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Equity Research
Global

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Global Equity Strategy

US election implications

Investment Strategy | Strategy

Big picture on markets: We remain constructive on equities. In our view, central banks will continue to suppress government & corporate bonds, hence the need to focus on the ERP; the change in attitude to fiscal policy and the vaccine are all much more important than the US election result.

The key issue for markets is the near-term fiscal boost: On our estimates: c$2trn under a Democratic clean sweep, $1trn under a Trump Presidency, and $500bn under a Biden Presidency and Republican Senate (but this could be higher). The long-term fiscal stimulus (c$2trn infrastructure) will probably be half the amount without a Biden sweep. Under a Biden Presidency and Republican Senate scenario, we expect GDP growth to be at least 50bp lower than under a Trump Presidency (and at least 1.5% lower than under a Biden clean sweep).

The market is right to be relatively sanguine. The negative impact of Democrat policies (on tax, regulation and min wages) is offset to a large extent by the positive impacts (on GDP growth, easier trade relations). We see a marginal Democratic clean sweep boosting EPS by 3%, a Trump presidency leaving EPS up 2%, and a Biden Presidency with Republican Senate resulting in a 3% hit to EPS. A split legislature should mean less regulation that helps 30% of the US market (tech ex-semis, and pharma) and the fall in bond yields underpins the equity risk premium (7.4% against a warranted level of 4.8%).

Non-US equities no major implication. Non-US equities are more highly operationally leveraged; but a Biden presidency eases trade tensions (Biden wanted to normalize relations with the EU and has been less aggressive with China). A Biden win should see NJA outperform.

Sectors: Banks and materials have been the most correlated sectors with Biden's popularity (tech and healthcare the worst). **Don't give up on cyclicals:** We are benchmark European cyclicals which are discounting a PMI of just 52 (1.2% GDP). We are likely close to a vaccine and in general governments are committed to spending if GDP disappoints. We had today an unwind of the cyclical rally of the last 2 weeks.

Some areas of common ground between Biden and Trump: Repealing Section 230 of the Communications Decency Act (for platform companies), bringing drug prices down to international levels, and more infrastructure spending. However, there is limited Republican Senate support for drug price control and infrastructure. Executive orders can achieve a lot in terms of trade and Biden wants to use them for procurement.

Specific areas: Biden victory is negative for oil; whilst Trump is good for defence (P/E relatives at 20-year lows). A clean sweep would be very supportive for construction materials (especially insulation) and renewables; negative for oil, luxury, drugs and platform companies.

A second lockdown? We don't think President Biden would impose a lockdown (not least because it is up to the mayors and governors, Trump is in charge until Jan 20th and only 37% of the public supports significantly stricter measures).

Contested election: As in 2000, we think the Supreme Court would probably not allow this to go on past 8 December. *NB this is up to date as of 17.45 GMT/12.45 ET.*

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US election

Biden win most likely but clean sweep has a low probability.

The US Presidential election remains highly uncertain. Joe Biden maintains a credible path to victory were he to win Wisconsin, Michigan and Nevada, but vote counts, and legal challenges, could still take some days. Nonetheless, given the information we have (particularly with respect to the Senate), we would make the following tentative conclusions: we believe there is a 70% chance of a Biden Presidency, a 20% of a Trump Presidency and a 10% chance of a Democratic clean sweep, though the result may not be decisively known until Nevada releases its next count on Thursday or until Pennsylvania has finished its count on Friday. If the Senate result comes down to Georgia, then we will not know the result until the runoff on 5 January.

How much of a fiscal boost will be delivered?

The size of any near term fiscal boost is the key to markets, and in particular the following three areas: Federal unemployment benefit (bearing in mind that the FEMA lost wage assistance are running out very quickly), aid to states (which are in deficit and by law have to have a balance budget which could drive significant spending cuts) and the renewal of the PayCheck Protection Progamme.

