US Presidential elections; investment implications

- Whichever candidate wins the US Presidential elections, they will face the immediate challenge of dealing with the fiscal cliff and longer-term challenge of detailing a credible deficit reduction plan.
- The most important medium to long-term investment implication is likely to be at a sector level; the Democrats’ policy proposals favour alternative energy, infrastructure and medical care providers such as hospital groups.
- The Republican approach, with an emphasis on tax cuts and looser regulation as well as repealing ‘Obamacare’ could benefit financials, defense, auto manufacturers and pharmaceuticals.
- Monetary policy could also be less dovish under a Romney administration compared to an Obama administration.

Short term market reaction to election unclear

Should the Democrats be re-elected it would be easy to assume the US stock market would suffer a modest initial decline as investors expect a continuation of a divided government coupled with a lack of clarity on future business regulations. However, the increased likelihood of a continuation of dovish Federal Reserve policy led by Ben Bernanke may also be seen as a positive by investors (see below).

A Republican victory would normally be expected to result in an initial stock market gain on the back of expectations of more business friendly tax policies and less regulatory influence from Washington. However, Romney’s pledge to label China a “currency manipulator” on his first day in the Oval office could negatively impact stock markets. So even in the short-term, the difference in market reaction between the two candidates may not be so great or as clear cut as widely assumed.

‘It’s about sectors, stupid’

Even the longer-term direction of the stock market will not necessarily be determined by the outcome of the election as since the mid-1970s average S&P500 index returns have been very close under either a Democrat or Republican President (excluding the 2008/09 credit crisis). However the performance of certain sectors would likely be influenced by certain policy decisions. Indeed, to paraphrase Bill Clinton, in terms of investment implications, ‘it’s about sectors, stupid’. Lighter regulation in areas such as healthcare, environmental requirements for motor vehicles and financial services are likely to follow a Romney victory favouring pharmaceuticals, auto producers and financials. Coal producers and for-profit education providers are also expected to benefit from lighter regulations should the Republicans win the elections. Also defence companies are much less likely to be hit by automatic spending cuts next year under a Republican presidency.

Under a Democrat administration, medical care providers such as hospital groups are likely to do better due to an increased usage pool as Obamacare is maintained and not repealed. Similarly infrastructure (in particular telecoms and energy) may perform better under the Democrat administration as it will be more likely to boost public spending on infrastructure in an effort to boost the economy.
Alternative energy is also likely to do better under a Democrat administration with subsidies and tax breaks for this sector more likely to continue.

**Monetary policy could change under Romney**

From a monetary policy perspective a Republican victory could lead to a more hawkish central bank. Mitt Romney has said that if elected he would not reappoint Ben Bernanke, Federal Reserve Chairman, when his current term expires in January 2014. This could lead to more uncertainty over the nature of monetary policy in the future. Ben Bernanke has arguably been the most dovish Federal Reserve Chairman in US history favouring extremely low interest rates for an extended period of time and three rounds of Quantitative Easing (QE) asset purchases to date. Bond markets may suffer from a rise in yields and volatility caused by reduced monetary policy accommodation which would arguably be less supportive towards risk assets as well.

**Budgetary challenges ahead**

Whether President Obama or Governor Romney wins the upcoming election, it is evident that there will be a number of key budgetary challenges to be addressed which will most likely require bi-partisanship. The most pressing will be to deal with the so called ‘fiscal cliff’. The fiscal cliff refers to the fact that on current policies a large amount of tax increases are due to kick in at the beginning of 2013 and automatic spending cuts take effect as well.

It represents roughly $600bn (5% of GDP) in 2013, and if left unaddressed would probably tip the US economy back into recession. In reality, it is more likely that a compromise between Republicans and Democrats will lead to most elements of the fiscal cliff being postponed, but negotiations could go down to the wire and there remains the possibility of political gridlock. Indeed, it is not beyond the realms of possibility that most long term fiscal policy decisions are postponed again and that the US is hit with another credit rating downgrade. Whether Obama or Romney wins, we still think the most likely outcome is a compromise in Congress to reduce the size of the fiscal cliff. But it is also worth emphasising that the ‘tail risk’ of political gridlock with obvious negative implications for risk assets is higher under an Obama victory.

Indeed, looking at the political balance of power in Congress a gridlock scenario is more likely under an Obama re-election than with a Romney victory. Even if the Democrats win the presidency again, Republicans are likely to retain control of the House of Representatives while the Senate will probably remain in control of the Democrats by a very slight margin. This would require bi-partisanship and mutual cooperation in Congress to overcome challenges ahead such as the fiscal cliff and sustainable deficit reduction plans. In contrast, a Republican Presidential victory would likely also be accompanied by Republicans having the balance of power in Congress and so make it easier to force through their own policy proposals into legislation if necessary, boosting the chances of a near term resolution to the fiscal cliff.

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