2 March 2020

Super Tuesday: why it is important and what to expect for US assets

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- ***Super Tuesday***: *On 3 March, 14 US states will hold* ***primaries for the Democratic presidential nomination****.* ***Following Senator Bernie Sander's good start and Senator Joe Biden's landslide win on 29 February, the field is now narrowed to a two-person race.***
- ***Factors that could change the race***: *one of the more moderate candidates could drop out due to a poor showing; Michael Bloomberg could see a resurgence, having initially performed well and having made an enormous personal investment in his campaign; though it would be a challenge, Elizabeth Warren could become a viable populist alternative to Sanders; and an unexpected winner in California, the state with the largest number of delegates. After Super Tuesday there will be another large set of delegates awarded on 28 April on the way to the Democratic convention in July. Then, September and October will set the stage for the presidential and vice presidential debates in the run-up to the November election.*
- ***Implications for financial markets***: ***a Sanders win of the nomination would be the most challenging outcome for financial markets****, as investors are concerned about the cost of his economic agenda. The healthcare sector is sensitive to the prospects of a populist nomination.* ***A Biden win would be neutral for markets since it would not lead to the implementation of costly policies****. In addition, a moderate fiscal expansion with higher infrastructure spending could be positive, but may be offset by a possible expiration of the income tax cuts.* ***The most favourable outcome would be a Bloomberg victory*** *since his agenda focuses on investment in education and vocational training, higher R&D spending and increased investment in rural broadband access.*
- ***Possible features of Trump's second term:*** *from an economic standpoint, the Trump presidency has proved good, with real wages up and tax cuts supporting growth. However, there has been* ***a growing polarisation of US society****.* ***Inequality*** *is at its highest level for more than a century as Trump's policies have mainly benefited the wealthiest. Trump's proposal consists of a continuation of his policies, including an extension of tax cuts. This would reduce taxes in 2026-30 relative to what they would be in case of no extension. However, this proposal is not really new, as it has already been implicitly endorsed by the current administration.* ***In a second term, Trump could toughen his position on trade with China and increase tariffs on European goods****. The Fed will not hesitate to act forcefully in the short run in a pure risk management approach in the wake of the coronavirus pandemic.*
- ***Our convictions on US assets:*** *we believe that* ***markets have not priced in a meaningful probability of a Sanders presidency.*** *Assuming a Trump vs. Sanders election, markets could stabilise with an expected Trump victory, while they would face more downside risks in response to the rising likelihood of Sanders' socialist democrat agenda. Some* ***equity sectors (e.g., healthcare) are already under pressure*** *and we expect that sector divergences and sensitivity to electoral noise will characterise equity performance in 2020, when the focus will move from the coronavirus issue to US domestic matters. Beyond electoral considerations, in* ***US fixed income****, US Treasuries seem overvalued following the search for safety in reaction to the coronavirus outbreak. This is expected to last for a while, as US Treasuries are proving an effective hedge during the market turmoil. There are opportunities to invest in* ***selected corporate credits****, where bearish sentiment is incongruent with fundamentals. We favour bonds that may benefit from firm* ***domestic demand****, centring on the US consumer and housing markets. Recent spread widening could provide opportunities to re-enter the markets (both IG and HY) with less stretched valuations, but investors need to be selective, discriminating between among companies that could be affected by the risk-off but have good quality (buying opportunity), and companies that could see a material default risk increase.*

Super Tuesday: what to watch and what comes next

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The United States has no national primary for its presidential nominations but Super Tuesday comes close. What makes 3 March super is that 14 states – including the populous states of California and Texas and one US territory (American Samoa) – will be holding primaries for the Democratic nomination. Super Tuesday was born following the defeat of Walter Mondale in 1984, who was perceived to be too liberal by many in the party. Consequently, conservative Democrats decided to hold their Southern state primaries on the same day to help influence the selection of the nominee by creating more balance between liberal and conservative democratic-leaning regions. Some 40% of the US population resides in the states casting ballots on Super Tuesday and these states represent almost 70% of the delegates required to win the nomination. **Key factors to watch for on Super Tuesday will be:**

