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2020 Election Commentary: Divided We Stand

Biden's win is significant in many ways, but we believe the likely outcome of divided government may be more impactful for markets and the economy. Compared to a sweep by either party, split power with smaller majorities in each house of Congress provides little path for a party to implement extreme policies. Looking forward, we remain focused on the sector impacts of the election outcome.

ELECTION OUTCOME SUMMARY

- ***President***: Biden won the Presidential race as counting of mail-in ballots provided a comfortable margin and, while Trump's team is mounting legal challenges in several battle-ground states, we expect the outcome to stand with a largely peaceful (but more tumultuous than normal) transition.
- ***Congress***: Democrats retained control of the House and, pending the results of two January runoff elections in Georgia, we believe Republicans are likely to retain control of the Senate. However, it appears each party saw its majority narrow, which could help facilitate passage of moderate legislative proposals that enjoy at least some bipartisan support.
- ***Stock Market Reaction***: The S&P 500 rallied more than 7% in the week of the election as votes were cast and as results from battleground states began to show a clear path toward a Biden victory and a likely split in Congress. We believe this initial market rally reflected an easing of political uncertainty and the reduced legislative risks associated with gridlock, particularly the relief from the risk of major corporate tax reform, rather than an endorsement of the expected Biden administration policy agenda.

See Exhibit 1 on following page for potential sector-by-sector implications of the election.

MACRO IMPACTS

Markets should look past election disputes

While the election appears decided, we expect the Trump campaign may continue to contest the results in the near-term. We believe these efforts will not change the outcome and markets will look past temporary delays in certifying the results. Instead, we expect the markets to focus on more fundamental economic factors, and we do not see the election results as dramatically changing the trajectory of economic recovery in intermediate term.

Split government and the Biden policy agenda

We view the divided election outcome as an overall positive for both economic growth and markets. Gridlock should provide policy stability that favors investment and continued economic recovery.

Taxes: Assuming divided government, we expect few major changes to corporate or individual tax policy. Stability of the tax regime should help facilitate business investment growth, and corporate tax rates at a post-WWII low remain positive for earnings. Even if Democrats gain control of the Senate through Georgia runoffs, we believe Biden's tax reform agenda will be delayed and watered down, due to both normal political wrangling and concerns over hampering the recovery from the COVID-19 recession.

Business Regulation: Divided government reduces risk of major legislative changes to the regulatory and business environment across a range of sectors and industries. While both parties have issues with big Tech firms, their concerns and preferred remedies differ, so without a single-party sweep of power, we anticipate risk of break-ups or other heavy regulatory restrictions on Tech giants is limited. Health Care should also benefit from reduced legislative risk, while executive action could help maintain covered patient populations. In our view, environmental policy should also be more moderate under divided government than a Dem. sweep, though executive action may still be a headwind to the Energy sector.

Stimulus: We expect explicit pandemic-related stimulus as well as infrastructure spending to be areas of potential bipartisan cooperation. Such measures should help support continued recovery, though they are unlikely to be as large under divided government as under single-party rule.

Trade: Under Biden, we anticipate a partial return to pre-Trump international relations and trade policy. We believe a re-emphasis of multilateral trade deals and easing of trade restrictions on allies in Europe and Asia could be an incremental positive for growth. However, we do not expect Biden to just abandon already-imposed tariffs on China without seeking some concession in return.

COVID-19 Response: We expect the Biden administration likely will be open to some lock-down measures, which could present a temporary headwind to economic recovery, but this could be offset in part by a greater willingness/ability to fund targeted stimulus for industries and citizens most impacted by the crisis. While state and local authorities will still have a major role in pandemic response, a stronger Federal response and coordination of efforts could eventually help facilitate a more full reopening of the economy.

SECTOR IMPLICATIONS

We expect the impacts of divided government to be moderately positive across most sectors, relative to a sweep by either party. This includes reduced risk of disruption for positive secular trends in certain sectors like Information Technology and Health Care. However, we believe the election results are unlikely to dramatically shift the intermediate term trajectory of economic recovery, which we see as a tailwind favoring more cyclical sectors. For our sector-specific expectations of potential election impacts, please see Exhibit 1, below.

Exhibit 1: Potential Sector Impacts of 2020 Election

Information Technology and Communication Services:

+ Reduced risk of major corporate tax reform a key benefit for Tech
+ Divided government could reduce the risk of break-ups and/or burdensome regulation of big tech platforms
+ An easing of recent restrictions on immigration/H1-B visas could reduce labor costs/maintain engineering talent pool

Health Care:

+ Reduced risk of loss of coverage for Medicare patient population
+ Reduced risk of extreme drug price regulation, while middle-of-the-road compromise on drug prices could reduce uncertainty
+ Greater certainty around regulatory framework could benefit historically low valuations, even if policies are suboptimal

Industrials:

+ Potential for increased infrastructure spending as an area of bipartisan cooperation
- Smaller stimulus likely under divided government than a Democratic sweep

Financials:

+ Reduced risk of major corporate tax reform
- Increased regulatory risk from Biden political appointees to roles in Treasury, CFPB, etc.

Consumer Discretionary:

+ Potential for targeted stimulus payments to individuals and small businesses (though likely smaller than in a Dem. sweep)
- Stronger potential Federal push on COVID-19 restrictions

Consumer Staples:

± Smaller size of likely stimulus may reduce risk of rising inflation/interest rates, but impact unlikely to offset cyclical headwinds

Energy:

+ Gridlock limits risk of legislative "Green New Deal"
± Potential executive action limiting project approvals and subsidies (- for domestic production/+ for energy prices).
- Re-engaging with Iran nuclear deal could increase global oil supplies, a negative for oil prices

Materials:

+ Potential for increased infrastructure spending as an area of bipartisan cooperation

Real Estate:

+ Gridlock reduces risk of change to favorable tax treatment
+ Reduced risk of a sharp rise in interest rates

Utilities:

+ Reduced risk of major corporate tax reform

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