Insight

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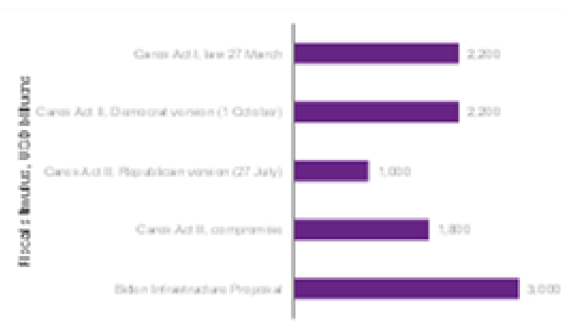
US election scenarios

With less than two weeks to go before the US elections, polls are pointing to a Biden victory, though a Trump comeback cannot be excluded. Here, we look at the different potential outcomes and what they might mean for markets.

The Blue Wave

Not only are polls increasingly pointing to a Biden win, they are also indicating a rising probability of a Blue Wave – Democrats winning the White House, the Senate & the House. In terms of the national polls that represent the popular vote, Joe Biden has ~10 point lead over Donald Trump. The Electoral College is of course the part that actually matters, and polls in battleground states are pointing to a smaller ~4 point margin. If the Democrats do take the Senate, there will still be a question of a big enough majority to avoid filibusters, but they would hold a majority in all three houses, allowing them to easily pass their policy priorities and bringing about significant change for the US, and globally.

Fiscal stimulus is coming, but timing & size could vary

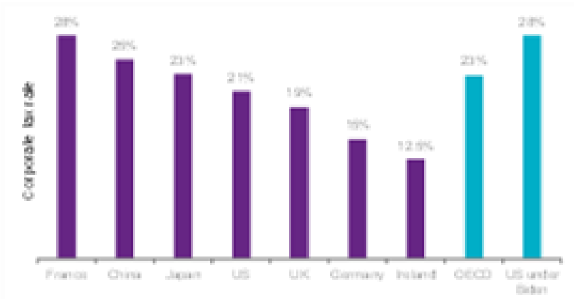


Source: Natixis IM Solutions, 22 October 2020

Typically, Republicans are seen as being more business friendly, but in the current environment, it is all about spending. Indeed, the most pressing topic for markets is fiscal stimulus. At the time of writing, it appears unlikely we will get an agreement ahead of the elections, so a potential Blue Wave implies a longer wait, but a much bigger fiscal package. Indeed, Biden and the Democrats are talking about ~USD2.0 - 2.5 trillion in additional stimulus, with another ~USD3 trillion to be spent on infrastructure, health care, education and climate, over the coming years. Moreover, the usual debt and deficit concerns have vanished amid a global pandemic, so while there might be some concern, at some point, over how to pay for this, markets are focused on the positive for now.

Conversely, the concern for markets is on taxes. Biden has already stated that he intends to hike the corporate tax rate from 21% to 28% (halfway back to the pre-Trump tax cut level), with a minimum 15% tax rate, and increase taxes on overseas income. Overall, these measures are estimated to likely shave 9-10% off of S&P500 earnings. While there are some market expectations that these taxes might be delayed, we believe this is unlikely, as the amount of spending Biden has planned will require funding and the Democrats will not want to hike taxes just before the midterm elections by waiting until 2022. We believe that some of these tax hike expectations are already priced in, though not 100%.

The US tax rate would become much less competitive



Source: Deloitte, Natixis IM Solutions, 22 October 2020

In addition, there appears to be optimism about US-China relations under a Biden administration. However, we believe that optimism to be misplaced as relations will continue to be strained. Admittedly, relations might be smoother, and there would be less uncertainty in terms of tweets and tariffs. Moreover, a roll-back in tariffs is likely as Biden sees them as hurting American farmers. Nonetheless, the technological Cold War is not a partisan issue and tensions will persist regardless of who is in the White House. A President Biden will probably use a more multilateral approach and get support from his European counterparts, but the pressure is here to stay.

