Trump will (likely) be gone, but what about Trumpism?

From the front page of this weekend's WSJ:

Stocks Cap Best Week Since July

Investors expect volatility to recede in the weeks leading up to Nov. 3 election

BY DAVID BENOIT AND JOE WALLACE

The S& P 500 rose Friday, closing out its biggest weekly advance in three months as investors welcomed signs pointing to a decisive result in next month's U.S. presidential election.

A week that started with President Trump in the hospital being treated for the new coronavirus and former Vice President Joe Biden widening his lead in national polls finished as the best stretch for the index since the week of July 2. ...

With just over three weeks before the U.S. election, the race is dominating traders' attention. For months, they have been wagering on extreme volatility around the election through the derivatives, stocks and currency markets, wary that the outcome could remain undecided for weeks.

Some of the uncertainty surrounding the contest appeared to recede this week, and traders began unwinding some of their cautious bets.

"Polling has further consolidated around a Biden advantage in the presidential election... and options markets have significantly reduced the premium they assign to that date," JPMorgan Chase & Co. strategists wrote in a note to clients on Thursday.

Strategists say surveys and talks with investors have recently found a flip-flop on sentiment in the event of a Biden win: Investors previously said it would be bad for stocks, but they now are predicting it would boost markets.

A Democrat "Blue Wave" victory "has curiously flipped from consensus bear catalyst to bull catalyst," Bank of America analysts wrote. ...

From Friday's Global Investment Strategy:

Market Implications Of A Blue Wave

Look, Here's The Deal: Joe Biden Is In The Lead

With four weeks remaining until the US presidential election, Joe Biden remains on course to become the 46th president of the United States. According to recent public opinion polls, the former vice president leads Donald Trump by 10 percentage points nationwide, and by 4 points in battleground states (**Chart 1**).

Far fewer voters are undecided today compared to 2016. This suggests that there is less scope for President Trump to narrow his deficit in the polls.

CHART 1
Opinion Polls Favor Biden ...

