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Biden's election momentum and financial markets

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- *Joe Biden has a historically large lead over President Donald Trump in the polls, including in the critical electoral college vote, but that could narrow closer to the election. The slide in Trump's approval rating was most noticeable among senior citizens and he has not led in a single major poll so far this year, though it should be noted that polls have proved unreliable in the past few elections. To put Biden's lead in perspective, no prior candidate or President has seen a lead this large at this point of the race. However, Trump still holds onto slightly favourable ratings on the economy. A game changer could be the Democratic party taking control of the Senate, which appared unlikely early this year.*

- *The market is not yet pricing in risks associated with a potential Biden presidency and/or Democratic sweep of Congress. Market volatility could rise if the likelihood of this scenario increases as the election gets closer. Biden's agenda would have sweeping implications for every industry and sector of the economy, with significant investment fallout. His tax plan would reduce corporate earnings significantly. He also plans to expand access to healthcare and support minority communities through a new affordable housing programme. He may keep a tough stance on China, though with less harsh rethoric than Trump, and launch a new infrastructure programme.*

- *On US fixed income, it is with the understanding of the risk posed by the election outcome that investors should build fixed income portfolios. Careful credit selection is critical, identifying companies with strong balance sheets, financial flexibility, resilient business models and ample liquidity. Diversification is also key within corporate bonds and other fundamentally stable sectors, such as securitisations across residential, consumer loans, and commercial loans. We believe US Agency mortgage bonds and TIPS can be good substitutes for richly valued US Treasury bonds to provide stable liquidity in portfolios. With an unknown administration taking office after the election, and the unpredictability of fiscal policy and the path of economic recovery, interest rate risk is best neutralised.*

- *On US equity, Biden's tax reform would reduce our S&P 500 earnings estimate for 2021 by roughly $20 per share, from $170 to $150. As a rule of thumb, every percentage point change in the effective corporate tax rate should change S&P 500 earnings by 1.2%, or $2 per share. The Biden plan would only reverse half of the Tax Cut and Jobs Act cut to the statutory domestic tax rate. Along with the other proposals we estimate it would lift the S&P 500 effective tax rate to 26%. A reversal in the reduction of regulations during the Trump administration may hurt financials, big tech, energy, healthcare, and any labour-intensive business the most. Longer term, larger industry incumbents with strong competitive positions can most easily absorb increased regulations and pass on increased costs. Past examples of this include tobacco, utilities, managed care, and defense.*

Momentum surges for Biden

The Covid-19 pandemic and protests throughout the United States have overshadowed the Presidential election and campaigning underway by President Donald Trump and former Vice President Joe Biden. As the markets have focused on the potential for a second wave of infection and widespread outcry against racial inequality, Biden has developed clear momentum. Not long after the protests began in cities throughout the country, Joe Biden clinched the Democratic nomination by winning a majority of delegates, averting a contested battle with Bernie Sanders. There are still several state primaries left on the calendar, including delegate-rich New York, which will only strengthen Biden's ability to frame the election agenda. In just a few weeks, the underlying dynamics of the election changed dramatically. In recent polls, Biden is positioned well going into the 3 November election. According to pollster RealClearPolitics (RCP), as of 2 June, **66% of US citizens believe the country is moving in a wrong direction**, while just 28% think the country is moving in the right direction. **This data reflect the two pivotal issues that have**

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shifted the race in Biden's favour: Covid-19 and race relations. According to the CNN/SSRS poll from 5 June, these two issues are now among the top issues for the 2020 election.

According to a Pew survey on 12 April, **65% of Americans think Trump responded to Covid-19 too slowly.** The same poll also found that 52% believe he is pretending the situation is better than it is, while 8% feel he is over-exaggerating the seriousness of the situation. **As the cases and deaths in the United States climbed to the largest in the world as of early June, popular opinion of Trump's handling of the coronavirus declined accordingly**, with 43.1% approving and 54.6% disapproving, according to an RCP poll of polls on 8 June. **The slide in his disapproval rating was most noticeable among senior citizens**, and it is no coincidence that Biden has taken the lead in Florida, Pennsylvania and Arizona, which are ranked second, eight and tenth in population, respectively, based on older voters in the United States. This was a key voting block for Trump in the 2016 election.