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- **Any candidate eventually dropping out:** will moderate candidates succumb to pressure to narrow the field or will they hold out for the potential to compete in a brokered convention in July? If no candidate secures a majority of the delegate total, the winner will be determined by a second and more inclusive round of delegates voting, which favours an establishment candidate.
- **Michael Bloomberg's performance**: his strategy has been to avoid the first primary and caucuses and focus on Super Tuesday and the Acela Primary (primaries of north-eastern states) on 28 April. Initially, this strategy was working as Bloomberg rose to second/third place in the national polls, and was first in a few state polls. However, since his disappointing debate performance on 19 February, Bloomberg's momentum has stalled. He is looking to Super Tuesday to regain momentum.
- **Biden and Warren's performance**: Biden has seen a sharp reversal of fortune with his landslide win in South Carolina on 29 February and has regained momentum. He is the favourite to win states with large African American populations, such as Arkansas, Alabama, Tennessee, North Carolina and Virginia. Warren faces a daunting challenge not only to win her home state of Massachusetts, but also to win the two or more additional states needed to make her a viable populist alternative to Sanders.
- **Who wins California**: California is the most diverse and populous state in the United States. A Biden win would allow him to regain front-runner status, while a Sanders win would suggest his recent victories were not a fluke and that he is building a broad coalition.

Following Super Tuesday, the next pivotal race for the democratic nomination is on **28 April,** known as the **Acela Primary**, aptly named for the US train that runs through the six states in the Northeast and Mid-Atlantic corridor. The following are key milestones that will have significant political ramifications that could affect financial markets:

Date	Event	Significance
28 April	Acela Primary	Awards second-highest number of delegates following Super Tuesday
13-16 July	Democratic Convention	Following a likely complicated nomination process, party unification will be key; lack of unity will make it difficult to win
24-27 Aug	Republican Convention	Trump will reinforce his dominance on the party and platform
29 Sept	First Presidential Debate	It will be the first real opportunity for the Democratic candidate to sell him/herself to the public
7 Oct	First Vice Presidential Debate	Not as important as the Presidential debate but VP debate allows candidates to test message and launch attacks
15 Oct	Second Presidential Debate	It will allow candidates who may have stumbled in the first debate the possibility to come back
22 Oct	Third Presidential Debate	Final opportunity to convince voters, especially for the opposition candidate
3 Nov	2020 Presidential Election	In a 50/50 nation, it will all be about which side gets their base out

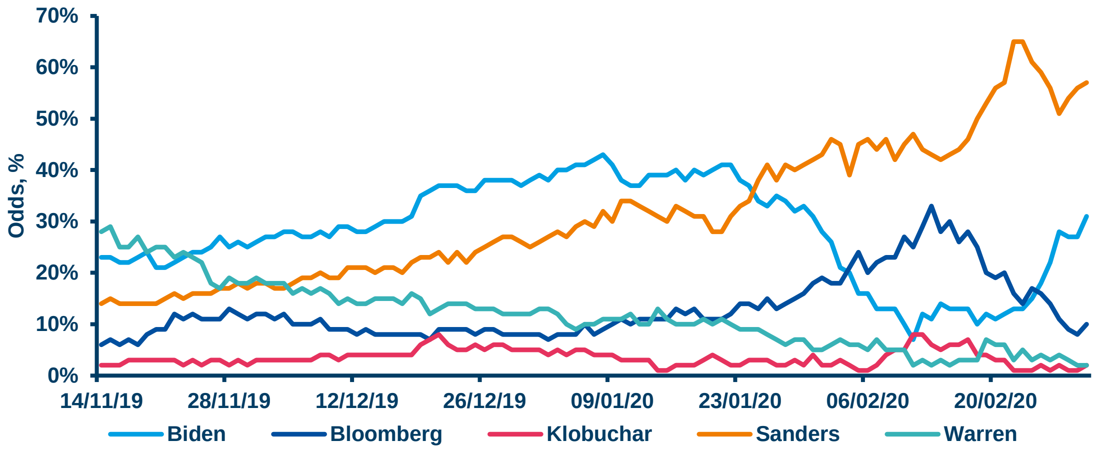
Source: Amundi.