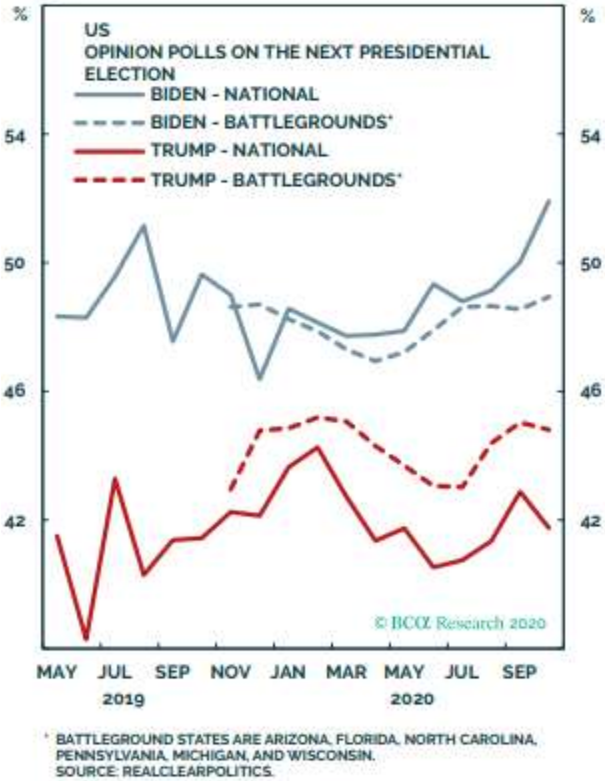
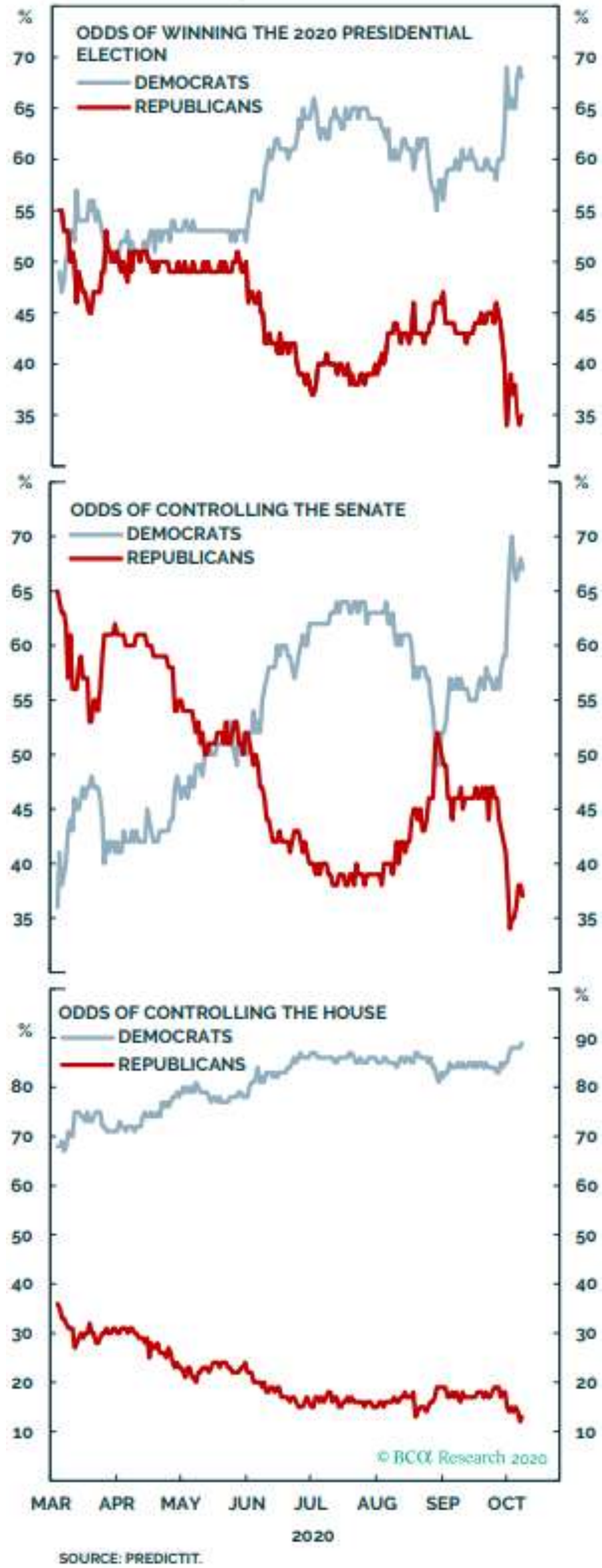


CHART 2
.... As Do Betting Markets



Betting markets give Biden a 68% chance of prevailing in the race for the White House (**Chart 2**). They also assign a 67% probability that the Democrats will take control of the Senate and 89% odds that they will retain their majority in the House of Representatives.

Mixed Impact On The S&P 500

What would the market implications of a "blue wave" be? Our sense is that the overall impact on the value of the S&P 500 would be small, largely because some negative repercussions from a Democratic sweep would be offset by positive repercussions.

On the negative side, Biden has pledged to raise the corporate income tax rate from 21% to 28%, bringing it halfway back to the 35% rate that prevailed in 2017. He has also promised to introduce a minimum 15% tax on the income that companies report in their financial statements to shareholders, raise taxes on overseas profits, and lift payroll taxes on households with annual earnings in excess of $400,000. Together, these measures would reduce S&P 500 earnings-per-share by 9%-to-10%.

On the positive side, while geopolitical tensions will persist, US trade relations with China would likely improve if Joe Biden were to become the president. Biden has roundly criticized Trump's tariffs, saying that they are "crushing farmers" and "hitting a lot of American manufacturing… choking it to within an inch of its life."1 He has pledged to honor multilateral agreements. The World Trade Organization concluded on September 15 that Trump's tariffs violated international trade rules.This judgement and the desire to turn the page on the Trump era could give Biden the impetus to eventually roll back some of the tariffs. In contrast, having been stricken by what he has called the "China virus," Trump could take things personally and retaliate with a flurry of new punitive measures.