On Trump's handling of race relations, 63% of voters disapproved while 31% approved, according to a CNN poll on 5 June. Trump has tried to position himself as a 'Law and Order' President to regain public opinion. However, this approach is failing in the face of a tectonic shift in the urgency to eradicate racial injustice. The murder of George Floyd at the hands of Minneapolis police officers on 25 May fueled nationwide protests. According to a Monmouth poll, 57% of Americans -- including 49% of whites -- agreed that police were more likely to use excessive force against African Americans. In contrast, following the death of Eric Garner in the hands of New York police in 2014, which also triggered national protests, just 33% of Americans -- including 26% of whites -- agreed.

In addition to minorities and supporters of social injustice, three major groups of voters are contributing to Biden's lead, and may ultimately determine the next winner: senior citizens, white woman and independents. In Monmouth and Quinnipiac polls, **Biden leads each of these groups, which Trump carried in 2016.**

"In addition to minorities and supporters of social injustice, three major groups of voters are contributing to Biden's lead: senior citizens, white woman and independents."

Key swing groups

	2016 exit polls	Monmouth/Quinn Poll	Swing
Senior citizens	+7	-4	-11
White women	+9	-11	-20
Indipendents	+4	-16	-20

Source: CNN Exit Polls on 23 November 2016, Quinnipiac Poll on 20 May 2020, Monmouth Poll on 3 June 2020, positive number reflects Trump lead, negative number reflects Trump trailing.

As of 10 June, Trump's overall approval-rating average was 42.6%, according to RCP, and 41.0%, according to FiveThirtyEight. Both numbers are the lowest Trump has registered since October 2019.

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Does Biden have an insurmountable lead?

As of 9 June, Biden led Trump by eight percentage points in national polls on a head-to-head contest in the November election, according to RCP. **This is the largest lead for a challenger since 1944.** What has been equally astonishing is that Trump has not led in a single major poll in 2020. To put Biden's lead in perspective, no prior candidate or President has seen a lead this large at this point of the race. According to RCP, George Bush in 2004, Barack Obama in 2008 and 2012 and Hillary Clinton in 2016 led at the end of May by 1%, 1%, 3% and 1%, respectively. As Al Gore and Bill Clinton can attest, it is not the popular vote that elects the President, but the electoral college. Here too, **Biden has a solid edge by leading in all but one of the battleground states**. According to RCP poll of polls of battleground states, Biden leads in Arizona, Florida, Pennsylvania, Michigan and Wisconsin while Trump leads in North Carolina. At this stage of the election, this gives Biden 320 electoral votes against 218 for Trump, well above the 270 needed to win the Presidency.

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Biden has led Trump since beginning 2020, US general election poll average
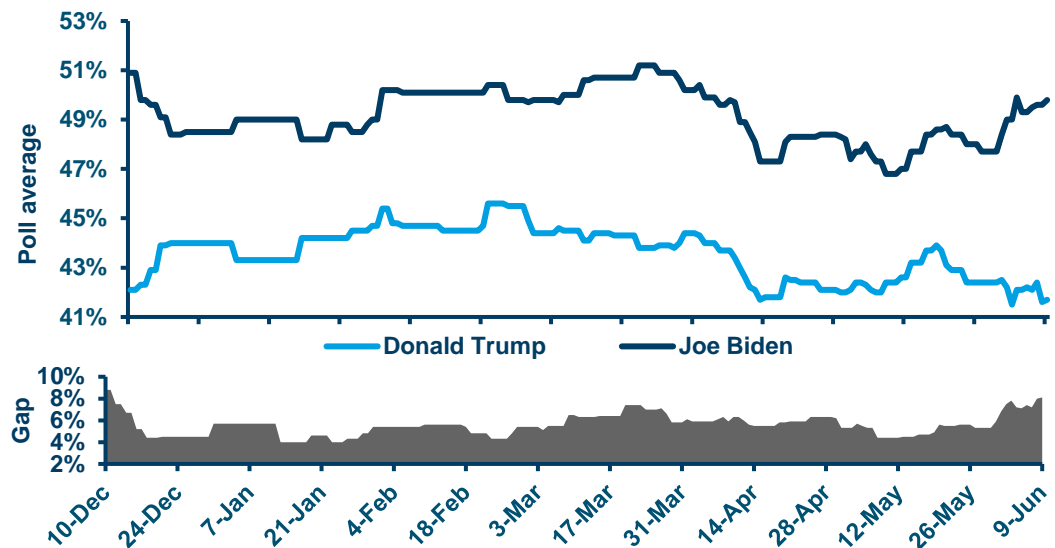
Source: Real Clear Politics as of 9 June 2020.

"Despite poor opinion survey numbers and a dramatic plunge in the US economy, Trump still holds on to one potential bright spot, with a consistently strong economic approval rating."