The Democrat camp and investment implications

"The landslide win by Biden in South Carolina narrowed the field to a two-person race."

It is too early to determine any potential Democratic ticket at this stage. **The landslide win by Biden in South Carolina on 29 February changed the Democratic race, with the field narrowing down to a two-person race**. The key states now are California, Minnesota and Massachusetts: before the South Carolina result, Sanders was expected to win those states easily but now he will probably lose Minnesota and his margins will narrow in the other two states. This will lead to **a more equitable dispersion of delegates**, while Biden's margins in seven states, mostly Southern, will be decisive, giving him the vast majority of the delegates. National polls now have a 57% probability of Sanders winning the Democratic nomination, followed by Biden at 31% – up sharply following his win in South Carolina – and Bloomberg at 10%.

Odds of different candidates winning the Democratic nomination



Source: Amundi, Predictit.org. Data as of 1 March 2020.

A Sanders win of the nomination is the least favourable outcome for financial markets. The markets are concerned over the high costs of his economic agenda, such as '*Medicare for all'* and a '*Green New Deal'*. The healthcare sector is most sensitive to the prospect of a populist Democratic nomination. **The S&P 500 Managed Healthcare Index has been under increasing pressure as the prospect of a Sanders or Warren nomination has risen**. This index has fallen 12% since Sanders' landslide win in the Nevada caucuses on 22 February. The rolling back of corporate and personal income tax cuts, and the potential passage of anti-trust action against large tech companies, would be negative for markets.

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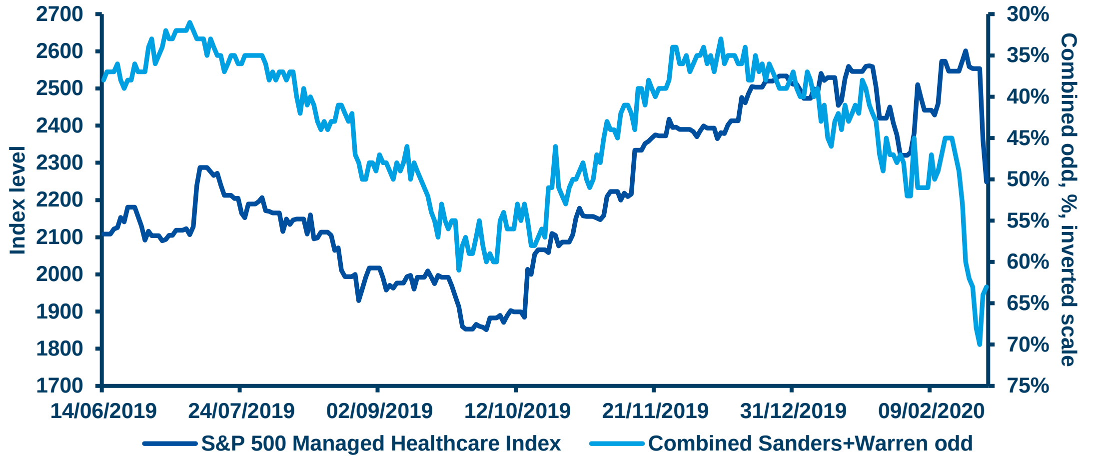
A Biden win would be neutral for markets since it would not lead to the implementation of costly populist policies. In addition, a moderate fiscal expansion with higher infrastructure spending could be seen as a positive, but this may be offset by the prospect of an expiration of the personal income tax cut. **The most favourable outcome would be a Bloomberg victory** since his '*all-in economy'* agenda focuses on investment in education and vocational training, higher R&D spending and increased investment in rural broadband access. The recent stock market sell-off and 'insurance-bid' rally in US treasury bonds is reflective not only of the potential economic damage from the reaction to the spread of the coronavirus, but also of its impact on the US Presidential election. **Uncertainty regarding asset prices, US economic growth and employment could damage the incumbent party and pave the way for a Democrat – potentially a Democratic socialist – to shape US policy for the next four years.**