Fiscal policy would be further loosened in a blue wave scenario, an outcome that the stock market would welcome. Voters would also applaud more pandemic relief. ... 72% of Americans, including the majority of Republicans, support the broader contours of the $2 trillion stimulus package that President Trump has rejected.

At this point, the odds of Republicans and Democrats agreeing on a major new stimulus deal before the November elections look increasingly slim. If Biden wins and the Republicans lose control of the senate, the Democrats would likely enact a stimulus package worth $2.5-to-$3.5 trillion shortly after Inauguration Day on January 20.

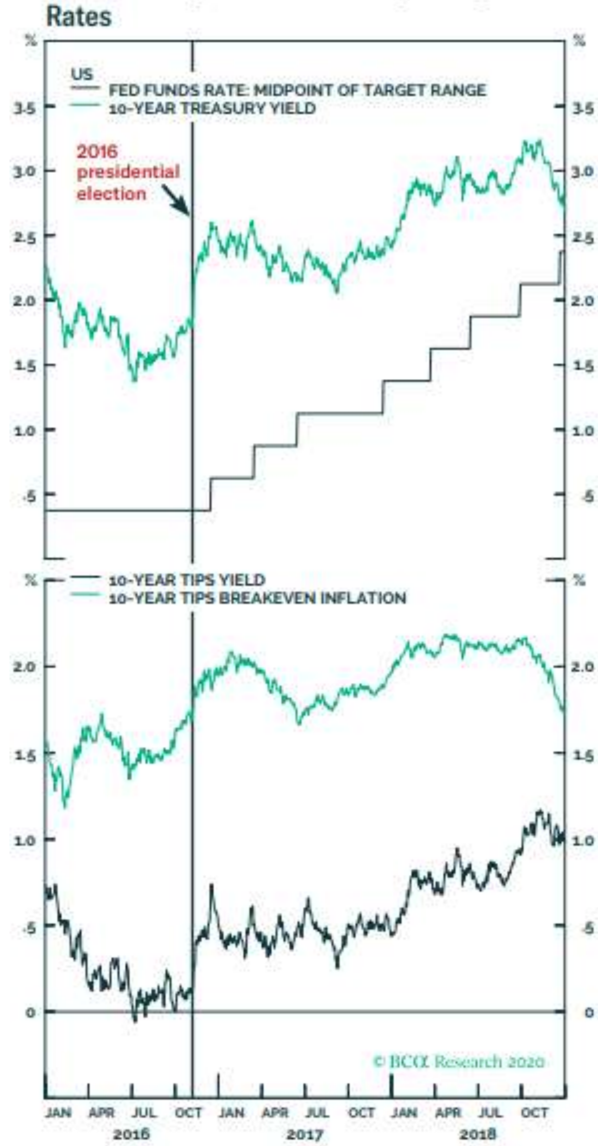
In addition to pandemic-related stimulus, Joe Biden has called for around 3% of GDP in spending on infrastructure, health care, education, climate, housing, and other Democratic priorities. Only about half of those expenditures would be matched by higher taxes, implying substantial net stimulus for the economy.

A Weaker Dollar And Modestly Higher Bond Yields

The greenback jumped on Tuesday after President Trump said he is breaking off negotiations with the Democrats over a new stimulus bill. This suggests that the dollar will weaken if fiscal policy is loosened. If that were to happen, it would be different from what transpired following Trump's victory in 2016 when the dollar strengthened.

Why the disconnect between now and then? The answer has to do with the outlook for monetary policy. Back then, the Fed was primed to start raising rates again – it hiked rates eight times beginning in December 2016, ultimately bringing the fed funds rate to 2.5% by end-2018 (**Chart 3**). This time around, the Fed is firmly on hold, with the vast majority of FOMC members expecting policy rates to stay at rock-bottom levels until at least 2023. This suggests that nominal bond yields will rise less than they did in late 2016.

CHART 3
Trump Victory Was Followed By Rising Interest Rates



Since inflation expectations will likely move up in response to more stimulative fiscal policy, real yields will rise even less than nominal yields. Over the past 18 months, US real rates have fallen a lot more in relation to rates abroad than what one would have expected based on the fairly modest depreciation in the US dollar (**Chart 4**). If US real rates remain entrenched deep in negative territory, while the US current account deficit widens further on the back of strong domestic demand, the dollar will continue to weaken.

