

2020 Election Preview: Focus on the Sector Impacts

Election uncertainty is high, with polls in question after 2016 and prediction markets recently near even odds, but we believe lack of a strong consensus reduces the risk of a market-dislocating surprise. Thus, we are focused on potential sector impacts of various election scenarios.

TOO CLOSE TO CALL

- Polls show Biden with a seven-point lead over Trump (49.9% vs. 42.9%¹), but polls proved unreliable in 2016.
- Prediction markets have shown Presidential election odds at essentially 50/50 as recently as Sept. 2nd, though Biden has since pulled back ahead by about 53% vs. 47%.²
- There is an abnormal risk of delayed or contested results, but, in our view, any related market disruption should be temporary.

BROAD MARKET IMPACT COULD BE LIMITED

Given current market expectations, a Democratic sweep or gridlock would not be a major surprise and, thus, should be less likely to cause a sharp shift in market direction in our view (i.e. these scenarios are likely somewhat “priced into markets” already).

- A key investor worry, Biden’s tax plan, would require a **Democratic sweep** (est. at about 50% probability³) and, in our view, its impact on earnings should be less than feared
 - We estimate raising the corporate tax rate to 28% should only have a roughly -7% impact on 2021 S&P 500 EPS
 - Expanded fiscal stimulus and a likely delay in passing or implementing tax reforms amid the COVID crisis should partly offset expected impacts of higher corporate taxes.
- **Split government** is the second-most likely scenario (est. about 34% probability⁴), but also carries the least legislative and regulatory risk for markets, in our view, due to gridlock.
- A **Republican sweep**, which we view as very unlikely (est. about 16% prob.⁵), could be seen as an economic positive by investors in the near-term, much as the GOP’s 2016 win was.

CONSIDERATION OF SECTOR IMPACTS

- More economically-sensitive sectors could receive a temporary performance boost from a Republican sweep, like in 2016, as that might avert some perceived tax and regulatory risks.
- Less economically-sensitive sectors, conversely, might temporarily benefit on a relative basis from a Democratic sweep, amid fears of a less business-friendly political agenda.
- Sectors across the spectrum of economic sensitivity, however, face more nuanced opportunities and risks, depending on the election outcome – we highlight some key potential impacts based on our analysis in the exhibit below:

Select Election Opportunities and Risks by Sector

Health Care: *Democratic sweep likely a net positive*

- + Medicare expansion could increase covered patient population
- We would expect increased, but targeted, government control on pharmaceutical pricing
- + Greater certainty around regulatory framework could benefit valuations, even if policies are suboptimal

Industrials: *We see near-term positives in all election outcomes*

- + Could benefit from increased infrastructure spending in a **Democratic sweep** or as a rare area of bipartisan cooperation in a **split government** scenario
- + Likely one of the greater short-term beneficiaries of possible economic optimism if there is a **Republican sweep**

Info. Tech. and Comm. Services: *Sweep by either party has risk*

- Democratic tax plan could negatively impact international profits
- Both parties have problems with major Tech firms, but their concerns and solutions don’t match so a sweep could increase risks of break-ups and/or more regulation of big tech platforms

Energy:

- ± **Democratic sweep** could see significant reduction in fracking and other oil and gas exploration (- for output / + for oil prices)

Utilities: *Democratic sweep is primary risk*

- Utilities earnings would likely be among the most directly impacted by a corporate tax rate increase by Democrats

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¹ "General Election: Trump vs. Biden," RealClearPolitics.com, accessed September 15, 2020, https://www.realclearpolitics.com/epolls/2020/president/us/general_election_trump_vs_biden-6247.html.

² "Betting Odds – 2020 U.S. President," RealClearPolitics.com, accessed September 15, 2020, https://www.realclearpolitics.com/elections/betting_odds/2020_president/.

³ "Will Democrats win the White House, Senate and House in 2020?", PredictIt, accessed September 15, 2020, <https://www.predictit.org/markets/detail/6770/Will-Democrats-win-the-White-House.-Senate-and-House-in-2020>.

⁴ WestEnd Advisors; "What will be the balance of power in Congress after the 2020 election?", PredictIt, accessed September 15, 2020, <https://www.predictit.org/markets/detail/4353/What-will-be-the-balance-of-power-in-Congress-after-the-2020-election>.

⁵ WestEnd Advisors; "What will be the balance of power in Congress after the 2020 election?", PredictIt, accessed September 15, 2020, <https://www.predictit.org/markets/detail/4353/What-will-be-the-balance-of-power-in-Congress-after-the-2020-election>.