Research
Asset Allocation

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US Elections:
Investing Amid Political Risk

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Executive Summary

Key Points

- Polls suggest the general mood in the US is gloomy and the electorate disapproving Trump on many key election issues, according to RealClearPolitics. Media sentiment suggests that Trump is losing ground against Biden both in the entire country and in key swing states.
- There is some evidence that sectors (particularly Tech) appear to be more sensitive around the election date than cap factors and smart beta.
- Investors seem to position their portfolios cautiously before elections and only venture slowly back to equities afterwards.
- Macro momentum, rather than the current state of the economy, is likely to be important in the election and Trump is currently trailing past re-election winners on key indicators.

Emerging Policy Themes for 2020 Presidential Election

Policy Themes	Expected Impact in a Policy Change Scenario, e.g. a Democratic Victory
Higher corporate tax	Adversely affects all sectors except IT and Real Estate
Higher minimum tax rate on foreign earnings	Adversely affects mainly Communication Services, Health Care and Tech
Higher payroll taxes on high earners	Negatively impacts Communication Services, Tech and Financials mainly
Climate change/green policies	Negatively impacts Energy and, to some extent, Materials and Industrials. Utilities could be a winner with green policies
Consumer protection and antitrust	Mainly Communication Services affected
Health care	Health Care (Biotech/Pharma and Health Care Services more vulnerable than Health Care Equipment)
Labour market reforms	Consumer Staples and Consumer Discretionary vulnerable to an increase in minimum wage. Tech and Communication Services may benefit from easing of immigration rules
Public spending	Materials, Industrials and Health Care could benefit. Impact on Aerospace & Defence finely balanced
Small business	May underperform large caps as small business outperformed more under Republicans in the recent past

Potential Outcomes

Scenario A: Clean Democratic sweep We favour Fossil Fuel Free/ESG, Infrastructure, Health Care, dividends.

Scenario B: Democratic President, Republican Senate We favour Fossil Fuel Free/ESG, Infrastructure, dividends, Discretionary.

Scenario C: A disputed Biden or Trump victory We favour low volatility, Staples, Utilities.

Scenario D: Trump is re-elected, status quo We favour Infrastructure, Utilities, Oil & Gas, and mid/small caps.

Introduction

Polls Suggest a Gloomy Mood in the US and Trump Faces High Disapproval Ratings

With the election fast approaching, public sentiment surveys, polls and betting markets all imply that former vice president Joe Biden remains the slight favourite to defeat incumbent Donald Trump in the upcoming presidential elections. These projections stand in marked contrast with predictions at the start of the year when Trump was widely expected to be re-elected in light of his incumbency advantage.

However, a combination of the deteriorating economy, a perception of incompetence in the handling of the COVID-19 pandemic and recent social unrest have eroded his once clear path to re-election. Polling shows widespread dissatisfaction across the spectrum. In a recent Gallup poll, a meagre 13% of total participants were pleased with the current state of affairs in the US, a thumping drop from 41%[1] since January. According to another recent survey published by the Pew Research Center, the collapse in Republicans' satisfaction was even more drastic, falling from 55% of the respondents in April to just 19% in June.

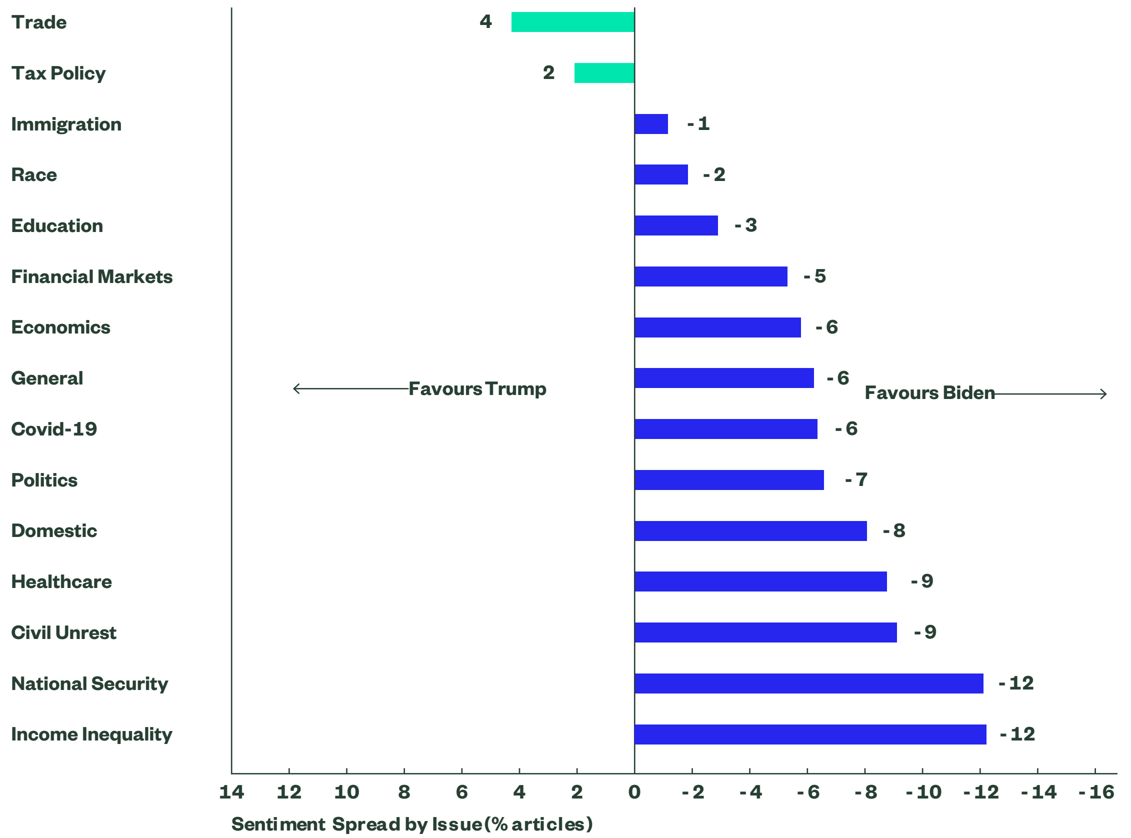
Along with this poor general sentiment, national polls suggest that the public may have also turned against the president on many specific issues, based on our analysis of media sentiment. Indeed, Trump only maintains a sentiment advantage on tax policy and trade while Biden leads on most of the important issues, including the handling of COVID-19 and civil unrest (see Figure 1). The last poll of polls compiled by Real Clear Politics indicates that Biden's ratings stand at 49.1% with Trump's at 42.7%.[2]

