Clinton vs. Trump: **Investment perspectives**

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With the **58th U.S. presidential election** days away, investors worldwide are asking what the **implications are for the economy** (and for their portfolios) of a Hillary Clinton or Donald Trump victory on Election Day – Tuesday, November 8, 2016. Canadians in particular have **a lot at stake**, given the United States is by far **our largest trading partner**.

Without taking sides or making predictions of the political results, this paper will briefly examine some of the possible economic and market consequences of various outcome scenarios.

- Macro overview
- Implications for Canada
- Clinton victory – Macro implications
  Sector winners and losers
- Trump victory – Macro implications
  Sector winners and losers

These comments are by no means comprehensive, and are based on statements and policy announcements released before and during the election campaign. There is no guarantee any policy proposal from either candidate will be acted upon during their time in office. Furthermore, if and as polling results leading up to Election Day suggest a more definitive outcome, markets will of course react accordingly, pricing in the likely outcome and perhaps leaving little reaction for the event itself.

There are of course a number of scenarios:

- **Clinton victory, Democratic sweep of Congress**. Long considered an unlikely scenario, the possibility of Democrats regaining control of both the U.S. House of Representatives and the U.S. Senate becomes real if Trump fails so miserably in the campaign that he drags down other Republican House of Representatives and Senate candidates with him. In a Democratic sweep scenario, expect a much more aggressive pursuit of Clinton's campaign platform positions that would be possible in a divided government.
- **Clinton victory, divided government.** Most observers have placed their bets on this outcome as

their base case, where the Democrats win back control of the Senate but leave the House of Representatives in Republican hands. In this scenario, Clinton would have to work in a more bipartisan, co-operative nature with the U.S. Congress, limiting the extent to which her legislative initiatives can be pushed.

- **Trump victory, Republican sweep of Congress.** Similar to the Democratic sweep scenario, this would likely result in an aggressive legislative agenda. A Trump victory with divided government is extremely improbable. Given the current make-up of Congress and likely voting patterns, it is unlikely we could see a Trump victory without an accompanying Republican sweep.

Macro overview

The market prefers Clinton

Historically, the statistics suggest the stock market will react more positively to a Clinton victory. Since 1928, the average annual return of the S&P 500 during the first year of a Democratic presidency is +16.4%. By comparison, the average annual return during the first year of a Republican presidency is only +0.8%. In the narrower sample of outgoing Democratic presidencies, average S&P 500 performance in the first year after a Republican takes over the White House from a Democrat is -10.2%, while consecutive Democratic presidencies leads on average to a +7.8% first year (Source: Strategas Research Partners, LLC).

Aside from the statistics and even the comparative policies, there is a sense in which investors can be reasonably certain of an equity market reacting more favourably to a Clinton victory than to a Trump victory. Markets hate uncertainty. Clinton's policy proposals, while still subject to the vagaries of legislative support, are at least available in some detail for analysts to consider. Trump on the other hand has offered very few specifics on major issues. On those economic issues

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that he has talked about, he has often prevaricated or even reversed positions. The populist rhetoric and lack of policy depth has led to expectations that a Trump presidency would be as erratic and uncertain in its style of governing as is his campaign. Policy uncertainty would without question pressure market multiples and valuations.

The biggest risk

A Trump win, and the implied Republican sweep, poses a serious risk to the U.S. economy if he follows through on his protectionist, anti-trade rhetoric. His threat to rip up existing treaties and impose new tariffs – even if there are limits to what can actually be accomplished under executive authority – would disrupt global supply chains, jeopardizing the integrated international trade system that has been the key foundation of decades of global growth and prosperity. A protectionist turn in the U.S. could be expected to significantly affect the broad market, multinationals in particular.

Furthermore, the projected massive increase in the deficit under his spending tax and spending proposals would certainly spook the bond market, putting pressure on the U.S. dollar. Trump's loose talk about defaulting on U.S. debt and his apparent lack of respect for Federal Reserve independence are also likely to reduce demand for U.S. assets.

In some ways it doesn't matter

There are a few things to look forward to regardless of who wins the White House in November.

