# Perspectives

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## What Does the Biden Win Mean for Financial Markets?

**On Saturday, November 7th, Joe Biden was declared the winner of the presidential election and will become the 46th president of the United States in January. Markets were surprisingly positive last week despite the uncertainty around results as multiple states were too close to call until all the votes had been tallied. While there is still pending litigation in certain states, it seems highly unlikely that these actions will reverse the election result. Thus, market participants have turned their attention to what the market can expect from a Biden-led White House coupled with a split Congress, while the coronavirus pandemic marches on.**

In the following, we tackle this question for each of the "traditional" asset classes: Fixed Income, U.S. Equities, and Non-U.S. Equities. The impact on alternative asset classes such as hedge funds, real assets, and private equity are more nuanced and will be covered in our 2021 market preview to be released in January.

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## FIXED INCOME

With the Biden presidency and a divided Congress, we expect less sustained fiscal support for the recovery next year and less potential for higher corporate and personal tax rates.

- Interest Rates & Inflation: A Democratic sweep would have likely resulted in larger stimulus and spending measures that would elevate U.S. growth prospects, thereby boosting inflation, raising rates, and steepening the yield curve (at least in the near term) but the higher taxes would have likely been deflationary, depressing rates and flattening the curve. However, with Biden's win and a more balanced Senate and House, these new measures are less likely to be passed, and therefore we may expect more moderate inflation, rising rates and yield curve steepening that may just be the result of the recovery from the pandemic rather than more stimulus and spending or higher taxes.
- Credit Spreads: More fiscal stimulus would serve to tighten spreads, but higher taxes would serve to widen spreads. However, we expect the same dynamic here with the more divided Congress. Spreads would be expected to tighten roughly in accordance with the gradual recovery from the pandemic rather than stimulus, spending, and taxes.
- Currencies: Any tax hike would be expected to weaken the dollar, but deficit spending would be expected to strengthen the dollar. However, a balanced Congress may prevent any tax hikes or significant deficit spending to be passed.
- Core Bonds: Even though greater spending would have raised rates and steepened the curve while higher taxes would have depressed rates and flattened the curve - which equates to roughly breakeven returns even if these are passed through a divided Congress - core bond managers are generally duration and yield curve neutral and more focused on bottom-up security selection while also focusing on beaten-up credits in the COVID-stricken industries such as airlines, energy, and gaming that have strong balance sheets and market leadership that could enjoy further spread-tightening. The securitized sector — residential mortgages, commercial mortgages, and asset-backed credit card, auto loan, and student loan receivables — would likewise depend more purely on COVID recovery than on deficit spending and stimulus.
- Bank Loans/High Yield Bonds: Because more fiscal stimulus would serve to tighten spreads but higher taxes would serve to widen spreads - essentially a wash between the two - bank loan and high yield managers are likewise more focused on bottom-up security selection while also focusing on similar beaten-up credits in the COVID-stricken industries mentioned in the prior section.
- Emerging Markets Debt: Biden's pro-trade policies may create a weaker dollar and more investment in U.S. infrastructure that could raise imports of commodities from emerging economies, a tailwind for emerging markets debt. However, a divided Congress may limit the expansion of pro-trade policies and the ultimate impact on EMD.
- Municipal Bonds: A blue wave would have resulted in greater federal aid to states, which should tighten municipal bond spreads. Higher taxes would have driven greater demand for municipal bonds, also a tailwind. However, again, with the balanced Congress, these results are now less likely.

## U.S. EQUITY

U.S. equity markets have rallied since their late-October doldrums in light of increased clarity surrounding the political landscape, as well as good news on the COVID-19 vaccine front. Since the end of October alone, the S&P 500 has notched an impressive 8.6% gain through market close on Monday, November 9th. Value-oriented names have led the way within the large-cap equity space, with the Russell 1000 Value Index up roughly 9.9% during that time period, outpacing its growth counterpart by 2.4%. Small-cap stocks

have seen even more significant gains since the end of October, with the Russell 2000 Index rallying 10.9%, reaching a level not seen since 2018. This surge in equity prices has brought with it a drop in the CBOE Volatility Index — which saw a significant spike in the previous month — of approximately 33% since November 1st.

### Don't Panic!

- Despite political rhetoric and skew, markets tend to perform similarly whether a Republican or Democrat is in office. From 1853 to 2015, average annual returns under a Democrat-controlled White House were 10.7%, compared to an average annual return of 10.5% for Republicans.
- Over the last 12 presidential election years, only two have ended negatively (2000 and 2008). Absent a recession like we saw in the Dot-Com era or the Global Financial Crisis, we expect election years to end positively, with the remaining historical 10 election years averaging an annual return of 16.8%.
- Looking forward, the S&P 500 has averaged a return of more than 8% in the year following a presidential election.

