

## The potential impact of a surprise Trump victory

By Angelo Katsoras

### Introduction

Former U.S. Vice-President Joe Biden remains the overwhelming favourite to become the next president of the United States. However, recent polls, particularly in the battleground states, have tightened somewhat. This race could become even more competitive should the following scenarios play out:

- The U.S. economy continues to reopen and gradually recovers.
- A successful vaccine is announced just before the election.
- Polls underestimate the number of Trump supporters, many of whom are unwilling to tell pollsters what they really think.
- The perception that Democrats have moved too far the left on the political spectrum and have gone soft on law and order gains traction.

### U.S.: General Election – Biden leads the polls

Real Clear Politics Poll Average as at 9/21/2020

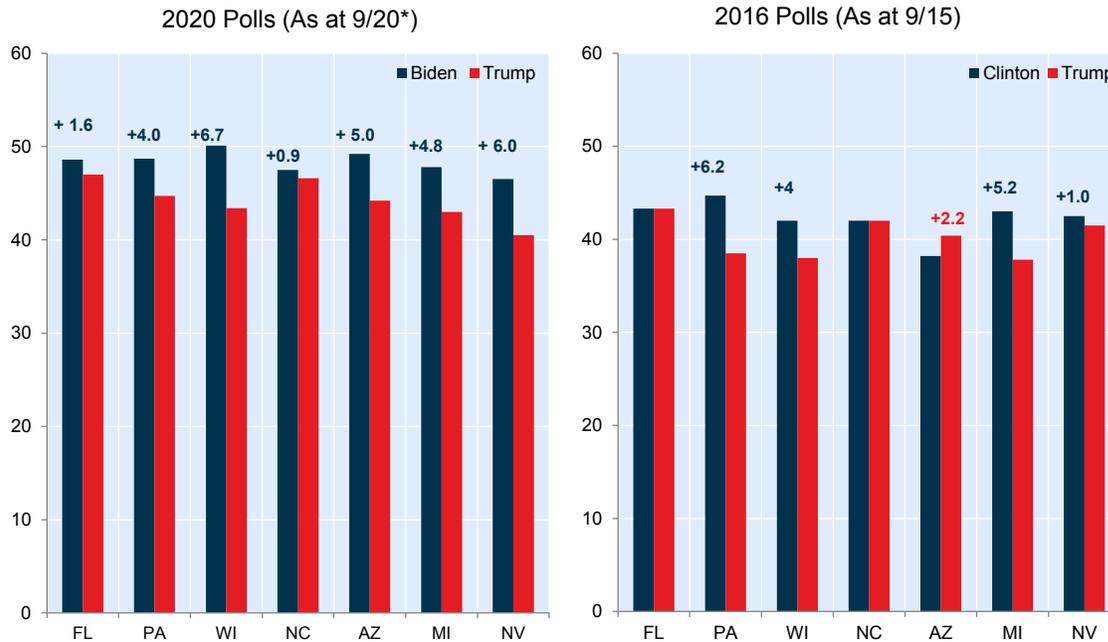


NBF Economics and Strategy (data via Real Clear Politics)

As the following charts illustrate, Trump was polling behind Clinton, too, in most of the battleground states in 2016 but then went on to win all the states listed below, with the exception of Nevada.

### Like 2020, Trump was polling behind Clinton in most battleground states in 2016

Battlegrounds – September 2020 Polls vs. September 2016 Polls in crucial states



\*Nevada 2020 data as at September 5 to 10 (latest available)

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Should Trump pull off a surprise victory, his second term would likely be spent continuing to pursue his first-term priorities. These include further deregulation, lower taxes, appointing more conservative judges, protectionist trade policies, and further decoupling from China. Also, government-led efforts to compete with China for leadership in key sectors would intensify.

This report examines Trump's second-term priorities in greater detail. The growing risk of a contested election is also analyzed.

### Greater government involvement in healthcare

Breaking with traditional Republican free-market orthodoxy, Trump's re-election platform includes pledges to lower prescription drug prices, cover all pre-existing conditions, cut insurance premiums, and stockpile essential medical equipment for future pandemics.<sup>1</sup> Many other countries will be stockpiling as well, thus ensuring a bull market in this sector for years to come.