Healthcare is highly sensitive to populist democratic chances



Source: Amundi Pioneer, data as of 25 February 2020.

"US Treasuries seem overvalued and there are attractive opportunities to invest in selected corporate credits."

If we put aside the coronavirus situation that is roiling financial markets, **the US Presidential elections present asymmetric risk to the financial markets**. **We believe that markets have not priced in a meaningful probability of a Sanders presidency, or the potential speed and impact of re-regulation on the US economy**. At this point, assuming a Trump vs. Sanders presidential election, markets could stabilise with an expected Trump victory, while they would face more downside risks in response to the rising likelihood of a socialist Democrat agenda. Periods of heightened uncertainty and volatility can yield opportunity.

We favour exposure to value stocks that are cyclical in nature. In **US fixed income** we are de-emphasising credit and interest rate risk. **US Treasuries seem overvalued and there are attractive opportunities to invest in selected corporate credits** – outside of the commodity-related corporate bond issuers – where bearish sentiment is incongruent with fundaments, even under stressed scenarios.

We favour bonds that benefit from firm domestic demand, centring on the US consumer and housing market, such as MBS and ABS securities.

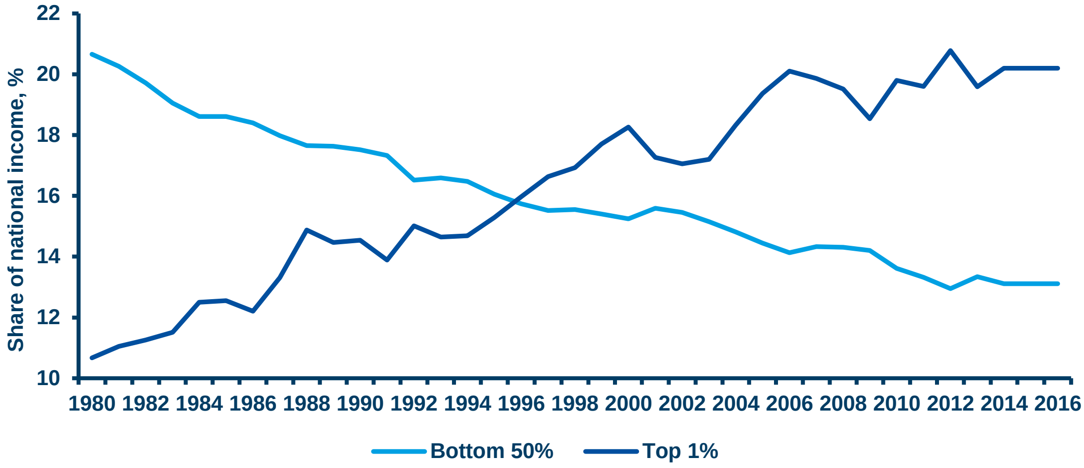
Trump's second mandate: what to expect

Didier BOROWSKI
Head of Global Views

From an economic standpoint, **the Trump presidency has proved good**: real wages have been rising and household taxes have been declining since 2017, together with the marginal income tax rate. In addition, the employment and participation rates have been rising and unemployment is at a 40-year low, including for low-skilled workers. Finally, the equity market rise has been boosting private wealth. However, the favourable backdrop masks a growing polarisation of US society**.**

Inequality is at its highest level for more than a century, as Trump's policies have benefited the wealthiest above all as they now pay less taxes and are the first to benefit from the rise in equity prices. This has intensified the feeling of social injustice and explains the rise of radical proposals in the Democratic camp, such as those pursued by Warren and Sanders.