## Key Issues Moving Forward

### Stimulus

- Should the U.S. government remain divided as most have projected, we still expect a new stimulus bill soon, albeit one more modest in scope than the $2.2 trillion aid package proposed by House Democrats in late September.
- Regardless of size, the passage of an additional fiscal relief bill will have a greater impact on cheaper areas of the market, particularly small and mid-cap value stocks, and could cause cyclical names to continue their recent outperformance.

### Taxes

- Biden campaigned on hopes of "making the wealthy and corporations pay their fair share," while easing the tax burden on "working families." This translates to:
  - Raising the top marginal tax rate and long-term capital gains tax rate to 39.6%
  - An increase in the corporate tax rate from 21% to 28%
  - A minimum tax rate of 15% on book income
- While the revision of current tax rates closer to pre-Trump levels would likely dampen corporate profitability and may incentivize current investors to sell holdings that have accrued large gains over the last four years, we view the passage of these initiatives to be unlikely in a split Congress. If the current Senatorial run-off in Georgia swings blue, we could see volatile equity markets as investors try to assess increased stimulus measures against potentially lower corporate profits.

### Regulation

- It is possible that the incoming Biden administration will pursue continued anti-trust actions against large technology companies, which could spell trouble for growth-oriented names like Facebook and Google.
- President-elect Biden's climate plan proposes $1.7 trillion in new federal investments into clean energy initiatives over the next decade. If the Senate remains in Republican hands, these investments are expected to be met with resistance.

### COVID-19

- With the election largely in the rear-view, the single largest determinant of U.S. equity performance going forward will be the containment of COVID-19 and progress toward vaccine development.
- On Monday morning, Pfizer announced its vaccine candidate was more than 90% effective in preliminary trials, which sent the Dow Jones surging more than 5% at the opening bell on Monday. Conversely, leading COVID beneficiaries like Zoom and Teledoc closed down 17% and 13%, respectively, as a path to reopening and normalization seems closer.
- That said, with the U.S. now exceeding 10 million cases — accounting for a fifth of all cases worldwide — there seems to be little to no containment plan coming from President Trump as he enters a lame-duck session. While scientists are still positive that we will have a safe and effective vaccine next year, many doubt that there will be one "silver bullet" vaccine.
- We expect the road to remain volatile until there is a vaccine.

## NON-U.S. EQUITY

### Market Reaction & Volatility

- Markets, both domestically and internationally, appeared to have hedged their bets on the election results heading into Tuesday.
- With the election being called for Biden, we have seen major international developed and emerging markets indices respond positively to the news. At the close of markets in Europe on November 9th, the U.K.'s FTSE 100 posted its best day since March (up over 4.5%) — buoyed by both positive developments on the Pfizer vaccine and optimism on the outlook of risk assets with a Biden presidency. Markets appear most optimistic about less geopolitical tension, more political certainty, less trade angst, and potential for a lower U.S. dollar. Other notable foreign index performance numbers from yesterday:
  - Germany's DAX was up over 5%
  - France's CAC40 was up over 7%
- As we learn more on the final state of the Senate and soon-to-be President's approach to foreign policy, trade, and taxes, we may see further rumbles/volatility in the major international developed and emerging market ("EM") indices.

### Trade & Trade Policy

- The EU may be breathing a sigh of relief, as the anticipation of escalated trade tensions brought on by the Trump administration has likely subsided with the news of Biden's win.
- U.S.-China trade relations will remain an unknown as the Phase One deal has not materialized into any meaningful negotiation win for either side.

### Taxes

- While largely a domestic issue, the knock-on effects of any corporate tax changes will play in international markets. Under a Biden administration, potential increased taxes from repealing corporate tax cuts (along with potential increased public spending) could be a boon for international companies as it will weaken the dollar and improve international firms' relative performance vs. U.S. domiciled companies (better valuation versus U.S.). However, higher taxes could lead to a lower U.S. economic growth trend, which would translate into lower sales for foreign exporters.

### Diplomacy

- Most world leaders have reached out to congratulate Biden on his win; will the U.S. return to its former standing on the international stage as the coalition maker?
- With Biden's administration, the U.S. could sign back onto the Paris Climate Agreement and start making steps to address climate change in the U.S., possibly through infrastructure spending in the clean energy space.

## CONCLUSION

With the actual election now complete, attention turns to conquering the coronavirus pandemic and the subsequent economic recovery. New policies set forth by Biden and Congress will undoubtedly aim to eliminate the virus and restore economic growth through additional stimulus. However, these initiatives are still several months away and until then, market volatility will continue, waxing and waning as news emerges about further outbreaks and/or vaccine progress. We encourage investors to remain diligent yet not overreact to headlines while focusing on strategic asset allocations and long-term portfolio performance goals.

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