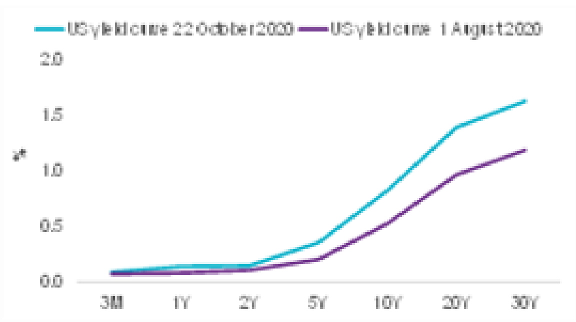
US election scenarios

That said, we are not concerned about the technology sector for now. The recent antitrust announcement by the Democrats is likely to move very slowly, and we do not believe that the size of these companies will be Biden's initial concern. We might see more on regulation and on privacy, but we do not foresee a breakup of these companies. Indeed, we expect technology, as well as healthcare, to remain secular winners.

While markets are preparing for this scenario, we do not believe it is completely priced in at this point. Expectations for a more traditional, less impulsive President would be welcome, but questions about policy and taxes would persist. Growth prospects for 2021 would be boosted and the "reopening trade" would gather speed, supporting cyclicals, though unless the yield curve steepens meaningfully, this is unlikely to be a structural, long-term shift.

Yields would likely rise on spending expectations, lifting inflation expectations, though we expect they would ultimately remain capped by the Federal Reserve. Nonetheless, if yields rise too much too quickly, equity markets might struggle.

Yields have started to move on a potential Blue Wave



Source: Bloomberg, Natixis IM Solutions, 22 October 2020

Status quo

Polls and betting markets are indicating that a Blue Wave is the most likely scenario, but President Trump could retain the White House and the Republicans could retain the Senate, maintaining the split Congress and the current political stalemate. In such a context, markets might be concerned about fiscal stimulus, but we would probably get the phase 4 package this year, but on the scale currently being discussed, ~USD1.5 - 1.8 trillion.

From a market perspective, this outcome would not materially change the outlook. Worries about China might resurface and President Trump could pass additional measures, adding to volatility. But yields would remain low, central bank support extensive, and companies' profitability would have better prospects with current low taxes and little regulation prospects.

Split, but reversed

With many tight races in the Senate, the Republicans could retain their majority while Biden wins the presidency. We would therefore be in a similar situation to today, with a split Congress. In this scenario, the Senate would block many of the Democrats bigger spending plans, though a fiscal package would be expected. Some form of infrastructure spending would also be likely, as this issue has gathered partisan support. Here again, we believe that market reaction would be relatively muted, as both sides' more extreme tendencies would be reined in.

Worst case

In our view, the worst case scenario for markets would be a second term for President Trump, but a Blue Sweep of Congress, giving the Democrats the power to block almost any of Trump's policies and setting up a stalemate / veto situation that would see very little get done, and a lot of executive orders. Concerns about fiscal stimulus, China and more would remain on investors' minds, extending uncertainty and volatility.

Looking through the noise

While a Blue Wave appears the most likely today, plenty of other scenarios could materialise. Indeed, we have not discussed a contested election scenario, because we believe this is less likely than headlines would suggest, but prolonged uncertainty would of course weigh on markets in the short. Ultimately though, we look beyond the election and believe that the supports for risk assets over the medium term are not entirely dependent on the election result.

Indeed, here is what we think will matter: fiscal stimulus is coming – a bit more with the Democrats, but it is coming regardless. Central banks will remain ultra-accommodative for a very long time, with expectations for additional asset purchases by the European Central Bank and the Bank of England, and possibly from the Federal Reserve if inflation expectations do not rise (this is likely to depend on how much fiscal spending is announced early next year). There is a lot of cash on the side-lines and earnings expectations for 2021 are robust. While the pandemic is not under control, vaccine and treatment expectations for next year are improving and the economic recovery will continue, even if unevenly. As such, we remain constructive on risk assets and look through the potential short-term volatility of the coming weeks.

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