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U.S. Election Look Ahead – Impact of Clinton vs. Trump victory?

With November 8 looming, investors are increasingly focused on the U.S. presidential election. We asked some of our portfolio management experts to share their thoughts, including the potential impact of a Clinton vs. Trump victory.

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Importance of the election?

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From an investment perspective, political developments are best ignored most of the time. While election campaigns lead to bold statements from politicians, once in power, candidates manage the economy back to the center, leading to only incremental policy changes at the margin. That said, an underlying global trend of 'voter discontent' certainly makes this an election worth following more closely.

A study from Erikson and Wlezien on national polls covering presidential elections going back to the early 1950's seems to indicate that the candidate that pulls ahead in the polls by early September has most often won the election. The current race shows that the Clinton camp would benefit from that trend. Historical evidence has also shown that a positive stock market helps re-elect the incumbent party most of the time. If Mark Twain is correct that history does not repeat itself but it rhymes, so far the odds are leaning towards the Democrats to win the November election.

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There is a great deal of academic research examining the relationship between the economic cycle and the political cycle. And the conclusion of virtually all of it is the same: No one party (Republican or Democrat) is consistently better or worse for stocks, bonds, or economic sectors than the other—at least with any degree of statistical significance.

Brexit parallels

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The Brexit vote was another symptom of a growing dissatisfaction with globalization and the political elite. Globalization is now blamed for growing economic uncertainty, susceptibility of financial markets to risk contagion, and income inequality within countries. This is demonstrated not only by the increasing prominence of populist political parties across Europe, but also in the U.S. with the popularity of Bernie Sanders and Donald Trump, and Hillary Clinton's opposition to the Trans-Pacific Partnership free-trade agreement.

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This is a train that's moving down the tracks, and I don't see it stopping until substantial change occurs. Minor fixes—like raising the top tax bracket to 39% from 36%—are not going to create an enduring solution. We are going to see it in the U.S., in our presidential election. One of the reasons I believe Trump might win is that Brexit won. The parallels are far too great to be coincidental. They are identical in time. They are identical in mood, in the attitude of 'I'm not doing what you say anymore.'[1]

Shorter-term U.S. economic & market repercussions

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Political uncertainty looks likely to persist given the wide distribution of potential outcomes in November.

In the months leading up to the elections, political uncertainty is likely to continue dampening business investment spending in the U.S. as companies weigh the potential for significant changes in taxation and government spending. This uncertainty could spill over into the labor market and reduce hiring in the third and fourth quarters of this year.

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On the fiscal front, our expectation is that U.S. fiscal policy will become slightly more expansionary following the election. So far, both parties have signaled intentions to boost fiscal spending through increased public investment in infrastructure and tax reform, which would boost economic activity. This would be consistent with last year, when fiscal policy eased slightly despite the divided environment of a Democrat presidency and Republican Congress.

Clinton victory implications

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If the betting markets are right and the November elections result in a President Clinton with a Republican majority in Congress, the economic and market implications of this "status quo" outcome seem somewhat limited. A few policy actions could potentially garner bipartisan support. Two that merit consideration: changes in corporate tax laws to promote repatriation of corporate profits held overseas to fund infrastructure spending, and immigration reform. In our opinion, both would likely represent structural and cyclical positives for the economy.

Risks to business of a Clinton presidency include possible executive orders on drug pricing, antitrust enforcement, and restrictions on fracking for domestic oil production.

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It would be a status quo with changes at the margin given that the Republicans are expected to maintain power over Congress.

Trump victory implications

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The potential economic, political, and societal implications of a Trump victory, not just for the U.S. but for the rest of the world — especially emerging markets — are much greater than those of a Clinton victory.

If Trump wins, Republicans are also likely to dominate Congress. In this scenario, we would place higher odds on enactment of the following policies:

- Corporate and individual tax reform that simplifies the tax code and lowers tax rates
- Higher defense and infrastructure spending
- Regulatory reform (particularly in the financial and health care sectors)
- Entitlement reform (Trump would likely have to give in to trimming federal spending on pensions and health care; otherwise the deficit would widen substantially)

Continued protectionist rhetoric could also make emerging markets more vulnerable — especially those that have benefitted most from trade with the U.S., such as Mexico. A Trump victory could further accelerate the shift away from globalization, potentially causing risk premia to rise across almost all asset classes.

	Clinton victory	Trump victory
Broad political / policy implications	• "Status quo" outcome, with strong checks and balances from a Republican House	• Corporate and individual tax reform that simplifies the tax code and lowers rates • Increase protectionist measures such as higher tariffs and import restrictions • Regulatory reform (financial and health care) • Possible entitlement reform
Initiatives with higher likelihood of enactment (bipartisan support)	• Corporate tax repatriation to fund infrastructure spending • Immigration reform	• Higher defense and infrastructure spending
Initiatives with lower likelihood of enactment	• Substantial productivity-enhancing reforms, given the vast disagreements between both parties on fiscal policy	• Negatives for EM, especially those countries which have benefitted from the structural rise in free trade (e.g. Mexico)
Risks	• Executive orders on drug pricing, antitrust, and fracking	
Potential market implications	• Low-for-longer interest rates and inflation • Range bound or weakening U.S. dollar	• Initial risk-off movement driven by uncertainty over Trump's governing style • Fiscal stimulus even at a time when the U.S. is at/near full employment • Higher inflation through imported goods • Question marks over U.S. "willingness to pay" given Trump comments and history of selective defaults

Source: Wellington Management as at July 14, 2016

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From a financial market impact, in our view, this U.S. presidential election is likely to lead to greater policy uncertainty. This would be particularly true under a Trump presidency, given his emphasis on renegotiating or repealing trade agreements and limiting immigration. These actions would likely have negative implications for U.S. productivity and economic growth. But more generally, Trump has not followed traditional economic ideology of the Republican party which makes his candidacy less predictable if he were to win the Presidential election. Increased political uncertainty would likely translate into increased financial market volatility.

Do long-term portfolios need adjusting based on the U.S. election?

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It is clear that both candidates are talking about expanding the deficit with infrastructure spending and, with Trump, also military spending. If you are going to increase government spending it will add to GDP. That is probably not friendly to bonds. [2]

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Even if we knew the electoral result ahead of time, this is not sufficient for a viable investment strategy. Instead, we would argue that investors would do well to tune out the electoral echo chamber and focus on developing a risk-appropriate, sustainable saving and investing plan. A balanced, diversified approach gives investors the best opportunity to ride out volatile market conditions and stick to their financial plan.

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We recently reduced our exposure to equity markets in general and the U.S market in particular. These strategy changes represented our assessment that equity markets were becoming expensive. Economic and political uncertainty, not only in the U.S. but in Europe as well following the Brexit outcome, was growing at a time when central bank policymakers were running out of policy tools. We find this to still be the case and continue to advise a more balanced approach to clients' portfolios until some of these uncertainties can be clarified.

[1] Source: S&P Global Market Intelligence, Aug. 10, 2016, Q&A Interview transcript with Todd Rosenbluth and Jeffrey Gundlach

[2] Source: Barron's, July 9, 2016, article by Ben Levisohn entitled "Jeffrey Gundlach on Stocks, Trump, and Gold"

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