Drug companies, however, face the risk of price controls regardless of who wins the election. Biden supports allowing Medicare to negotiate drug prices, while Trump recently signed executive orders aimed at lowering the cost of prescription drugs. One requires healthcare providers to pass along the price discounts that they receive on certain drugs directly to patients. Another requires Medicare to purchase drugs at the same prices that other developed countries pay. This executive order will no doubt be challenged in the courts by Big Pharma.

Unlike in 2017, Trump has recently gone silent on his vow to repeal Obamacare, including not being mentioned in his official platform. The Supreme Court will be hearing a case against Obamacare on November 10 and will probably not render a decision for many months. The most likely outcome is that much of the law will be left in place.

<sup>1</sup> "TRUMP CAMPAIGN ANNOUNCES PRESIDENT TRUMP'S 2ND TERM AGENDA: FIGHTING FOR YOU!" 2020

Regardless of who wins the election, two factors will lead to greater healthcare coverage:

1. The pandemic is highlighting the fact that healthcare inaccessibility does not just hurt the individual, it can potentially undermine the health of an entire population.
2. History demonstrates that once a social benefit has been extended, in this case temporary financial support to COVID-19 patients lacking insurance, it is nearly impossible to claw back. In 1961, Ronald Reagan warned that if Medicare was passed into law (this occurred in 1965), Americans would lose their economic freedom. Needless to say that when Reagan became president in 1980, he did not abolish Medicare.

## Trump would push for lower taxes in the short term...

The following bullets taken from Trump's official platform highlight his continual push to lower taxes:

- Cut taxes to boost pay and keep jobs in the United States
- Tax credits for companies that repatriate jobs from China<sup>2</sup>

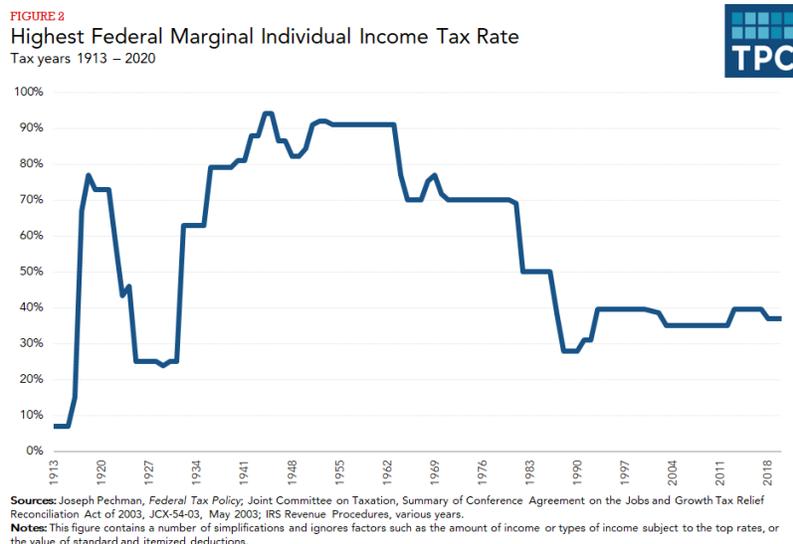
Surprisingly, Trump's official platform does not mention two positions that he has publicly supported in the recent past: 1) extending his 2017 individual tax cuts, which took effect in 2018, past their expiration date of 2025; and 2) cutting capital gains taxes, which Trump wants to reduce from today's 23.8% to 15%. In contrast, Biden would raise the rate to 39.6% to match taxes on ordinary income for those with incomes exceeding \$1 million.

More recently, the president signed an executive order temporarily suspending payroll taxes through December 31 for employees earning \$100,000 and less with the aim of boosting their income during the pandemic. If re-elected, he would push for this temporary tax cut to be made permanent. He has promised to replace the lost tax revenue, which funds Social Security and Medicare, with other government funds.

It is important to note that the odds of passing further tax cuts would be exceedingly low given the high likelihood that the House of Representatives would remain under Democratic control. The size of the budget deficit would also limit the scope for cuts.