- **Government austerity is over**. Every president in the last 50 years has introduced a large fiscal package early in their first term. George H.W. Bush and Bill Clinton both focused on increased taxes and austerity, but for every other president, it was stimulus. Government spending's contribution to gross domestic product (GDP) has now been growing for two years after being a net drag for over four years following the financial crisis. Both Clinton and Trump are expected to boost that even further with stimulative policies. Clinton's platform includes significant infrastructure spending, and defense spending (which is now rising on a year-over-year basis for the first time since 2011) and is expected to be given a boost under both candidates.
- **Tough path for Trans-Pacific Partnership (TPP)**. Trump has called the signed – but not ratified – TPP "a disaster", while Clinton has said she opposes the deal in its current form. Under the President's Trade Promotion Authority process, or "Fast Track", Congress would be required to give a simple yes or no vote on the 12-country treaty once it is presented. With neither candidate supporting the deal, don't expect it to be presented.
- **Some form of tax repatriation package**. Trump and the Republicans prefer to allow corporations holding profits overseas to bring them back with little or no additional tax. The Democrats, although favouring a higher minimum tax that would provide less incentive to repatriate, also would like to see some kind of deal. Any agreement on this issue would likely result in more share repurchases and dividend increases, as well as increased mergers and acquisitions and buyout activity as the cash was brought back to the U.S.

What does it all mean for Canada?

Historically, Canadian markets do better under Democratic administrations that they do under Republican administrations. This should come as no surprise given the significant U.S. market performance preference for Democrats described above, and the high correlation of the U.S. and Canadian markets generally.

Trade agreements

In general, less trade is bad for Canadian consumers, and with both candidates against the TPP, most Canadians will be less well off than they could be if the deal proceeded. In terms of businesses, non-ratification means less shipping, port traffic, logistics and transportation. Some industries, such as food processors and restaurants, could have looked forward to lower cost imported supplies under TPP. Others, such as the seafood sector, have been anxious to see expanded access to foreign markets currently marked by high tariffs. On the other hand, some analysts believe no TPP is possibly good for the Canadian auto sector which could lose some of its protection if the deal is implemented.

In addition to his characterization of TPP as a disaster, Trump has said he wants to end or renegotiate the North American Free Trade Agreement (NAFTA) and either renegotiate or pull out of the World Trade Organization (WTO). Clinton too has suggested she would like to see NAFTA "reassessed or adjusted". Talk of messing with NAFTA is a serious concern for Canadians, as the provisions of the agreement are extensively woven into almost all North American supply chains and trade patterns. Canadian trade with the U.S. has soared compared to our trade with the rest of the world after the deal came into force in 1994.

But before panicking over the threat to NAFTA, consider the following:

- In the 2008 U.S. campaign, both Obama and Clinton said they would renegotiate NAFTA. It never happened.
- Congressional approval for ripping up the deal is highly unlikely given the degree to which major beneficiaries of the agreement are to be found in many congressional districts.

- When Trump criticizes NAFTA, it is usually in the context of railing against flows to and from Mexico, not Canada. Even if the agreement were re-opened, it is not clear to what degree changes with Canada would be sought.

Keystone XL Pipeline

Clinton has stated opposition to the pipeline, which was rejected by Obama in 2015. Trump, on the other hand, has said he supports the project, but only if TransCanada gives the U.S. a "big, big chunk of the profits, or even ownership rights." It is not clear if that can be interpreted as actual practical support for the pipeline.

Other Canadian winners and losers

Beyond the implications for Keystone XL and companies dependant on NAFTA, there are a myriad of Canadian firms who do business in the U.S. and may see their opportunities expand or contract commensurate with the outlook for their respective U.S. industry counterparts.

With that in mind, let's take a broader look at potential winners and losers by sector under both Clinton and Trump proposals.