Is the economy Trump's ace card?
Despite poor opinion survey numbers and a dramatic plunge in the US economy, Trump still holds on to one potential bright spot. His economic approval rating remained positive as of 10 June, **with 51% approving and 45% disapproving his performance on the economy**, according to RCP. His polling numbers on the economy have remained relatively high so far during the pandemic and protests, even as the economy collapsed. **Potentially, this gives Trump an opening to recover some ground, with 75% of voters considering the economy its number one issue.**
Trump's broad and consistent strength on the issue of the economy is in sharp contrast to the weakness of Biden's 'enthusiasm gap'. According to a CNN survey, 60% of Biden supporters are casting a ballot against Trump, and only 37% 'for' Biden. The same survey found that 70% of Trump voters are motivated in support of their candidate.

A game changer: could Senate democrats edge closer to control?
At the beginning of the year, the GOP (Grand Old Party, Republican Party) was overwhelmingly favoured to retain control of the Senate, according to Predictit, the online market for betting on politics. However, by May, that perception had evaporated, when market expectations shifted to favouring a small majority for Democrats.
Democrats need to win three Senate seats to break a tie vote if Biden wins, and they need four seats to break a tie if Trump is re-elected. Republicans have an uphill battle to retain control of the Senate. They are defending 23 seats to 12 for Democrats. Democratic challengers have outraised incumbent Republican Senators by an amount of $237.5 million versus $220.0 million, according to OpenSecrets as of 10 June. Democratic challengers are polling strongly in ten states, including four states where they are ahead or near the margin of error. There is only one Republican challenger leading an incumbent Democratic senator, and that is in Alabama. In this polarised era, the United States is witnessing less ticket splitting, where voters pull the lever for one party for President and another for the legislative branch. If Senate races are influenced heavily by the Presidential contest, Democrats have the edge.

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Market expectations for US Senate majority
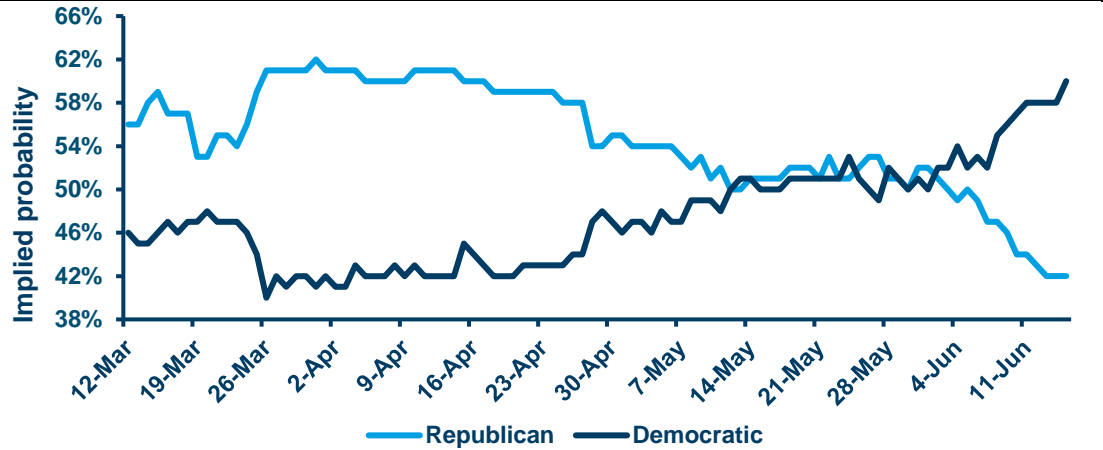
Source: Predictit.com as of 13 June 2020.

"Biden has focused on expanding access to healthcare through a new public insurance option and on bolstering Obama's Affordable Care Act by increasing market subsidies."

Implications of an evolving Biden agenda

The Covid-19 pandemic and protests that have inflamed the country may change some aspects of the Biden agenda. Based on his recent statements, we have summarised his policy priorities and noted where he may make adjustments.