The near-term fiscal spending outcomes going into this election ranged from the $2.2trn proposed by Nancy Pelosi down to $500bn proposed by Senate Republicans. In our judgement, a Trump White House win with a split Congress would likely lead to a stimulus outcome somewhere in the middle of this range (around $1trn, itself down from the $1.8trn Trump had earlier sought). A Biden White House win with Republican Senate would, we believe, see the stimulus package toward the lower end of this range, which in turn would obviously limit any GDP growth upside (a clean Democratic sweep could have seen growth forecasts rise by 1.5p.p.). That said, in July, the Republican Senators did sign up to a $1trn fiscal plan, so perhaps there is scope for their current $500bn offering to increase in size.

Critically we have consistently seen that US politicians react to stock market or economic weakness by easing fiscal policy.

Clearly, there is a lot of uncertainty over this. There are 4 Republican Senators up for reelection in 2022 (and 7 in total) in potentially very close races and it is possible that one of these could be persuaded to vote with the Democrats in return for more fiscal spending in his own state. Trump on his campaign trail suggested more fiscal easing than he did in his manifesto (admittedly via tax cuts rather than spending).

The long-term fiscal boost is less relevant than the short-term fiscal boost. Under a Biden clean sweep, there was $2trn of largely green related infrastructure (as well as $775bn on making childcare and nursing more affordable and $700bn on Made in America government procurement and R&D of which some is counted in the infrastructure spending) yet Moody's estimate that the tax hikes would be just $1.4trn (and with 80% of the tax hikes falling on the richest 1% of the population, who have a low marginal propensity to consume). Hence, we estimate that a Democratic clean sweep, though unlikely, would lead to a long-term fiscal boost of an additional 1% p.a. quite easily.

Under a Biden split, we could see $500bn of infrastructure spending; under a Trump split, there may be similar increase in infrastructure spending.

Markets

For the most part, net net little change to EPS….

The absence of a sweep outcome brings positives and negatives: in most of our EPS scenarios, we had the negative impact of a Democrat policy platform (on tax, regulation and minimum wages) being offset to a large extent by their positive spending impact (on GDP growth, and easier trade relations).

Figure 1: Impact on EPS

Likely size of corona stimulus						
	Biden marginal clean sweep		Biden + Republican senate		Trump + Democratic house	
	Proposal	% of GDP*	Proposal	% of GDP*	Proposal	% of GDP*
Corona stimulus	$1.5tn fiscal stimulus	4.0%	$500bn fiscal stimulus	2.0%	$1tn fiscal stimulus	3.5%
* adjusted for clear water impact						
EPS impact						
	Outcome	**EPS Impact**	**Outcome**	**EPS impact**	**Outcome**	**EPS impact**
Corporate tax increase	Probability high	-5.4%	No tax increase	0%	No tax increase	0.0%
Other tax increases	Probability low	0.0%				
Minimum wage legislation	Probability low	0.0%	No min. wage increase	0%	No min. wage increase	0.0%
EPS impact from tax reform and minimum wage increase		**-5.4%**		**0.0%**		**0.0%**
EPS impact from fiscal stimulus	Large fiscal stimulus	8.0%	Small fiscal drag	-3%	Small fiscal stimulus	2.0%
EPS impact (adj. for fiscal stimulus)		**2.6%**		**-3.0%**		**2.0%**

Source: Credit Suisse research

We can see that:

- A Biden Presidency but Republican Senate reduces EPS by c3%,
- A Trump presidency with split Congress increases EPS by c2%
- A Clean sweep increases EPS by 3%.

To some extent, these earnings numbers underestimate the benefit of stalemate and compromise. It will be much harder to regulate technology (recall the Republicans refusing the highly critical Congressional Report into the Big 4) or pass healthcare reform. Close to 30% of the US market cap is pharma and tech (ex-semis) which would be under less regulatory attack under a split Congress than a Democrat clean sweep. Moreover, growth stocks (c44% of US market cap) benefit from a lower discount rate (i.e. lower bond yield).