Clinton victory: Main macro-economic implications

Among the major economic proposals of the Clinton campaign:

- Stimulus spending on infrastructure
- Tax cuts for the middle class, tax hikes for high income earners
- Higher short-term capital gains tax
- Increased estate taxes
- Closing corporate tax loopholes
- Expanded social security
- Boosting the minimum wage to $15 per hour
- Education funding for preschool and low income earning college applicants
- Increased financial regulation
- Increased support for alternative energy initiatives
- Public option in health insurance exchanges, premium caps
- Limits on drug pricing, lower exclusivity period for biologics
- No change to leadership of Federal Reserve

> According to estimates from the Committee for a Responsible Federal Budget (CRFB), Clinton's economic proposals would **add roughly a quarter of a trillion dollars to the public debt**, raising it from 74% to 87% of GDP by 2026.

In the case of a Clinton-Democratic sweep, all the tax hike proposals are very much in play. So too is the increase in the minimum wage, which will especially hurt restaurants and retail (see Clinton "losers" below). A Democratic sweep also dramatically increases the chances of seeing action on climate change policies and drug pricing.

A divided government scenario would likely mean significant new energy and climate change policies, and regulation on financials will have a difficult time. Comprehensive or significant tax reform would also be doubtful.

Clinton 'winners'

The following list is not intended to be comprehensive. The degree to which any of these outcomes are likely depends on the size of the mandate received in the election and the make-up of Congress.

- **Infrastructure companies.** Clinton and the Democrats have proposed a doubling of public spending on infrastructure ($275 billion over five years) focused on ports, airports and highways (how this actually gets paid for will depend on the make-up of the House and Senate). She has also proposed an infrastructure bank to support private investment.

- **Solar, renewable energy.** Expect to see policies in support of solar and other alternative and renewable energy initiatives, including policies to increase the cost of fossil fuels. Clinton has voiced a goal of installing half a billion solar panels by 2020 and a reduction of carbon emissions to 30% below 2005 levels by 2025 (and a further 80% by 2050).

- **Hospitals, Medicaid HMOs.** A Clinton presidency would see the maintenance of the Affordable Care Act (ACA or "Obamacare"). With some modifications to ACA and the expansion of Medicare and Medicaid, providers would likely do better. Clinton has also talked of a government-provide option on the exchanges, but this proposal would see no support from Congress in a divided government scenario.

- **Life science equipment makers.** A democratic administration would likely direct more funding to the National Institutes of Health (NIH).

- **Selected manufacturers.** A proposed crackdown on trade violations would benefit companies exposed to competition from targeted countries (e.g., China).

Clinton 'losers'

- **Oil, natural gas, coal.** Clinton has talked of putting the coal industry out of business, and of imposing tougher regulations that will make fracking and other oil and gas operations more difficult. And she opposes Keystone XL.

- **Pharma and biotech, managed care.** Proposals to cap or lower prescription drug prices has been a major element of the Clinton campaign. Blocking excessive health insurance premium hikes and creating a public option on the exchange will pressure managed care companies. By mid-summer, both the biotech and managed care groups in the U.S. equity markets were moving with high (negative) correlation to the polls and the projected probability of a Clinton victory (large pharma on the other hand has been supported by investors reach for yield).

- **Financials.** Clinton is a supporter of the Dodd-Frank Act and has talked about giving regulators more power to break up risky or complex banks. Other proposals include a risk fee that will hit banks and investment firms, and a crackdown on loopholes utilized by hedge funds.

- **Restaurants, retail.** Hurt by higher minimum wages.

- **Multi-nationals.** Hurt by blocking of TPP opportunities, as well as less-friendly (than Trump's) proposal for foreign profit repatriation taxation.

- **Gun makers, tobacco.** Gun makers are thought to be at risk from possible liability legislation and a shift in the Supreme Court's support of the Second Amendment, after the potential addition of Clinton appointees. Other social targets such as tobacco firms may be subject to higher taxes and more regulation.

- **Student loan lenders.** Clinton has been an outspoken critic of the student loan industry.

- **Prison operators.** Proposals to reform immigration and the criminal justice system will reduce need for jail facilities.

Trump victory: Main macro-economic implications

According to estimates from the CFRB, Trump's campaign proposals would lead to much larger deficits, adding about $11.5 trillion to the public debt and bringing it to 127% of GDP by 2026.