Main points of Biden's agenda

Healthcare	The pandemic has affected disproportionately minority communities and exposed the rising gap in access to healthcare among minorities and lower-income families. This is reinvigorating Biden's focus on **expanding access to healthcare through a new public insurance option and on bolstering Obama's Affordable Care Act by increasing market subsidies.** Biden has also called for **federally funded testing for every worker called back on the job**, guaranteed paid sick leave for workers affected by Covid-19, and a **federally coordinated contact-tracing** workforce. Biden would like to restore the White House National Security Council Directorate for global health security and biodefense, which was eliminated by the Trump administration. This council was responsible for pandemic preparedness.
Income inequality	The protests across the United States put a spotlight on income inequality. Given the importance of the minority community constituents for the Democratic party -- including African Americans -- **Biden will call for initiatives in support of those communities**. For example, the former VP aims to **strengthen the Community Reinvestment Act of 1977**, a law requiring commercial banks and savings and loan associations to **meet the needs of borrowers in all segments of their communities**, including low- and middle-income neighborhoods. Further, Biden wants to **expand Congressman James Clyburn's 10-20-30 plan, where 10% of funds are allocated to counties where 20% of the population has been living below the poverty rate for the last 30 years**. In addition, the candidate has called for new protections for voting rights, eliminating state and local housing regulations that might perpetuate discrimination, and establish $100 billion affordable housing programme. With broader implications, Biden wants to hike the Federal minimum wage to $15/hr.
Tax policy	Under Biden leadership, **the corporate tax rate is likely to increase to 28%,** reversing half of the cut enacted by Trump and the Republican-led Congress in late 2017, when the rate was lowered from 35% to 21%. On top of that, Biden would also impose a **minimum corporate rate of 15%.** Biden's tax plan is less likely to succeed if Democrats do not win the Senate.

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China and trade wars	US public opinion of China has deteriorated sharply over the past five years, and US-China relations remain an important bipartisan issue. In 2005, Americans had a 52% favourable view of China and 29% unfavourable. That has flipped to 66% unfavourable and only 26% favourable, according to a Pew poll on 29 March. **Biden is likely to continue the 'Tough on China' approach first started by Trump**, except that he will lower the tone and harsh rhetoric. **Several aspects of the Trump China policy are likely to continue, such as the US-China tech cold war restrictions inhibiting Chinese access to US technology**. As an experienced diplomat, **Biden is likely to impose more predictability into relationships with China and other trade partners**, restoring the **'old' global order by rebuilding alliances with Europe and Asia**. For example, **he is likely to maintain strategic alliances like the Quad,** which includes Australia, India, Japan and the United States. As well, Biden is expected to **resurrect the Trans-Pacific Partnership trade deal that excludes Chinese participation**.
Economic policy	Biden has an ambitious economic agenda aimed at **boosting infrastructure** and modernising the economy to focus more on tech and reducing the US carbon footprint. His plan includes boosting trade and economic growth through improvements to port, rail and highway infrastructure, funded by $1.3 trillion in spending over ten years.

Source: Amundi as of 22 June 2020.

Implications for US fixed income

The odds of a Democratic sweep have risen significantly, but fixed income markets are not yet focusing on the potential investment implications of a dramatic political regime change**. As we close in on November, we expect heightened volatility in global financial markets, including US fixed income, as investors consider the impact of Biden's policy agenda.** In particular, in the case of increasing odds of a Democratic sweep, the likelihood of tax increases will be discounted.

Biden endorses a series of **higher personal income and capital gains taxes, alongside curtailment of tax deductions, which may present challenges to the outlook for consumption,** as the economy continues to open up across industries and the nation. As well, corporate earnings are likely be factored in**. Absent a Senate majority, re-regulation is possible via executive order, and the burden of its expense will present headwinds to the economic outlook.** Social, infrastructure and green initiative spending will provide offsetting stimulus, perhaps at the expense of fiscal discipline. With the election still five months away, there may be time for Trump to close the monumental lead held by Biden. This outcome largely rests upon job growth and economic recovery.

It is with the keen understanding of **the risk posed by the US Presidential election outcome, along with geopolitical, social, and health uncertainties, among others, which investors must be discerning in building fixed income portfolios**. **Careful credit selection is critical**, identifying companies with strong balance sheets, financial flexibility, resilient business models and ample liquidity. **Diversification is also critical** within corporate bonds and other fundamentally stable sectors, such as securitisations across residential, consumer loans, and select commercial loans**. We believe US Agency mortgage bonds and TIPS can be good substitutes for richly valued US Treasury** bonds to provide a stable of liquidity in portfolios. **With an unknown administration taking office after the election, and the unpredictability of fiscal policy and the path of economic recovery, interest rate risk is best neutralised.**

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US equity outlook

A Biden win, amplified by a Democratic sweep, would have implications across all markets and sectors:

- **Taxes:** If enacted, Biden's **tax reform would reduce our S&P 500 earnings estimate for 2021 by roughly $20 per share, from $170 to $150. As a rule of thumb, every**

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"Every percentage point change in the effective corporate tax rate should change S&P 500 earnings by 1.2% or $2 per share."

percentage point change in the effective corporate tax rate should change S&P 500 earnings by 1.2% or $2 per share. The Biden plan would only reverse half of the Tax Cut and Jobs Act cut to the statutory domestic tax rate, but along with the other proposals we estimate it would lift the S&P 500 effective tax rate to 26%. **All else equal,** larger multinationals should fare better than smaller companies, which generally have a higher percentage of domestic revenues. **Sectors likely to take the biggest hits are financials, consumer discretionary, energy and telecom. Less impacted will be real estate and utilities**.