## ...but could be forced to raise certain taxes over the longer term.

As the chart below illustrates, the most significant income tax hikes in the past were implemented in the wake of the Great Depression and both World Wars. In fact, the top marginal income tax rate did not begin to decline significantly until the early 1960s, when it went from a high of 91% to a low of 28% in 1986. It currently stands at 37%. If the past is any indication of the future, the severity of this downturn, the worst since the Great Depression, would suggest that tax hikes are inevitable regardless of who wins the election, although it is safe to assume that taxes would be much higher under a Democratic administration.<sup>3</sup>



<sup>2</sup> "TRUMP CAMPAIGN ANNOUNCES PRESIDENT TRUMP'S 2ND TERM AGENDA: FIGHTING FOR YOU!" 2020

<sup>3</sup> "Key Elements of the U.S. Tax System," Tax Policy Center (Brookings Institution), 2020

Given that Trump's political base is working class, it would be politically more expedient to raise taxes on high-income earners who, as the table below shows, voted overwhelmingly for Clinton in 2016.

## Candidates' counties won and share of GDP in 2000 and 2016

Year	Candidates	# of Counties won	Aggregate share of GDP
2000	Al Gore	659	54%
	George W. Bush	2397	46%
2016	Hillary Clinton	472	64%
	Donald Trump	2584	36%

*Source: Brookings analysis of Moody's Analytics estimate*

## Continued protectionism with focus on China

On trade, Trump would maintain his hardline stance on China. Disputes over Huawei's access to 5G networks and China's access to U.S. semiconductor technology would only intensify. His official campaign goals regarding trade and in particular China include the following:

- Allow 100% expensing deductions for essential industries such as pharmaceuticals and robotics that bring their manufacturing operations back to the United States from countries such as China
- No federal contracts to companies that outsource to China<sup>4</sup>
- Produce all critical medical supplies and treatments in the United States: While Trump has already signed an executive order to this effect, it will take several years and tens of billions of dollars in investments to restore this capacity.

Trump has also cancelled Phase 2 trade negotiations with China, citing his displeasure with China's handling of Covid-19 as justification for the decision. One potential black swan scenario would have Trump canceling the deal altogether and increasing tariffs immediately following the election.

Strong bipartisan support in favour of taking a hard line against China would force a Biden administration to keep most of Trump's policies in place and perhaps even impose further tariffs. For example, China would be targeted by Biden's environmental plan, which would impose tariffs against countries with lower environmental standards. China would no doubt respond to such a move with counter tariffs. Biden has also promised to reduce America's economic dependence on China.

As he did with NAFTA and South Korea, Trump would continue his drive to renegotiate past trade deals. Next on the list could be trade with the EU, although he would likely shy away from taking drastic measures in order to focus his energy on China and on rebuilding America's economy.

<sup>4</sup> 'TRUMP CAMPAIGN ANNOUNCES PRESIDENT TRUMP'S 2ND TERM AGENDA: FIGHTING FOR YOU!' 2020

## Would Trump be able to get an infrastructure bill passed?

Despite the fact that both Republicans and Democrats have long supported increased infrastructure spending, they have so far been unable to agree on a bill for one main reason: Republicans tend to support an infrastructure plan led primarily by the private sector, whereas Democrats support much more government involvement focused on green initiatives.

Barring the very unlikely scenario of Republicans winning the presidency and both chambers of Congress, a divided government would make it very difficult for both sides to agree on an infrastructure package. At best they could agree on certain measures, such as expanding high-speed internet infrastructure and public transportation.

## Energy and the environment

In contrast to a Biden administration, a Trump presidency would continue to remove regulatory hurdles to oil, gas and coal production by way of executive order. Trump's accomplishments in his first term include rolling back limits on carbon dioxide emissions for power plants, expanding oil and gas drilling on federal lands, and withdrawing from the Paris climate agreement.

Trump has long said that he withdrew from the 2015 Paris Climate Agreement because it was unfair for the United States to have to reduce carbon emissions by 26% to 28% of 2005 levels by 2025 while China committed to start reducing emissions only as of 2030. China also promised in 2015 to more than double its energy production from renewable sources to 20% by 2030.