Among his significant economic proposals:

- Block TPP, renegotiate WTO, end or renegotiate NAFTA
- Impose 45% tariff on Chinese goods unless the Yuan is allowed to float freely
- Impose 35% tariff on Mexican goods to punish U.S. firms that outsource
- Deport undocumented migrants (would reduce national labour force by about 5%)
- Reduce personal tax brackets, increase standard deductions, end inheritance and gift taxes, eliminate alternative minimum tax, tax capital gains and dividends at the top marginal rate, close loopholes for the wealthy
- Cut top corporate tax rate from 35% to 15%
- Allow firms to repatriate foreign earnings at 10% rate or less
- Close loopholes benefiting hedge fund managers

It is generally thought that the significant tax reductions in his platform would be very stimulative in the short run, but the resulting debt projected by the CFRB would put upward pressure on interest rates, which could create serious problems longer term.

Trump 'winners'

- **Energy.** Trump supports opening up more areas for drilling, supports Keystone XL, and has spoken out in favour of coal.
- **Defense, homeland security.** Expect increasing intelligence work, more spending on defense, enforcing borders, and focus on fighting ISIS.
- **Consumer discretionary.** Benefit from increased spending spurred by lower taxes and low and moderate income workers.
- **Multi-nationals with offshore cash**. Favourable reform on repatriation taxes.
- **Financials.** Trump is critical of the Fed's easy money policies. Higher rates under a new Fed chairperson would boost bank profitability. Trump also opposes breaking up big banks and has said he would change or repeal Dodd-Frank.
- **Private health insurers.** Wants to repeal ACA and replace it with private plans.
- **Domestic companies hurt by international competition.** Protectionist, anti-trade agenda.
- **Infrastructure companies.** Trump's proposal to build a wall between the U.S. and Mexico could be a boon for the industry.

Trump 'losers'

- **U.S. multinationals.** Most U.S. multinationals will be put at a significant disadvantage if future trade deals are scuppered and existing ones undone. Also suffering will be railroads and shipping companies – in particular those leveraged to trade with Mexico and China.
- **Alternative energy.** Trump opposes wind turbines and doesn't believe in climate change. Look for the Republicans to roll back subsidies and tax breaks for alternative and renewable energy.
- **Outsourcing companies.** They will be hurt by tariffs on goods imported from Mexico, and changes to the H1-B visa program.

- **Housing.** Expelling millions of illegal migrants will reduce demand for housing and rental accommodations. Tax reform proposals might curtail tax breaks for housing and raise mortgage rates through housing finance reform.
- **Pharma.** Trump supports legislation to allow price negotiation of Medicare prescription drug costs.
- **Money transfer companies.** Fewer illegal migrants means fewer remittances to Mexico and elsewhere.

Final thoughts

As Election Day approaches, many pundits will be looking at the level of the U.S. equity market in addition to the latest polling numbers for an indication of the probable outcome, believing that the probability of a Clinton victory is positively correlated with the S&P.

This is nothing new - S&P 500 performance in the three months prior to the election has correctly predicted the outcome in 19 of the last 22 contests, and every one since 1984. Why? Because both the market and the polls are reacting to the level of economic optimism. If the economy is doing well, stocks tend to go up. And if voters are feeling good about the state of the economy, they tend to feel more satisfied with the incumbent party. Conversely, a lower stock market would be reflecting a struggling economy, for which voters will blame the incumbent party.

Given the degree to which investors fear the effects of a Trump presidency (as outlined above in the Macro overview section on page 2), it is possible the stock market at the margin may actually contribute to the election result, rather than just anticipating it. If Clinton advances in opinion polls, investor relief may be manifested in support for equities, which in turn contributes to voter sentiment through the wealth-effect. And positive economic sentiment translates into more incumbent support.

It is also important to remember that polls can be volatile. Trump's momentum after the GOP convention bounced and his numbers subsequently collapsed through early August. Furthermore, polls can simply be wrong, as demonstrated recently in both the British general election and the EU-Brexit vote.

In an election year unlike others in so many unpredictable ways, confidence in a well-defined long-term strategy as part of your financial plan is key to guiding you through the potential volatility.