



Thoughts on the U.S. election An equities perspective

For professional investors only



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With the day fast approaching for U.S. voters to express what they think *should* happen, we look at how equity markets and investors can only consider what *may* happen.

Key takeaways:

- A clean sweep versus a split outcome (in either direction) are equally as likely, at present.
- The latter could mean less legislative change and therefore impact equity markets positively.
- Expressing a political view via a portfolio is risky – better to adjust investments on the basis of how industries and firms may change as a result of policies.

Too close to call

The United States of America goes to the polls in early November with four main outcomes possible: Republicans or Democrats secure the White House as well as Congress (the ‘clean sweep’), and two outcomes where control is split, with either party controlling one of the White House or Congress but not both.

At the time of writing, national polling does not appear to indicate a lead for either candidate bigger than the forecast error and consequently the probabilities of each of the four scenarios are not significantly different. Any clean sweep outcome gives an incoming administration the greatest opportunity to implement its legislative agenda. Conversely, a split outcome complicates the passing of contentious legislation. It is interesting to note, therefore, that two of the four main outcomes are for control of the White House and Congress to be split. Because the polling remains very tight between candidates and across all four outcomes, in effect this suggests an approximately 50% chance of a moderate legislative outcome.

Such an outcome is likely to be well-received by equity markets. Investors price equities based upon what they think their future profits are worth but forecasting the size and timing of those future profits is complicated when there is lots of change. A split election result resulting in a moderate legislative agenda should mean less change than a clean sweep, supporting investors’ ability to confidently forecast future profits.

Taxes and tariffs: how the future could look

Either party could still achieve a clean sweep though. There are many differences between the candidates and their manifestos, but capital markets will inevitably focus most upon those with significant economic consequences. We may group these into three:

- **Corporation taxes:** the Republicans favour extending low rates, the Democrats favour increases. Increases could lead to U.S. earnings falling 5-6%. The current corporation tax rates, lowered by former President Trump, expire in 2025 and are unlikely to be extended for any outcome other than a Republican clean sweep of both the White House and Congress. Higher corporation taxes do not yet appear to be factored into bottom-up company earnings forecasts.
- **Tariffs:** the Republicans favour widespread import tariffs, which will increase prices in the short term until there is a domestic supply-side response. It is unclear the extent to which the tariff policy is a negotiating position or a firm commitment so forecasting the outcome is problematic. Some industries and supply chains may be impacted more than others and there is a possibility that it may complicate the Federal Reserve's efforts to get inflation back down to its 2% target. Tariffs are a policy tool exercised through the executive order giving a Republican president agency, even in the event of a split election result.
- **The budget deficit:** neither candidate has expressed a strategy for managing the size of the budget deficit. For the moment capital markets are accepting continued debt issuance. But if spending is pushed so far that the U.S. has to borrow to pay interest costs, market concerns over the sustainability of debt levels would increase, pushing up market interest rates. This would 'crowd out' availability of funding for companies, not just in the U.S. but internationally, and be a negative surprise given market expectations for lower rates in the U.S. and Europe.

It is important to remember that only voters get a chance to express what they think *should* happen. Equity markets and investors can only consider what *may* happen. This is an expression of risk but is also a risk that investors can choose how to respond to.

For the market, it is worth noting that elections are a regular feature of investing in democracies. They are always contentious and there is always speculation on the outcome. This can have a detrimental impact on investor confidence in the short-term, but the political situation is rarely as clear as it is the day after polling when the outcome is known. The increase in political clarity and reduction in uncertainty is usually a positive dynamic for equity markets. However, if there is a contested result, such as was seen in 2000, this dynamic may be weakened and delayed.

Tuning out the noise

Some investors may be tempted to express their views on what may, or even what should, happen to make allocations based upon polling or political concerns. In contrast, we recognise that we do not have a competitive advantage in predicting the outcome of the election; we invest in businesses, we are not political pundits. We think it would be a poor use of our risk budget, therefore, to allocate active risk to politics and are treating it as a risk to be diversified across a portfolio rather than an opportunity.

We consequently have maintained a balanced portfolio stance across multiple sectors, with the significant majority of active risk derived from stock-specific sources, consistent with our fundamental led, bottom-up approach. To the extent that policy actions lead to changes within industries, such as growth rates or the nature of competitive advantage, we will adjust our research agenda and, if necessary, our bottom-up assessment of company fundamentals. For example, heightened geopolitical tensions and the threat of tariffs is leading many companies to bring sourcing closer to home. This has fed into our assessment of end-market growth, a constituent part of our fundamental assessment of companies, and has led us to favour businesses exposed to factory automation whilst reducing exposure to investments exposed to international trade.

Elections need not be bad news

Although elections create a degree of uncertainty, they are a constant of investing in democracies and it is a feature of democracies that candidates compete through policies they believe will improve the lot of voters. Over the long-term, it hasn't tended to be elections that have determined long-term investment experience, but the value creation of corporate enterprise that has proceeded almost uninterrupted, save for occasional interruptions from economic cycles, war and pestilence. If investors want to speculate on the short-term outcome of the U.S. election for what *should* or *may* happen, betting on markets seem to be the most efficient way of doing so, not through their portfolios.

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