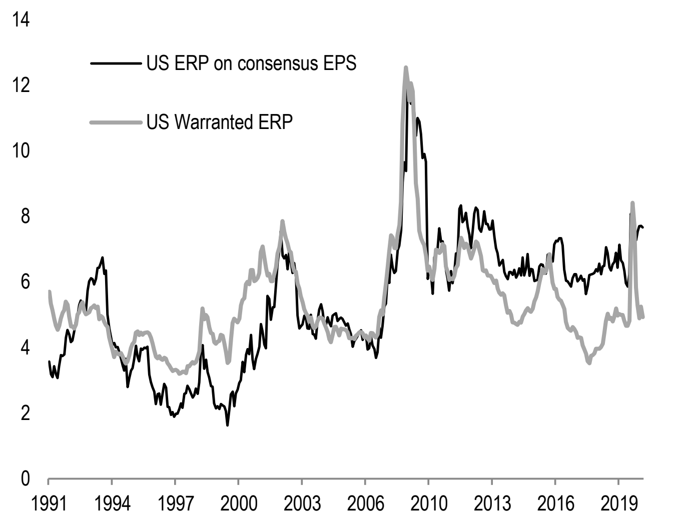
Bigger picture what matters more for markets:

We would argue that there are three critical issues in markets that are, if anything, more important than the US election result:

1) The vaccine (which in turns allow normalization). We would expect a successful announcement on a Phase 3 trial by year end and incremental roll out of c1bn a quarter. Even 50% efficacy is enough to smooth the curve.
2) Globally politicians are committed to fiscal QE; any weakness in GDP leads to a fiscal response.
3) The suppression of bond and corporate bond yields.

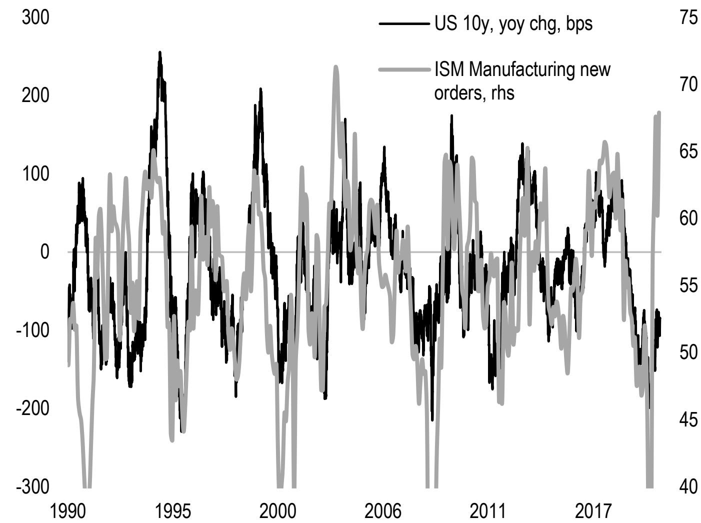
Central banks still have significant fire power and are keeping both bond yields and corporate bond yields abnormally low. This impact is illustrated in the disconnect between ISM and the 10 year bond yield. This means investors not only have to focus on the equity risk premium (currently the ERP is 7.4% on our numbers against our models that suggest that, even if ISM falls to 55 and credit spreads go to average levels, then equities (S&P 500) should be close to 4,020 by the end of next year) but we are starting to see a bond for equity switch (as bonds no longer diversify). Less than 10% of the Fed schemes have been used (and just 7% of the Main Street Lending Programmes have been allocated).