Financial stocks are overrepresented outside the US. They are also overrepresented in value indices. While a Biden administration would subject the largest US banks to additional regulatory scrutiny, the impact on their bottom lines would likely be small. US banks have been living under the shadows of the Dodd-Frank Act for over a decade. Today, banks operate more as stable utilities than as cavalier casinos.

Stronger stimulus-induced growth next year will allow many banks to release some of the hefty provisions against bad loans that they built up this year, while modestly steeper yields curves will boost net interest margins.

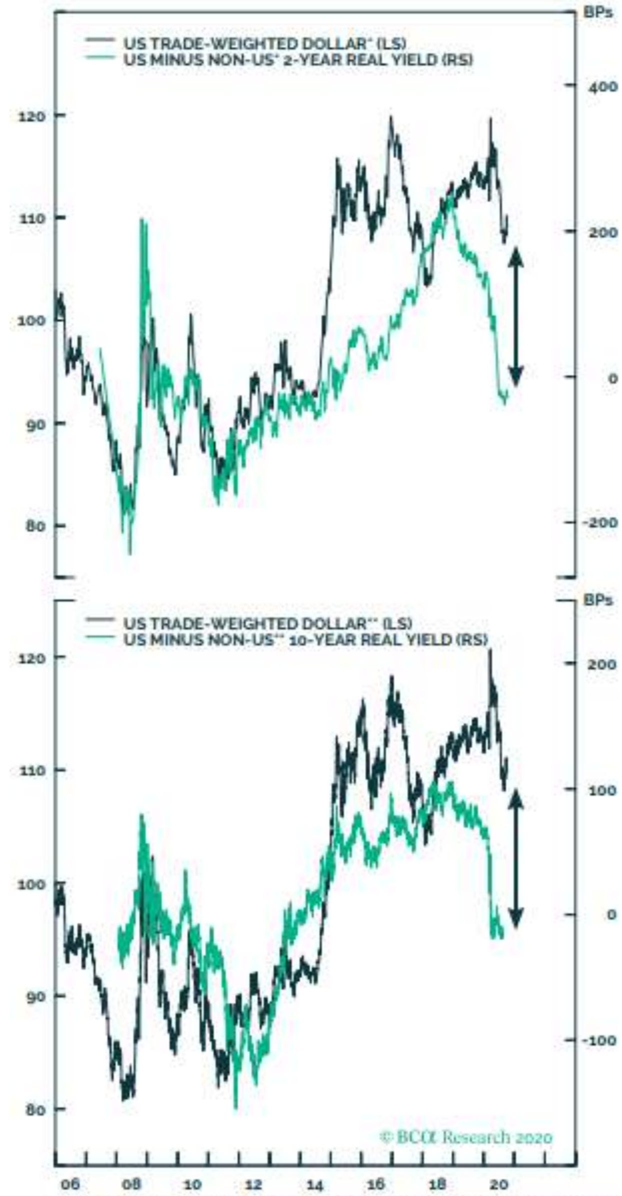
Tech stocks are overrepresented in growth indices. Better trade relations would help US tech companies, as would a weaker dollar. That said, Joe Biden's plan to increase taxes on overseas profits would hit tech companies disproportionately hard since the tech sector derives over half its revenue from outside the United States.

Stepped up antitrust enforcement and more stringent privacy rules could also weigh on tech profits.

On balance, while there are many moving parts, a Democratic sweep would favor non-US equities over US equities, and value stocks over growth stocks.

CHART 4

A Relatively Muted Decline In The Dollar Given The Move In Real Yield Differentials



* TRADE-WEIGHTED AVERAGE OF EURO AREA, JAPAN, UK, AUSTRALIA, AND SWEDEN.
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Trumpism Transcends Trump

In 2016, we bucked the consensus view that Hillary Clinton would win the election. On September 30, 2016, we predicted that "Trump will win and the dollar will rally," noting that "Trump has seen a huge (yuge?) increase in support among working-class whites. If the so-called "likely voters" backing Clinton are, in fact, less likely to turn out at the polls than those backing Trump, this could skew the final outcome in Trump's favor."