## IT sector under Trump

For starters, we feel that the tense relations with China increase the likelihood of IT companies not being broken up by either a Democratic or a Republican president because neither wants U.S. companies to become much smaller than their Chinese rivals.

However, there is strong bipartisan support for more scrutiny of IT companies. The Trump administration is conducting a wide-ranging antitrust probe into major tech companies. Like Biden, Trump has in the past called for the lifting of legal immunity for internet companies regarding content posted by their users, a position that is steadily gaining bipartisan support in Congress.

## Competition between China and United States could drive innovation

Growing tensions between China and the United States have substantially raised costs for many companies thanks to greater protectionism and the obligation of having to operate within increasingly separate economic zones, which entails, among other things, managing different standards and sometimes building separate supply chains.

Some people argue, however, that this great power competition could ultimately spur major technological breakthroughs. Indeed, both China and the United States are in the process of significantly ramping up government investments in research and development in an effort to dominate the next generation of technologies.

A similar thing happened after the Soviet Union launched the world's first space satellite in 1957. Fears that the United States had lost its technological pre-eminence led the government to invest massively in technological innovation through such government organizations as the Defense Advanced Research Projects Agency (DARPA). Unlike the private sector, DARPA could focus on long-term research without worrying about generating profits. In fact, as listed below, many of the innovations that have transformed the global economy originated with DARPA. The private sector took these inventions and transformed them into revenue-generating mega-trends. Without institutions like DARPA, Silicon Valley would only be a shadow of what it is today.

## Some of DARPA's major accomplishments

- 1 **The internet** — From 1962-69 Darpa developed a way to connect computers over a network, based on a paper by Joseph Licklider. The research took place at precisely the same period as the race to land on the moon. Some would argue that Arpanet, as it was initially known, was more important.
- 2 **Siri** — Darpa started researching voice recognition combined with artificial intelligence in 2003. Siri was an offshoot company, acquired by Apple in 2010.
- 3 **GPS** — The first satellite positioning system was launched in 1960.
- 4 **Stealth aircraft** — Darpa oversaw the development of HAVE Blue, the first viable combat stealth aircraft, which made its first test flight in 1977.
- 5 **The Mouse** — Computer controller, not rodent. Developed by Doug Engelbart.
- 6 **Drones** — Amber, the first long range Unmanned Aerial Vehicle, was launched in 1988.
- 7 **Autonomous vehicles** — A fruit of the Darpa Grand Challenges from 2004 to drive an unmanned vehicle 150 miles across the Mojave desert.

Source: "It is time for the UK tech sector to embrace 'moonshot' research," The Telegraph, March 30, 2020

## A divided Congress

Currently, the Democrats control the House of Representatives by a wide margin (233 seats to the Republican's 196, with 5 seats vacant). In the Senate, Republicans hold 53 seats and the Democrats, 47.

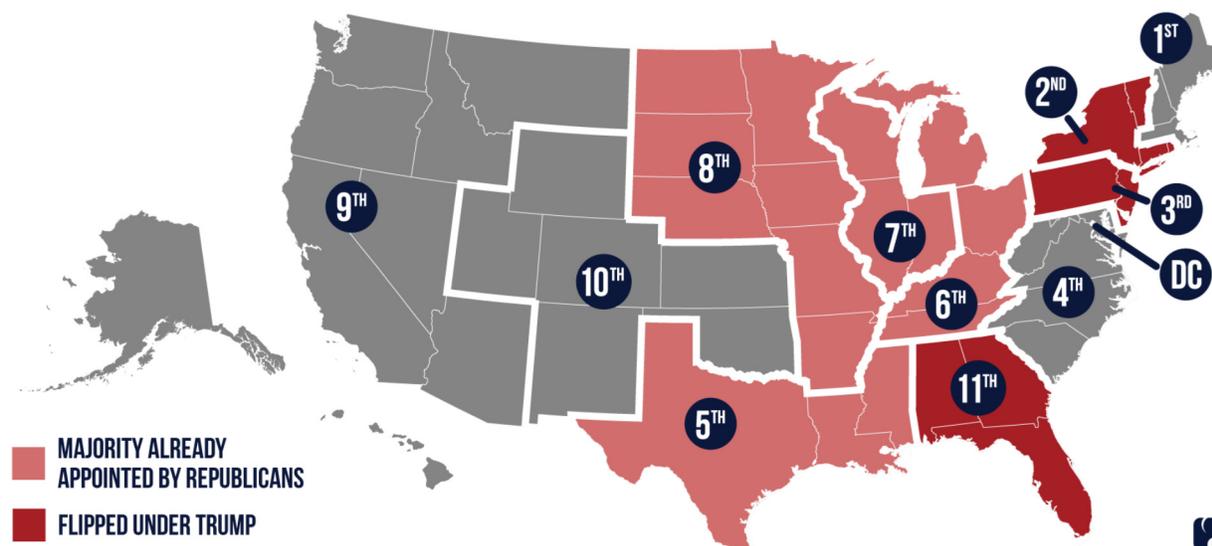
Were Trump to win the upcoming election, the most likely scenario is that Republicans will keep control of the Senate and Democrats will maintain their hold of the House. A divided Congress means that the Trump administration would largely try to advance its agenda via executive order, while the Democrats would seek to challenge these orders in the courts. This makes getting one's allies nominated to the courts more important than ever.