While national polls are important, it should not be forgotten that previous Democratic presidential nominee Hillary Clinton, despite winning the popular vote, was defeated by Trump as she did not garner enough electoral college votes from the swing states. Even in this area, Biden appears to have the upper hand. If the election were held today, he would deliver Trump a staggering defeat by receiving 308 electoral votes, 230 votes more than the incumbent.[3]

Given the stakes of this presidential election, including with regard to policy implications, investors can expect the election to receive intense coverage in the run-up to November. Although, to enact significant reforms and implement contentious or partisan policies, it would be necessary to control the presidency and Congress (the Senate and the House of Representatives). Only on five occasions since 1989 did a single political party control both Congress and the presidency concurrently and 2020 has the potential to be another such year.

All may appear rosy for the Democrats but, as we learned in 2016, having a strong poll lead at this stage may not define the outcome of the contest. Investors should therefore remain cautious, given polling errors. However, even at this early stage of the presidential contest, we believe that some key themes are already emerging.

Figure 1
Media Sentiment Spread Between Biden and Trump on Specific Issues



Source: MKT MediaStats, State Street Global Markets, as of July 2020.

In this research paper, we aim to:

- Examine the behaviour of returns of equity asset types, as well as institutional investment flows and media sentiment around previous and current elections.
- Study whether macroeconomics played a role in the previous and current elections.
- Highlight the policy areas that are particularly pertinent for this election.
- Analyse some of the most important themes emerging from the key policy areas.
- Conclude with various possible election scenarios and how investors may wish to 'play' such themes.

1 Public's Mood Turns Grim; Trump Trails Biden on Most Personal Traits, Major Issues, Pew Research, June 2020.
2 Source: RealClearPolitics.
3 *Biden vs Trump: who is leading in the 2020 US election polls?* Financial Times. https://ig.ft.com/us-election-2020.

Behaviour of Returns, Institutional Investor Flows and Media Sentiment

Overview

The aim of this section is to examine the behaviour of returns of different equity asset types as well as investor and media sentiment around previous and current presidential elections.

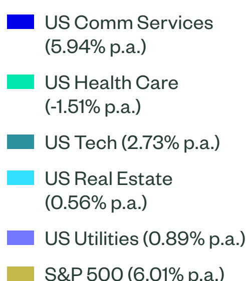
Behaviour of Returns of Different Asset Types