Figure 2: US ERP is well above warranted levels



Source: Refinitiv, Credit Suisse research

Figure 3: The 10y has significantly disconnected from ISM

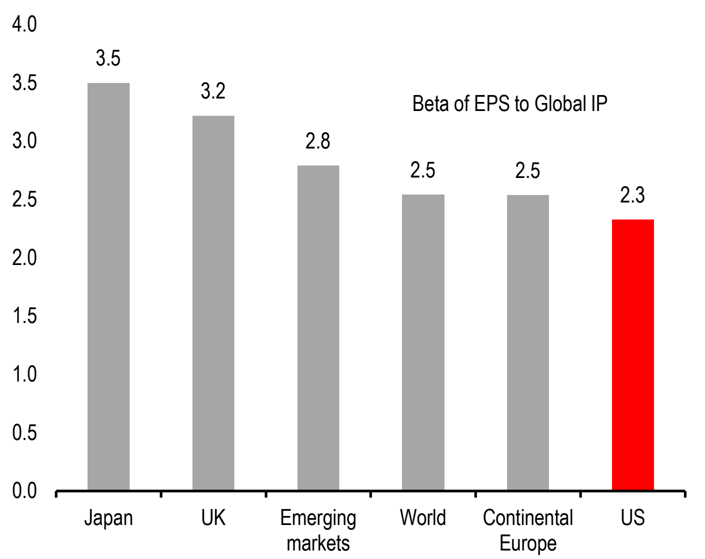


Source: Refinitiv, Credit Suisse research

Regions

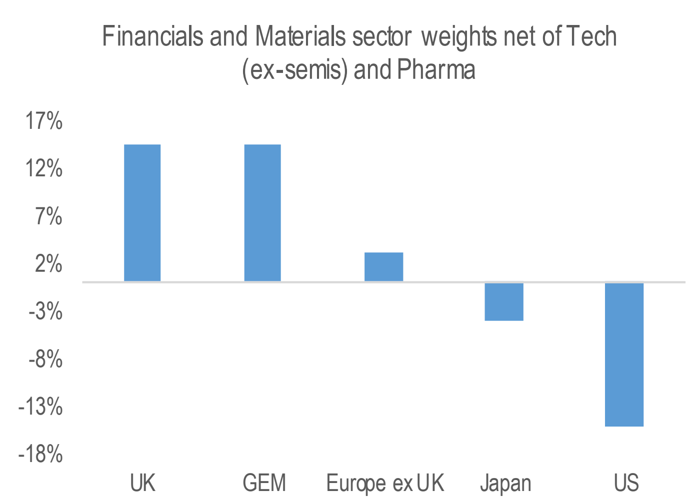
In our view, the less the fiscal stimulus in the US, the worse it is for the more operationally leveraged global markets. Moreover, non-US markets have a lower proportion of market cap in healthcare and technology ex semis (the relative winners from lighter regulatory backdrop).

Figure 4: US has low operational leverage



Source: Refinitiv, Credit Suisse research

Figure 5: Financials and materials sector weight minus tech (ex-semis) and pharma

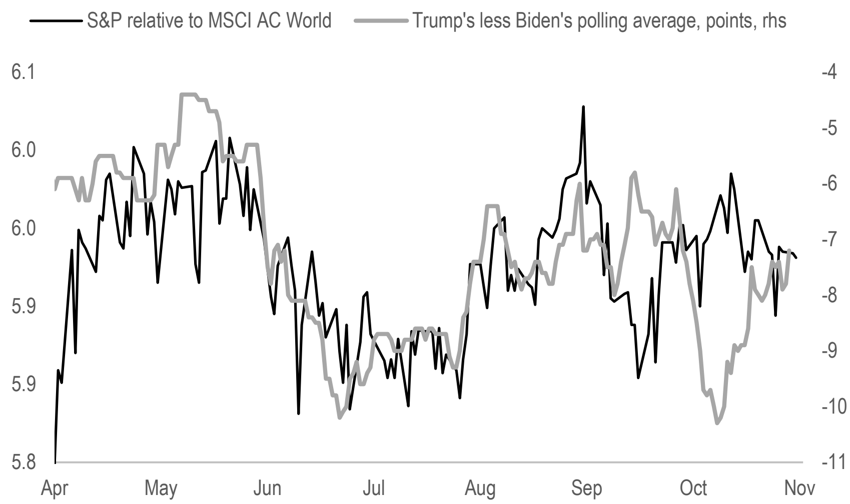


Source: Refinitiv, Credit Suisse research

Trade relations remain up to the President who can rule via executive action. As we highlighted in our note on Monday (see *US election scenarios,* 02 Nov), Biden tends to be a multilateralism and has spoken about wanting to normalize relations with Europe.

We can see that Biden has been perceived to be good for non-US relative to US equities.

