the pricing in of some key populist Democratic policies, most notably the Medicare-for-All proposal. This has led to a severe underperformance of the Healthcare sector, which had a year-to-date total return of -0.14% as of April 22, well below the 16.7% gain of the S&P 500 Index. Industrials have outperformed the S&P 500 year-to-date, while the Materials sector has lagged. The potential exists for materials to rally on expectations of an infrastructure program.

The Presidential election is still 21 months away, but the battle has already begun. The Democratic field has 20 candidates and counting, the largest field in recent memory, and the campaigning and fundraising is well underway.

At this time, I believe the GOP's probability of holding on to the Presidency is 50/50 – better odds than current polls and market expectations. There remains a constant tug and pull dynamic in this race that will ultimately determine the outcome and why Trump's chances remain even. The positive ratings on the economy remain the consistent pull, while voters disappointed in his personal flaws represent the tug. At this juncture, it is too early to know how close we are to the line. Our base case scenario envisions Trump running against an establishment Democrat. Under this scenario, the economy should continue to grow at or above trend. However, there could be a divergence in financial market performance, with equities and the USD performing better under a reelected Trump, while interest rates underperform.

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