## Battle for control of the courts

While the Supreme Court may be the highest legal body in the land, it only hears a very small number of cases annually (100 to 150). The vast majority of federal lawsuits are heard one level lower in the 13 circuit courts. As of June 2020, Trump had appointed 53 judges to circuit courts. By comparison, Obama appointed 55 over the span of two terms.<sup>5</sup> There are 179 circuit court judges in all. Since Trump came to power, three of the courts have gone from a majority of judges appointed by Democratic presidents to a majority appointed by Republican presidents.

<sup>5</sup> "Since 2017, The Senate Republican Majority Has Confirmed 200 Article III Judges," Mitch McConnell, Senate Majority Leader, June 24, 2020

## America's 13 circuit courts



Source: "Flipping Circuit Courts," Senate Republican Committee, December 10, 2019

## Growing risk of a contested election

One scenario with the potential to rattle the markets is a close presidential election where one candidate openly questions the legitimacy of the results. This could involve mail-in votes still not fully counted days or weeks past election day. In 2016, 24% of ballots cast in the presidential election were mailed in. This percentage will no doubt be much higher this time around as more voters will shun polling stations to avoid the risk of infection.

Something similar to this scenario occurred in 2000 between George W. Bush and Al Gore. The election hung in the balance for five weeks amid a battle over vote counting in Florida. The winner was declared on December 13 only once Gore conceded defeat after the Supreme Court intervened to award Bush the state. During the five-week wait, the S&P fell 12%, although the dotcom collapse also played a role in the decline.<sup>6</sup>

An indication of the delays that could ensue this time around was provided by New York's Democratic Congressional primaries on June 23. The volume of mailed ballots was ten times higher than usual and, in some congressional contests, the winners were not announced until well over a month later.<sup>7</sup>

Given the animosity between the two parties and their supporters, a replay of 2000 would likely be even tenser, with both parties portraying the other side as a threat to the country's future. It is also important to note that that dispute in Florida took place during a much calmer period than today. It occurred before all of the following: 9/11, China's ascension as a world power, the rise of divisive social media, and Covid-19.

Not surprisingly, both campaigns have put together massive legal teams to prepare for the risk of a contested election.

Officially, states must certify their electors by December 8 and electors must then cast their ballots by December 14. Congress then meets to ratify the results on January 6, and the president is inaugurated on January 20. In the event that no president is chosen by the date of the inauguration, an acting president would have to be chosen to temporarily lead the country until the leadership dispute is resolved. Some constitutional experts say this person would be Speaker of the House Nancy Pelosi, although Republicans would no doubt vigorously oppose this choice.<sup>8</sup>

<sup>6</sup> "If Joe Biden wins the U.S. presidential election, will the market collapse?" The Globe and Mail, July 31, 2020

<sup>7</sup> "Markets Aren't Great at Handling Contested Elections," Bloomberg, September 2, 2020

<sup>8</sup> "What happens if Trump loses but refuses to concede," The Financial Times, September 14, 2020

## Conclusion

The recent tightening of polls, especially in the battleground states, is requiring that investors analyze the potential impact of a surprise victory for Trump. Similar to 2016, his victory would likely also entail winning the electoral college but losing the popular vote – an outcome his opponents would no doubt find hard to accept.