Figure 6: Biden has been perceived to be relatively better for non-US equities



Source: Refinitiv, Credit Suisse research

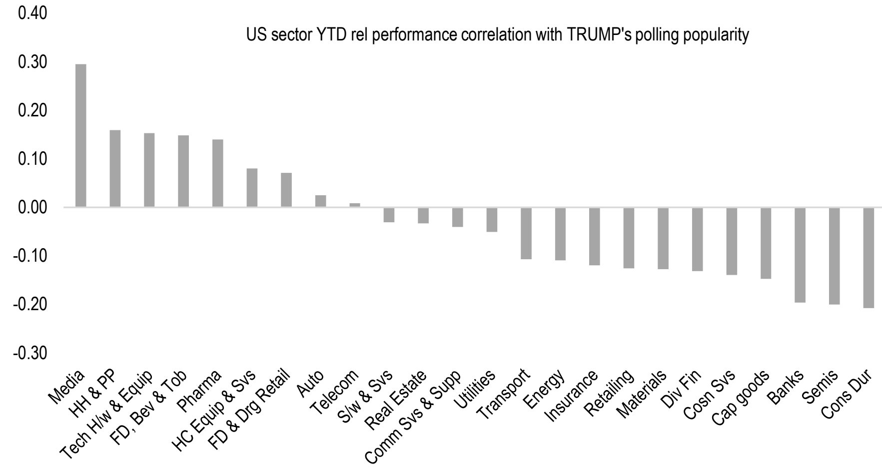
Bond yields

Volatility in the bond market has picked up. 10 year yields have risen sharply from 68bp Oct 15 to peak overnight today at 94bp and is now 78bp. We think that the Fed would not allow the 10 year bond yield to rise much above the 1.25% to 1.5% range (bearing in mind that average maturity of mortgage debt and corporate bond debt is close to 11 year and 7 years respectively); thus, we would expect any large rise in bond yields would be met by some form of yield curve control. We can see a record disconnect between ISM, highlighting the impact of central bank buying.

Sectors

Clearly the sectors most correlated with Biden had been materials and banks and those with Trump are pharma and tech (ex-semis).

Figure 7: US sector correlation with Trump popularity YTD



Source: Bloomberg Finance L.P., Refinitiv, Credit Suisse research

We have only seen an unwind of the 2 week cyclical trade today.

Figure 8: Recent US sector performance- an unwind today of the past two weeks cyclical trade

US Sectors	1 mth rel performance	2 wk rel performance	1 wk rel performance	Intraday rel. performance
Small vs Large	1.94%	1.56%	1.98%	-2.19%
Banks rel market	-1.39%	4.05%	5.26%	-5.45%
Tech rel market	0.95%	-1.72%	-1.29%	1.35%
Pharma rel market	-1.61%	-1.32%	-0.79%	2.15%
Industrials rel Market	-0.02%	4.04%	1.15%	-2.65%

*intraday prices last refreshed at 10.45am US Eastern Time

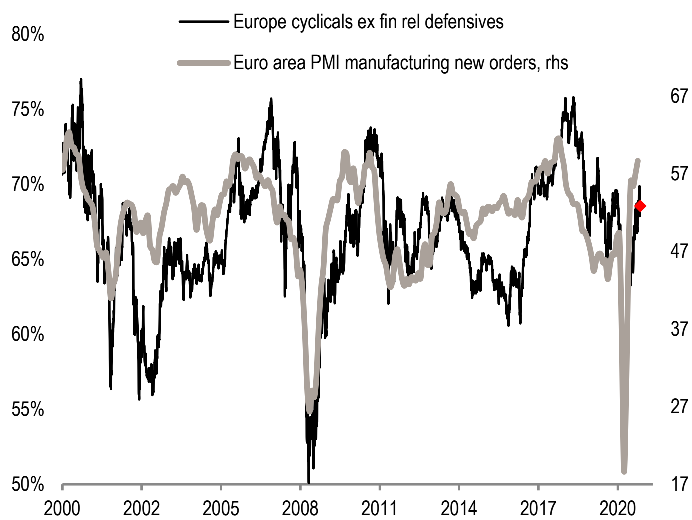
Source: Refinitiv, Credit Suisse research