- **Regulations: A meaningful reversal in the reduction of regulations** during the Trump administration **is likely to hurt financials, big tech, energy, health care, and any labour-intensive business** the most. Longer term, larger industry incumbents with strong competitive positions can most easily absorb increased regulations and pass on increased costs. Past examples of this include tobacco, utilities, managed care, and defense.

US equity sectors in the wake of a Biden win

Negatively impacted	Where to hide
Financials: This sector benefited the most of any sector from Trump tax cuts (mostly a domestic sector) and regulatory rollback; thus the opposite may be true.	**Utilities and REITs**: Increased taxes are a net neutral to earnings/cash flows for both sectors, which should relatively outperform.
Energy: Fracking regulations are likely to be increased and major tax incentives taken away.	**Consumer staples:** Demand should be relatively safe. The larger firms generate meaningful international revenues.
Capex-levered cyclicals: Aside from the tax hit, we expect indirectly that higher tax rates will limit private capex investment, economic growth, and therefore revenue growth for cyclicals, which include not only capital goods and transportation, but also tech hardware & equipment.	**Software:** While a hit to their low taxes will hurt, the industry is global, which is an offset. Importantly, software-as-a-service (SaaS) providers are not under the same regulatory microscope as big tech, and does not have the supply chain challenges of tech hardware & equipment and semis. Finally, SaaS enable companies to be more efficient and lower other costs.
Consumer discretionary: Most of retail is purely domestic, so higher taxes will hurt. In addition, the Democratic labour agenda is aggressive, with higher minimum wages and new laws to organise workplaces. Franchise business models face large risk as well under labor regulations**.**	**Retailers:** Retailers that have already increased wages and serve lower income levels, as redistribution to them is likely to be a benefit. Student debt relief is likely to help drive consumption.
Pharmaceuticals & Biotech: Drug pricing control is likely to happen regardless of who wins, but is likely be tougher under Biden. So the halo of their importance from Covid-19 solutions is likely to fade either way.	**Telecom:** The sector would suffer from higher taxes, but Biden policies should pave the way to build out broadband for all, with the carriers 'allowed' to generate a return similar to a utility.
Tech: We expect increased regulatory scrutiny and more pressure for break-ups of the major firms. The low taxes paid by large firms are a likely target. Tensions around China and the supply chain may remain high regardless of who wins, but with less drama/headlines under Biden.	**Managed care:** This sector is likely to be part of any expanded health care coverage solution.
	Healthcare Life Science Tools & Equipment: Increased research funding, the NIH budget, and future pandemic preparedness, should drive demand.
	Defense: Biden could be perceived as a negative, but military strength enjoys bipartisan support and geopolitical tensions are high. **Defense could be viewed as a safe haven** and have a few more years of growth ahead because of the lag between budget authorisation and cash outlays and any eventual declines, which in the defense complex, tend to mean just slower growth.

Source: Amundi as of 22 June 2020. NIH, National Institutes of Health.

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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.
- **Agency mortgage-backed security:** Agency MBS are created by one of three agencies: Government National Mortgage Association (known as GNMA or Ginnie Mae), Federal National Mortgage (FNMA or Fannie Mae), and Federal Home Loan Mortgage Corp. (Freddie Mac). Securities issued by any of these three agencies are referred to as agency MBS.
- **Diversification:** Diversification is a strategy that mixes a variety of investments within a portfolio, in an attempt at limiting exposure to any single asset or risk.
- **GOP**: Grand Old Party, the US Republican political Party.
- **MBS, CMBS, ABS:** Mortgage-backed security (MBS), commercial mortgage-backed security (CMBS), asset-backed security (ABS).
- **RMBS:** Residential mortgage-backed securities (RMBS) are a debt-based security backed by the interest paid on loans for residences. The risk is mitigated by pooling many such loans to minimise the risk of an individual default.
- **TIPS**: Treasury Inflation-Protected Security (TIPS) is a Treasury bond that is indexed to an inflationary gauge to protect investors from the decline in the purchasing power of their money
- **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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