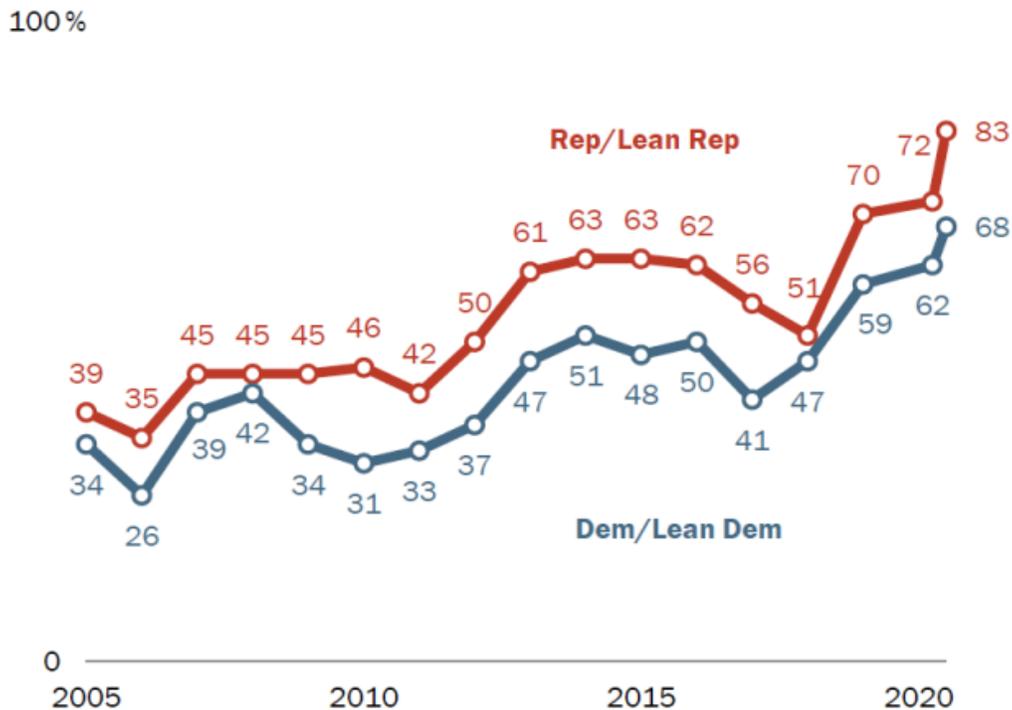
If Trump prevails, it is almost certain that he will preside over a divided government where the Republicans maintain control of the Senate and the Democrats hold the majority in the House of Representatives.

This in turn would force Trump to largely govern by way of executive order in setting policy in areas such as healthcare, energy, and financial regulations. The Democrats would respond by challenging the legality of these orders. Investors can make a reasonable guess as to how courts would rule on the legality of Trump’s executive orders based on whether most of the judges in a particular circuit court were nominated by Republicans or Democrats.

One subject on which legislation could be passed is China. Most recent legislation targeting China, including sanctioning its actions in Hong Kong, have passed with near-unanimous support in Congress. Indeed, anti-Chinese sentiment has increased almost as much among Democrats as it has with Republicans over the last few years. This means, for example, that Trump’s promise to award no federal contracts to companies that outsource to China would likely meet with strong bipartisan support in the Congress. For most other legislation not involving China, however, gridlock would remain the norm.

### Republicans remain more unfavorable toward China, but all partisans are increasingly negative

*% who say they have an unfavorable opinion of China*



Source: Survey of U.S. adults conducted June 16-July 14, 2020. Q8b. "Americans Fault China for Its Role in the Spread of COVID-19"

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Finally, the growing risk of a contested election would likely unsettle markets, at least until the winner is chosen. This scenario could lead to a temporary dip in stocks, push gold prices up, and place downward pressure on the U.S. dollar (potentially forcing the central bank to intervene).



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