Don't give up on the cyclical trade

We are benchmark European cyclicals but would not give up on the cyclical trade as:

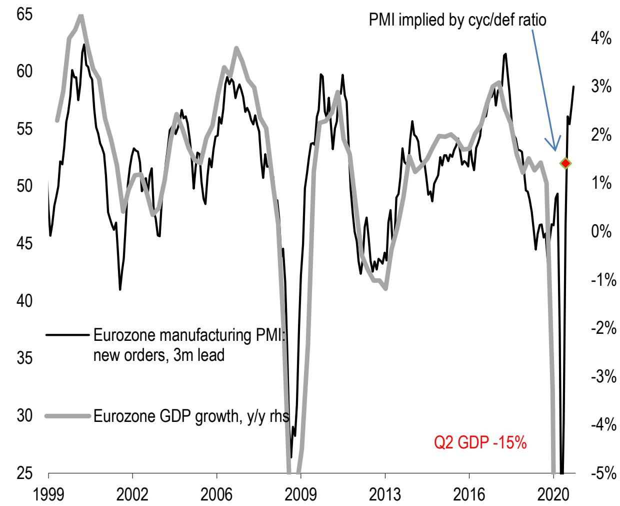
- Cyclicals are pricing in a PMI of 52 (1.3% GDP growth) against a backdrop when the underlying resilience in the US economy was much stronger than expected (e.g. ISM new orders on Monday was in the top 1% of its range) as is China.

Figure 9: The cyclicals-to-defensives ratio is discounting PMIs at c52



Source: Refinitiv, Markit, Credit Suisse research

Figure 10: …which would be consistent with c1.2% GDP growth



Source: Refinitiv, Markit, Credit Suisse research

- We are closer to a vaccine. Around the turn of the year, we should have the result of three Phase 3 trials
- It is too early to say there is clear cut gridlock in the Senate.

The policy outlook

What can the President do by executive action?

Essentially the President is in charge of trade policy (as Donald Trump has shown) and Biden has said he would use executive orders to increase government procurement (Biden has pledged to sign six 'Buy American' executive orders during his first week in office and has pledged $400bn on 'Made in America' government procurement, and $300bn in R&D on US technology). Biden might be able to use executive actions to impose some requirements for cleaner energy and maybe on areas of tech but this would be harder and subject to legal challenges.

What are areas of agreement between Biden and Trump?

Plausibly, there could be some common ground found in sustainability related areas of infrastructure spending and regulation of technology (e.g. the repeal/amendment of Section 230 of the Communications Decency Act). However, even here the common ground seems limited (the recent House Judiciary Committee report on monopoly power in tech was endorsed only by the Democrat members of the Committee despite increasing disquiet from Republicans at the power of the big tech firms).

Trump has favoured infrastructure but has not delivered anything so far (but clearly his infrastructure focus would not be green related). Hence, the infrastructure front, we would be surprised to see a package of more than $500bn over the next five years.

Donald Trump wanted to lower drug prices to international levels via his most favored nations (MFN) approach, which he would establish via an executive order. Despite Trump's aggressive rhetoric, he has had relatively few successes in this arena. Biden also wants to reduce drug prices to global levels and, in the absence of a majority in Congress, could choose a similar approach to Trump. We believe investors should be underweight big cap pharma (see Utilities to overweight, pharma and energy to underweight, 4 Aug).

Sector performance under Biden and split Congress

Under a Biden presidency, independent of Congress, oil is likely to suffer. We expect Biden to try to improve relations with Iran, which could lead to the potential release 2mbd of oil into the market, and ban drilling on Federal Land.