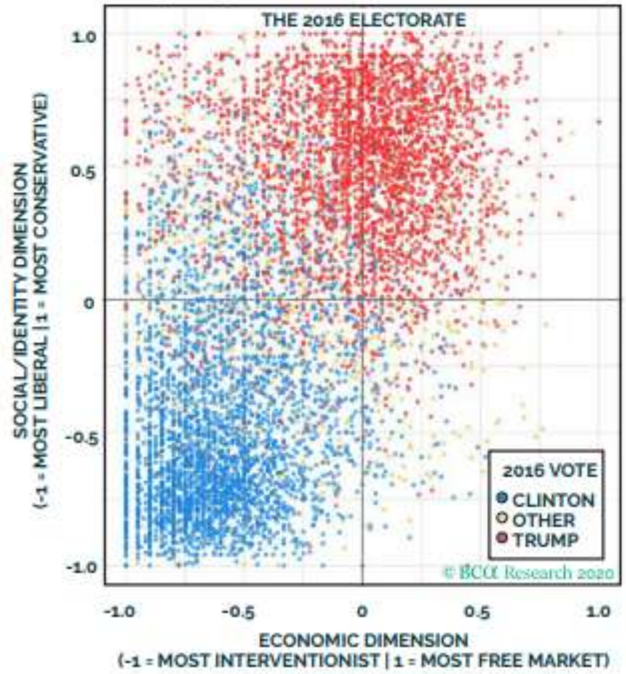
Right-wing populism was the $1 trillion bill lying on the sidewalk that no mainstream Republican politician seemed eager to pick up. According to the Voter Study Group, only 4% of the US electorate identified as socially liberal and fiscally conservative in 2016 (where the older of us still resides), compared to 29% who saw themselves as fiscally liberal and socially conservative (**Chart 6**).

The latter group had no political home, at least until Donald Trump came along. Rather than waxing poetically about small government conservatism – as most establishment Republicans were wont to do – Trump railed against mass immigration, unfair trade deals, rising crime, never-ending wars, and what he described as out-of-control political correctness.

While Trump was able to carry out parts of his protectionist agenda, most of his other actions fell well short of what he had promised. His only major legislative achievement was a massive tax cut for corporations and wealthy individuals – something that the vast majority of his base never asked for.

CHART 6

Trump Targeted Socially Conservative Voters



SOURCE: LEE DRUTMAN, "POLITICAL DIVISIONS IN 2016 AND BEYOND," THE DEMOCRACY FUND VOTER STUDY GROUP (JUNE 2017).

The Rich Are Flocking To The Democratic Party

How did corporations and wealthy Americans reward Trump for lowering their taxes? By shifting their allegiances towards the Democrats, that's how. According to the Pew Research Center, households earning more than $150,000 favored Democrats by 20 percentage points during the 2018 Congressional elections, a 13-point jump from 2016. Households earning between $30,000 and $149,999 favored Democrats by only 6 points in 2018. The only other income group that strongly favored Democrats were those earning less than $30,000 per year. (**Table 4**)

TABLE 4

Democratic Candidates Had Wide Advantages Among The Highest-And-Lowest Income Voters

% OF VALIDATED VOTERS WHO REPORTED VOTING FOR:						
	2016			2018		
FAMILY INCOME	CLINTON	TRUMP	MARGIN (DEM.-REP.)	DEM.	REP.	MARGIN (DEM.-REP.)
$150,000 OR MORE	51	44	7	59	39	20
$30,000 - $149,999	44	51	-7	52	46	6
LESS THAN $30,000	58	32	26	62	34	28

SOURCE: SCOTT KEETER AND RUTH IGIELNIK, "DEMOCRATS MADE GAINS FROM MULTIPLE SOURCES IN 2018 MIDTERM VICTORIES," *PEW RESEARCH CENTER*, SEPTEMBER 8, 2020.

Other data tell a similar story. Median household income in Democratic congressional districts rose by 13% between 2008 and 2017. It fell by 4% in Republican districts. Today, on average, Republican districts have a median income that is 13% below Democratic districts.

