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A Biden victory and split Congress may be welcomed by markets

by Mona Mahajan | 10/11/2020

Summary

With President-elect Joe Biden facing a split Congress, investors could welcome the resulting "Biden-lite" agenda, which may include portions of his spending plans – such as fiscal stimulus and infrastructure investment – but little in the way of tax increases.

Key takeaways

- Markets staged an impressive relief rally during the week of the US presidential election; while the market narrative shifted from a Democratic "blue wave" to a narrower margin of victory for Joe Biden, the overall tone seemed to be risk-on in financial markets
- Key priorities for the Biden administration will likely include building a new pandemic taskforce, passing fiscal stimulus, funding infrastructure, and enacting climate policy via executive order
- The Biden administration's renewed focus on infrastructure spending and initiatives related to climate change and clean energy could create new opportunities for investors, including in the private markets space
- With a potential "Biden-lite" policy agenda, markets will likely shift their focus to economic fundamentals, particularly around the prospect of an effective vaccine to counter Covid-19
- Stronger potential US economic growth, alongside low interest rates and further stimulus, may provide a favourable backdrop for risk markets globally in 2021

Joe Biden's apparent victory in the US presidential election marks an end to months of political uncertainty and turmoil. While both Mr Biden's victory and the outcome of the Senate races have yet to legally finalised – with two Senate races in Georgia set to be determined in January 2021 – the base case in markets seems to be a Biden presidency and split Congress. This outcome may usher in a more diluted Biden policy agenda.

Indeed, the market narrative seemed to shift in the final days before the election: hopes of a Democratic "blue wave" turned into cheer around "Biden lite", as Treasury yields declined and equity investors rotated from cyclical value stocks towards opportunities in growth and technology.

More broadly, the financial markets seemed relieved that this major political event was concluding, leading to a wave of risk-on sentiment in the US and globally. With a more incremental approach to policy changes under a Biden administration, we could see markets perform favourably, as both the US and non-US markets potentially benefit from more stable trade relations and better growth prospects heading into 2021. Markets may be buoyed by a return to a more multilateral approach to foreign policy, and the reduced uncertainty that may result.

Perhaps the key concern for markets under a Biden presidency was his proposed USD 4 trillion in tax hikes, including increasing corporate tax rates, capital gains taxes, and personal taxes on wealthy individuals. However, if Congress is divided, most – if not all – of these tax policies will be difficult to enact. And importantly, the Biden team may not view these as a year-one priority, as the pandemic and economic relief take centre stage again.

Top priorities of a Biden-Harris administration

As President-elect Biden and Vice-President-elect Kamala Harris consider their key priorities in the weeks ahead – potentially in the absence of a traditional concession from the sitting president – these focus areas could include:

Creation of a new pandemic taskforce

As the coronavirus pandemic remains rampant in the US and globally, one of the Biden team's first priorities will be to address the virus head-on, with support from a new pandemic taskforce of scientists and medical officials. This will set guidelines to stop outbreaks, double down on testing and contact tracing, and invest heavily in vaccine distribution. This will mark a return to "relying on the science" as a fundamental pillar in managing the pandemic.

Fiscal stimulus

One area of agreement for both Democrats and Republicans is the need for an additional fiscal stimulus to provide pandemic relief – albeit in varying amounts. Thus far, Congress has issued nearly USD 3 trillion in stimulus, and Democrats and Republicans have proposed competing packages for a next round of stimulus of USD 2.2 trillion and USD 500 billion respectively. Both packages cover unemployment benefits, small business relief, and another round of stimulus cheques to households. Notably, Senate majority leader Mitch McConnell has indicated he would like to see a deal done, perhaps even in the lame-duck period before inauguration day. We could certainly see stimulus passed early in the next presidential term, which is likely positive for risk assets.

More executive orders on climate and clean energy

Mr Biden's plan includes a USD 2 trillion investment in areas of clean energy, including wind, solar and renewable energy. While this policy would likely face opposition in a split Congress, we may still see a Biden presidency seek to push forward his climate and sustainability agenda via executive order, and he may appoint more "environmentally friendly" leaders to his cabinet. Overall, we could see new opportunities for sustainable investing under an administration that is pledged to take climate change seriously. Some actions that the new president could take without the support of Congress may include:

- Rejoining the global Paris climate accord, which aims to keep the global temperature rise this century to under 2 degrees Celsius above pre-industrial levels
- Reversing some of President Trump's executive orders on energy, including a March 2017 order for federal agencies to dismantle their climate policies
- Signing executive orders to cut emissions, including instructing agencies to develop methane limits and tightening efficiency standards for buildings and appliances.

Infrastructure investment

Another area where both Democrats and Republicans may ultimately agree is infrastructure investment. Both Mr Biden and Mr Trump have talked about investing in traditional infrastructure – such as the rebuilding of roads, bridges and airports – as well as technology infrastructure like 5G and artificial intelligence. While the Biden team proposed a USD 1.3 trillion infrastructure package, we may ultimately see a smaller package approved by both sides, perhaps in the USD 750 billion range. This would nonetheless represent an important investment in US economic growth and potential jobs. It could also stimulate opportunities in the private markets space to help finance these critical projects.

Returning the US to the world stage

In addition to rejoining the Paris climate accord, Mr Biden has also talked about restoring US membership in the World Health Organization (WHO), as well as repealing via executive order the travel ban on majority Muslim countries. Overall, a Biden administration would favour the US returning to the world stage as an ally and leader, aligning itself once again with its historical allies and perhaps coordinating globally on climate solutions.

In terms of US-China relations, while Mr Biden has pledged to be "tough on China", he has indicated he prefers a less unilateral approach than his predecessor and plans to bring US allies, labour groups and environmental organisations to the negotiating table. Mr Biden could repeal some tariffs via executive order but may also use these for negotiating leverage.

Reaching across the aisle

With a focus on reconciliation, a Biden administration may "reach across the aisle" for Cabinet and key position appointments. Indeed, there has been speculation that Mr Biden may maintain Mr Trump appointee Jerome Powell as chairman of the Federal Reserve and consider Republican senator Mitt Romney for the position of US Treasury secretary. Markets may welcome this balanced approach to governing, particularly in key roles impacting financial policy.

Markets like evolution, not revolution

Overall, the theme of a Biden victory and split Congress seems to be evolution rather than revolution – perhaps what voters and investors welcome most when it comes to government policy. This outcome also perhaps lessens the probability of unintended consequences that we may have seen from a "blue wave" – such as rapidly rising interest rates which could be disruptive to markets. Also note that, historically, investors have seen seasonally stronger market returns from election day through year-end.

Implications for investors

- Against this backdrop, we could see a broadening of participation across asset classes, with cyclical parts of the market performing alongside growth technology, and non-US markets playing catch-up, especially given more congenial global relationships and perhaps an ongoing softer US dollar. Notably, China and north Asia could benefit most from a thawing of tension, alongside better virus outcomes in that region overall.
- In credit markets, with yields expected to remain stable and low, we would continue to see investors "hunt for income". Our preferred credit risk includes parts of select high-yield assets (including "fallen angel" strategies), convertible bonds (which can participate in equity upside as well) and curve- steepener strategies that benefit from better growth and inflation potential.
- Finally, we see potential areas of opportunity outside of traditional value/growth strategies, including infrastructure, clean energy, US housing, and technology infrastructure like 5G – all of which could thrive in a post-election environment.

With the presidential race seemingly decided, there are several reasons to be optimistic about the broader economic environment as we head into 2021, particularly if we see one or more Covid-19 vaccines approved – see our earlier piece for full analysis.

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