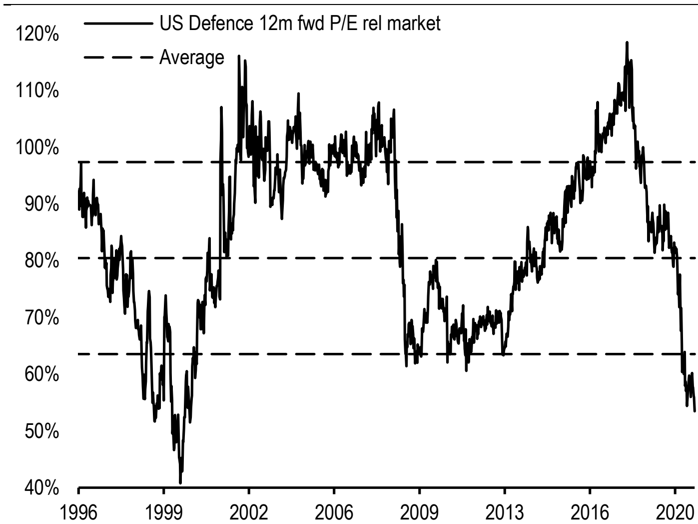
Moreover, Biden would likely show goodwill to Europe by abolishing the $7.5bn punitive tariff imposed by Trump (to the benefit of spirit, champagne and aerospace companies).

The Senate remains a key actor when it comes to the appointment and approval of many key positions across the judiciary and wider government. Having a Senate controlled by a different party to the executive could make any such appointments drawn out, and could act as a lightning rod for broader political division in the country. Moreover, it would limit the chances of major regulatory reform.

Sector performance if Trump becomes President?

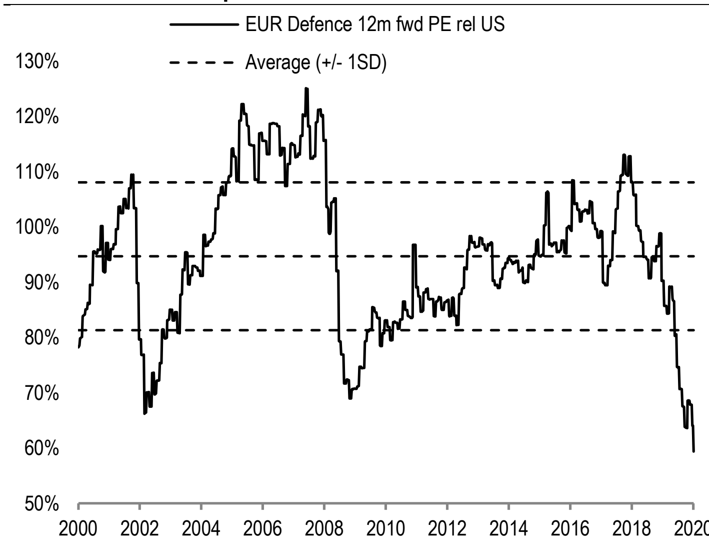
This is likely to lead to a relief rally in those areas that would have faced higher regulation (tech and pharma). Defense companies should also do well with Trump keeping up pressure on NATO members to spend more. This is at a time when US defense stocks are trading on P/E relatives at 30 year lows and European defense stocks look cheap relative to US stocks.

Figure 11: US defence stocks have de-rated sharply



Source: Refinitiv, Credit Suisse research

Figure 12: European defence stocks trade below their average relative to their US peers on 12m forward P/E…



Source: Refinitiv, Credit Suisse research

We think a lockdown under a Biden Presidency is unlikely

One of the concerns is whether Biden would implement a national lockdown to control COVID. The reality is that President Trump will remain in power until 20 January and, by that stage if there is a continuing sharp rise in infections, it would likely be too late to implement a lockdown. Moreover, the lockdowns are implemented by state governors rather than the President and so far few have hinted that they are prepared for such a move. In this, they are largely reflecting public opinion, with only 37% of Americans supporting significantly stricter measures (proxied by school closure), down from 76% in April, according to YouGov. Of course, state governors (11 governorships are up in 2020) might change their minds after their election. Finally, Biden's policy website only mentions testing and masks as central to combatting COVID, with no mention of federal lockdowns.

What about a clean sweep for Biden?