Campaign donations have shifted towards the Democrats. The latest monthly fundraising data shows that the Biden campaign received three times more large dollar contributions in total than the Trump campaign.

The nation's CEOs have not been immune from this transformation. Seventy-seven percent of the business leaders surveyed by the Yale School of Management on September 23 said they would be voting for Joe Biden.

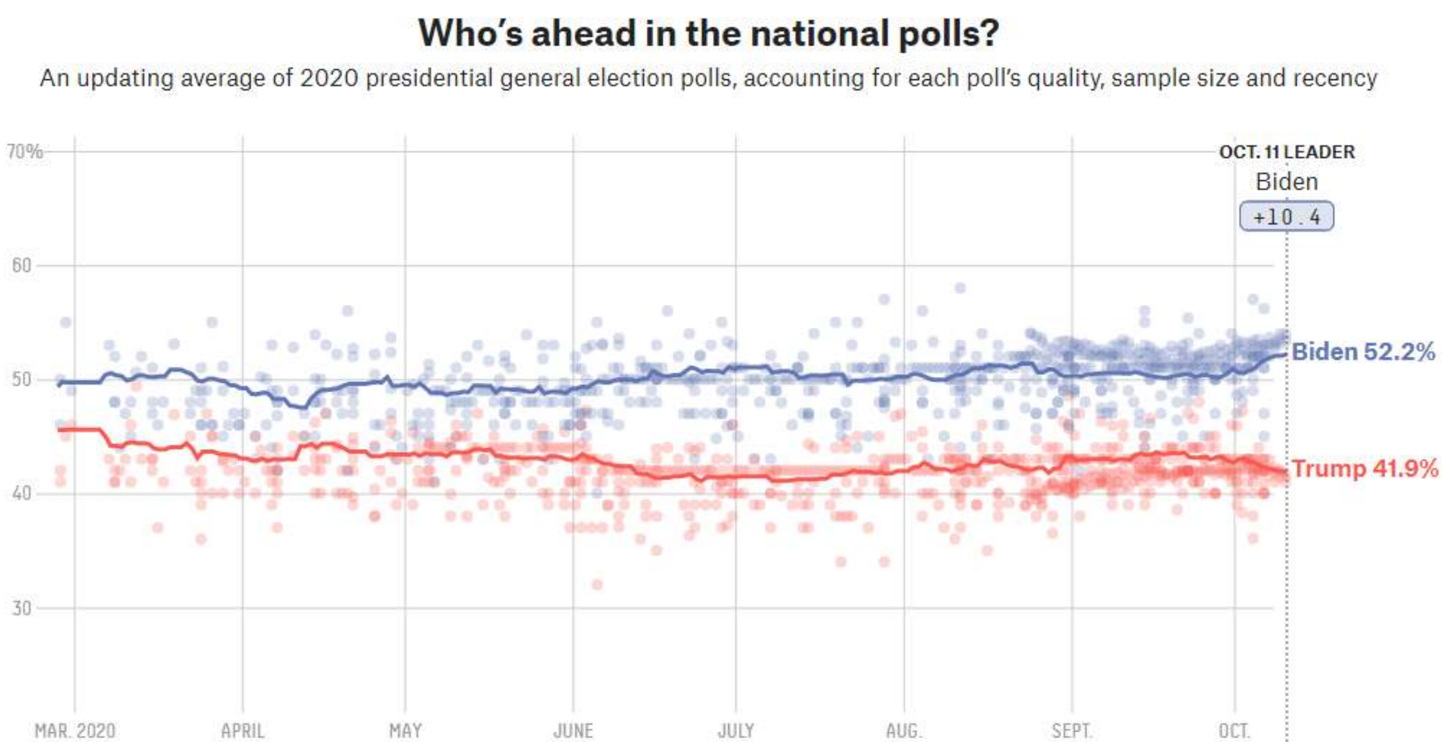
As elites desert the Republican Party, will the Democratic Party start championing lower taxes and less regulation? That seems unlikely. According to the Voter Study Group, higher-income Democrats are actually more likely to support raising taxes on families earning more than $200,000 per year than lower-income Democrats (83% versus 79%). Among Republicans, the opposite is true: 45% of lower-income Republicans are in favor of raising taxes, compared to only 23% of higher-income Republicans.