US inequality: share of national income earned by the top 1% vs. the bottom 50%



Source: World Inequality Report, data as of 28 February 2020.

"A second term in office could encourage Trump to toughen his position on China and increase tariffs on European goods."

Like all incumbent presidents, **Trump's proposal consists of a continuation of his first-term policies,** including an extension of the 2017 Tax Cuts and Jobs Act (TCJA) after its scheduled expiry in 2025 and of spending cuts, mainly in the area of income support and social services, with only a few increases in spending on defence, NASA and for veterans. This would reduce taxes in 2026-30 relative to what they would be if the TCJA were not extended. However, this proposal is not really new, as it has already been implicitly endorsed by the current administration. Despite the reduction in tax revenues, the Trump administration is forecasting a narrowing in fiscal deficit as the result of strong growth assumptions. In any case this would not stop the debt from skyrocketing. There are areas of overlap between the Democratic agenda and Trump's. For instance, Trump supports a plan that would allow the prices of US drugs to be set according to their overseas cost, and favours greater transparency in drug pricing. In addition, the Democrats and Trump both want to rein in the power of tech companies. The enforcement of anti-trust legislation has also been put forward by some members of the Republican Party. Having said that, Trump has proved to be unpredictable during his first term**. A second term in office could encourage him to go further in implementing some of his ideas**. **On trade, he could toughen his position on China and increase tariffs on European goods.** Regarding fiscal policy, his willingness to cut spending is questionable. Sooner or later US economic growth will slow and the issue of infrastructure spending will come back to the fore.

The Fed and US elections

"Historically the Fed has proved more reluctant to raise rates than cut them during a presidential campaign."

A presidential election is always a source of uncertainty, particularly this year as the Democratic field is divided between a centrist and a populist camp. Consequently, the Fed will be reluctant to take measures that it might regret later on, depending on the direction taken by fiscal and budgetary policies. **Historically the Fed has proved more reluctant to raise rates than cut them during a presidential campaign. Taking into account the two-month period preceding a presidential election, on four out of five occasions since 1984 when the Fed took action, its move was accommodative** (in 1984, 1992, 2008 and 2012, when the Fed announced QE3). The Fed hiked rates only once, in September 2004. Such an accommodative stance has supported equity markets going into any presidential election. **This year the Fed will not hesitate to act forcefully in the short run in a pure risk management approach in the wake of the coronavirus pandemic.**

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Definitions

- **ABS:** Asset-backed securities. These are financial securities such as bonds, which are collateralised by a pool of assets, possibly including loans, leases, credit card debt, royalties or receivables.
- **Basis points:** One basis point is a unit of measure equal to one one-hundredth of one percentage point (0.01%).
- **Credit spread:** Differential between the yield on a credit bond and the Treasury yield. The option-adjusted spread is a measure of the spread adjusted to take into consideration possible embedded options.
- **Default rate:** The percentage of issuers that failed to make interest or principal payments in the prior 12 months. Default rate based on BofA-ML indices. Universe consists of issuers in the corresponding index 12 months prior to the date of default. Indices considered for corporate market are ICE BofA Merrill Lynch.
- **MBS, CMBS, ABS:** Mortgage-backed security (MBS), commercial mortgage-backed security (CMBS), asset-backed security (ABS).
- **Value style** means purchasing stocks at relatively low prices, as indicated by low price-to- earnings, price-to-book, and price-to-sales ratios, and high dividend yields. Sectors with dominance of value style: energy, financials, telecom, utilities, real estate.
- **Volatility:** A statistical measure of the dispersion of returns for a given security or market index. Usually, the higher the volatility, the riskier the security/market.

Important Information

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