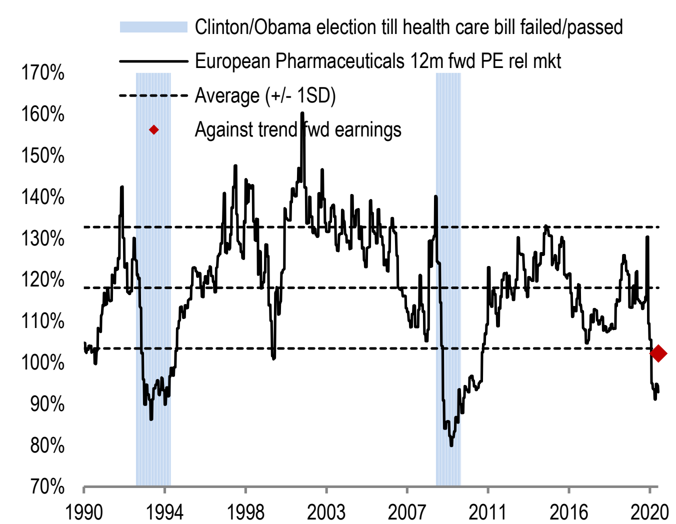
While looking increasingly unlikely, Biden could still achieve a small majority in the Senate (50) and this means that compromise would be required. This could see a lot of legislation around his green agenda being implemented.

The areas of uncertainty are: i) whether Biden would still try to abolish the filibuster rule and ii) whether he would try to pack the Supreme Court (given Democrat concerns that the current court threatens to overturn Roe v. Wade and the ACA).

Under this outcome we believe the clear winners would be renewables (Biden wants zero carbon emission from power generation by 2035) and insulation plays (see US election outlook, 2 Oct).

Negatively-impacted sectors under a Biden clean sweep would be luxury (the top 1% pay 80% of the tax hike), oil (owing to the move to renewables and EV) and tech (with the platform companies facing higher regulation/taxation) and pharma. We find that, when there has been a clean sweep and an attack on pharma, that sector remains on a 10% to 20% discount to the market for up to 20 months (compared to a 2% premium if we look at normalized earnings).

Figure 13: The pharma sector is very sensitive to political risk and stays cheap for a long time in the face of meaningful healthcare reform (it is not cheap if we adjust for trend earnings for the overall market)



Source: Refinitiv, Credit Suisse research

Figure 14: Historically, it stays cheap for 10 to 20 months after the implementation of meaningful healthcare reform

Start of derating	Start of rerating	Magnitude of derating, % change in rel PE	Length of time (in mth)
Nov-92	Jul-94	-31%	20
Dec-08	Oct-09	-43%	10
Start of current derating		**Magnitude of current derating**	
Apr-20		-30%	

Source: Refinitiv, Credit Suisse research

Appendix

Figure 15: Scenario summary

		Biden marginal clean sweep	Biden + Republican Senate	Trump + Democratic House
Government bond yields		+10bps	-20bps	-5bps
DXY		-0.5%	-0.5%	1.0%
EPS impact	**Tax reform/min wages**	-5.4%	0%	0%
	Adj. for fiscal stimulus	2.6%	-3.0%	2.0%
Market implications		US and Non US equities rise modestly and EM outperform (best outcome for equities as an asset class)	US and NJA outperform	Positive for US equities and EM underperforms
Style implications		Value outperforms	Growth outperfroms	Growth outperforms
Sector winners		Construction, infrastructure, ESG, financials	Healthcare and tech	Secular growth: tech, energy
Sector losers		Healthcare, energy, tech, luxury	Energy, value cyclicality	Value cyclicality: banks, autos
Key policy conclusions		$2trn infrastructure investment over 4 years. Higher corporate tax rate - 28% from 21% Rejoin Paris Climate Accord; net zero emissions by 2050 Increased regulation of tech Limit drug price rises; strengthen public health option A more conciliatory approach to trade with allies	Divided government may find some common ground on infrastructure spending, but policy paralysis more likely outcome	

Source: Credit Suisse research

Disclosure Appendix

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Restricted	2%	

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