There used to be a time when companies tried to steer clear of the political limelight. This is starting to change. As the relative purchasing power of Democratic voters has risen, many companies have become emboldened to adopt overtly political stances on a variety of hot-button social and cultural issues, even if those stances alienate many conservative customers.

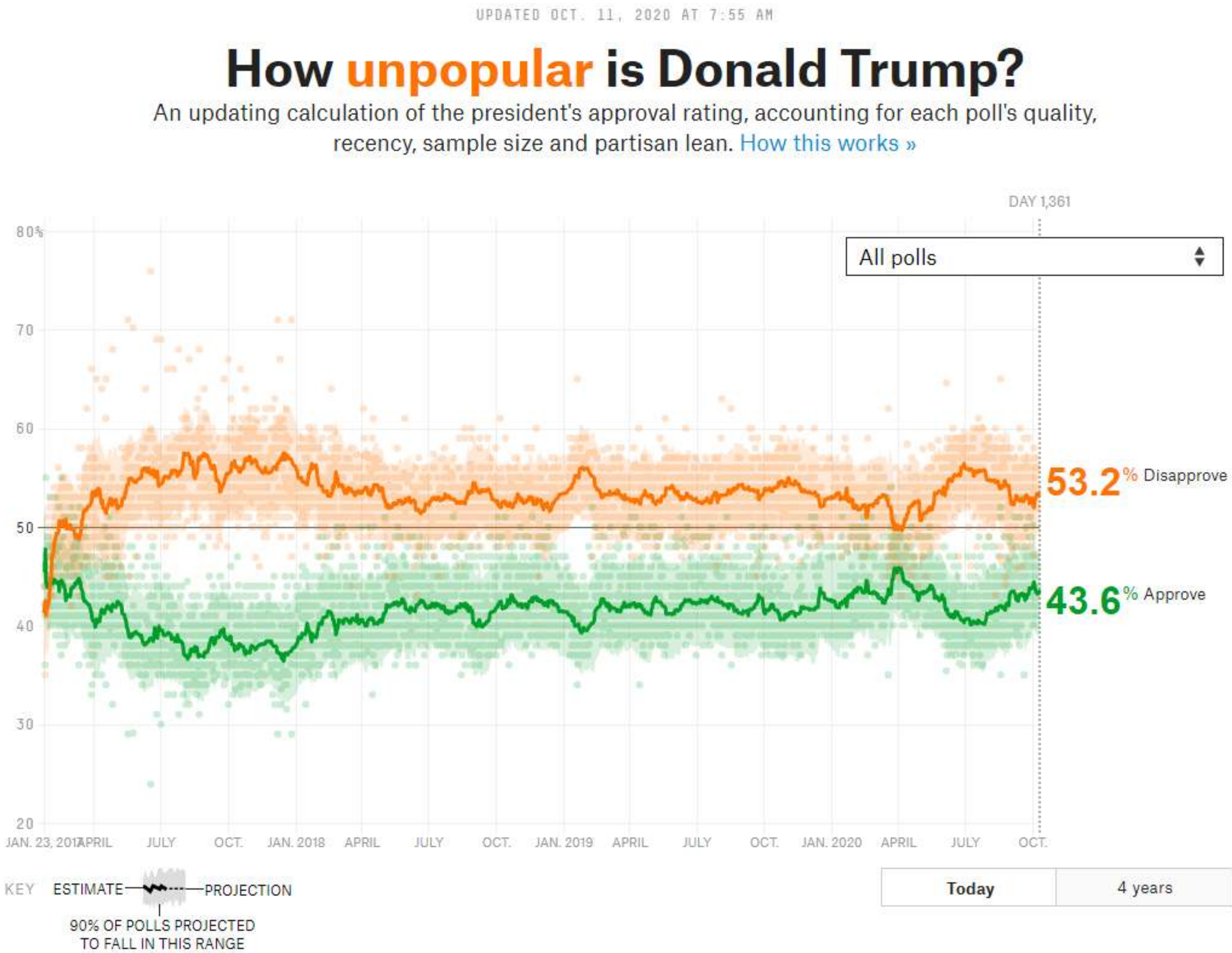
What does this imply for investors? If big business abandons conservative voters, conservative voters will abandon big business. Corporate America will be left with no clear backer among the two major parties. Over the long haul, this is likely to be bad news for equity investors. As such, while we are constructive on equities over the next 12 months, we see grave dangers ahead later this decade.

Our thoughts

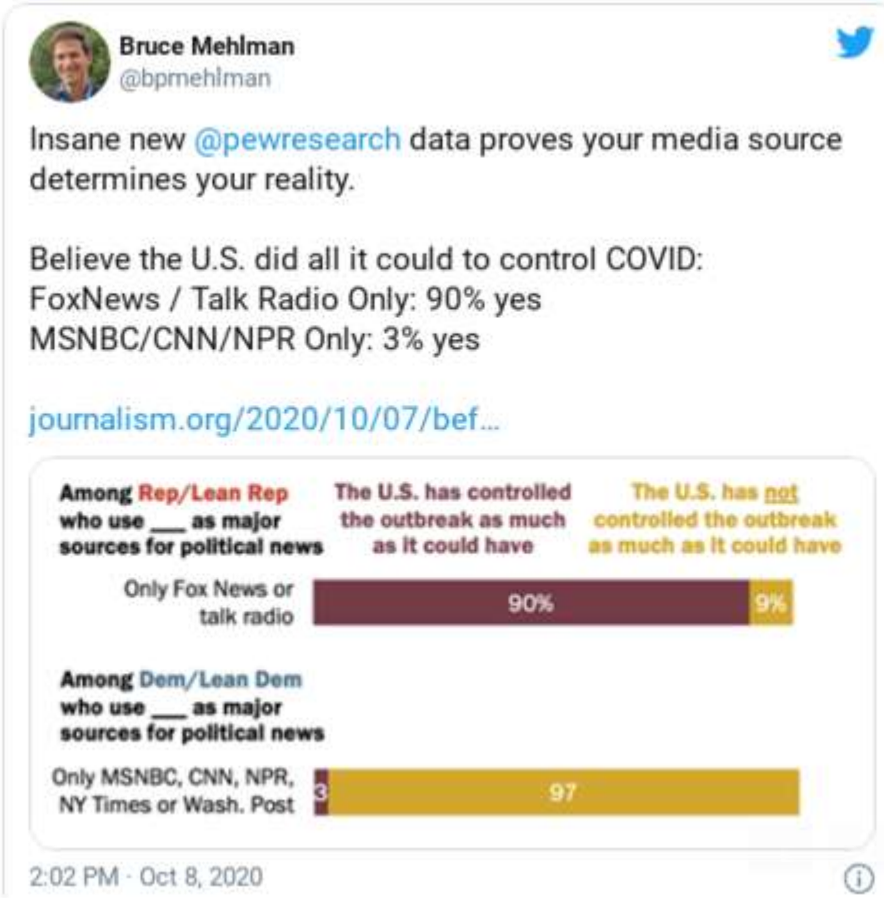
According to 538, Biden's lead in the polls has significantly expanded since the debate, and Trump's bout with Covid-19, or karma as some on the left have opined, with their simulation model currently giving Biden an 86% chance of winning.



Yet Trump's average approval rating stands at 43.6%:



How can over 40% of voters approve of Trump? Part of the answer:



For the record, neither of us watch Fox News, or listen to talk radio. Given the echo chamber that far too many of us live in, it is hard to see how Biden, or anyone else for that matter, can unite our country. Biden's election may slow the leftward drift of the Democratic Party, but will not reverse it. It is equally doubtful that the pre-Trump establishment will regain control of the Republican Party. Populism will continue to spread until the economic consequences of massive deficits become clear for all to see.

“Faced with the choice between changing one’s mind and proving that there is no need to do so, almost everyone gets busy on the proof.” - John Kenneth Galbraith