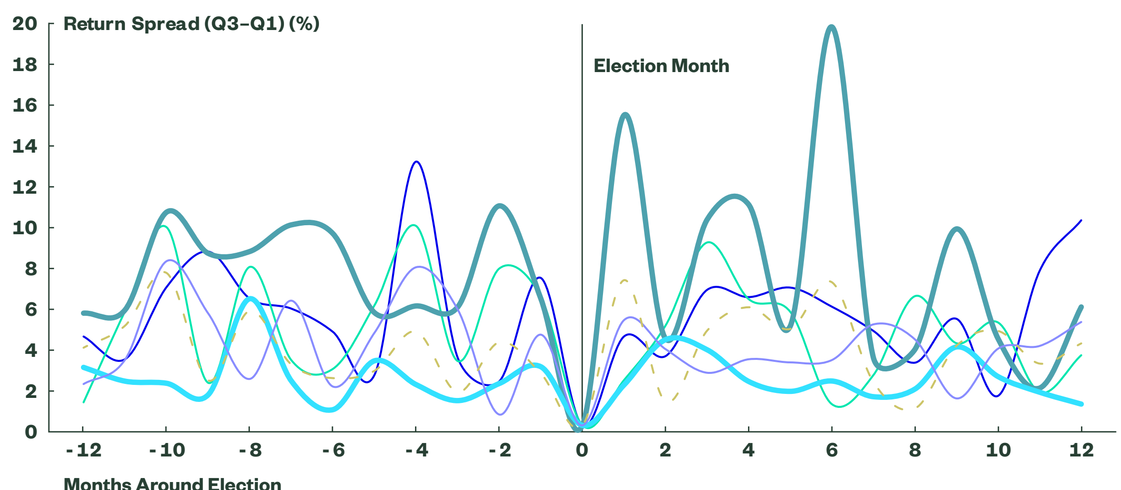
To analyse the behaviour of returns of different asset types, we study the variation of returns of three types of equities (sectors, smart beta and broad-based equities in the US) to see if there is large variation between their returns around previous election dates. We do this by calculating the H-spread, a form of statistical dispersion.

Figure 2 below highlights the sectors that have experienced the highest and lowest levels of H-spread. This figure shows that most sectors[1] have a higher H-spread than the benchmark, with Tech seeing the most return fluctuations. Relative to other sectors, the Tech H-spread is marginally higher prior to the election and shoots up to a peak of 20% around six months after the election, after which it stabilises. This may imply that the Tech sector is more sensitive than other sectors around the election date, especially since its return spread seems to resemble that of the S&P 500 index, though in a much more magnified manner.

Conversely, the Real Estate sector tends to offer relatively stable returns with low levels of dispersion throughout the entire period. From the analysis, the amount of dispersion observed around the election period also does not seem to be clearly linked to whether a sector is cyclical or defensive, as we see both Tech and Health Care having the highest return spreads.

Figure 2
Average Mid Spread of Select US Sectors Since 1989



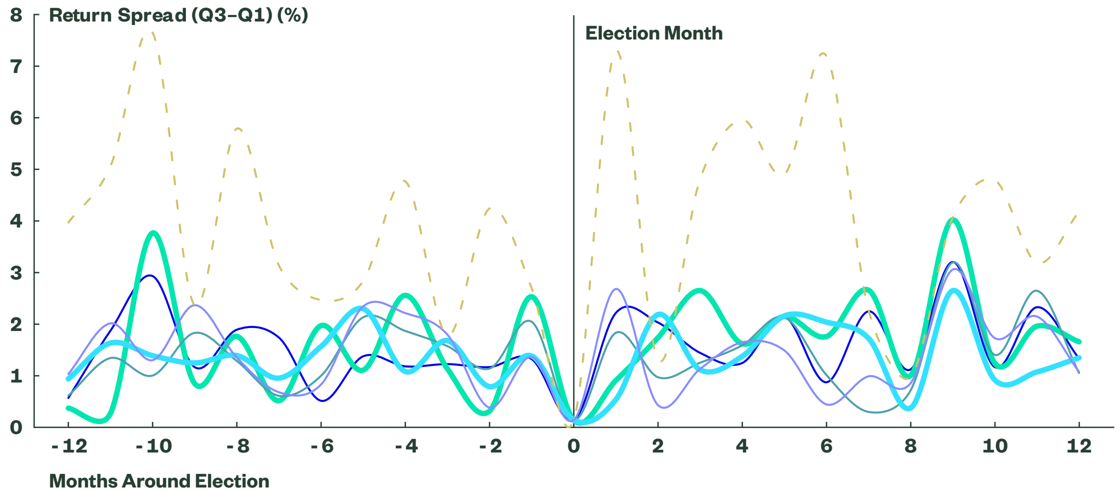


Source: State Street Global Advisors, Bloomberg Finance L.P., as of July 2020. For clarity, the above graph only shows the sectors with the highest and lowest return spreads. Numbers in parentheses shown in the legend relate to the annualised return during the period. US Comm Services, US Health Care, US Tech, US Real Estate, US Utilities are represented by the S&P 500 Communication Services Index, S&P 500 Health Care Index, S&P 500 Real Estate Index and S&P 500 Utilities Index, respectively.

In terms of overall return during the period under analysis, Communication Services offered the highest level of annualised return, followed by Tech and Utilities, among the sectors studied.

With regard to the smart beta strategies examined, they all have a lower level of dispersion than the benchmark (see Figure 3). The highest level comes from the growth strategy while the lowest comes from the low volatility strategy. For all the strategies, there is no unambiguous change in the H-spread before or after the election. Overall, all the factor strategies achieved lower returns than the S&P 500 during the period in question.

Figure 3
Average Mid Spread of Select US Smart Beta Since 1999

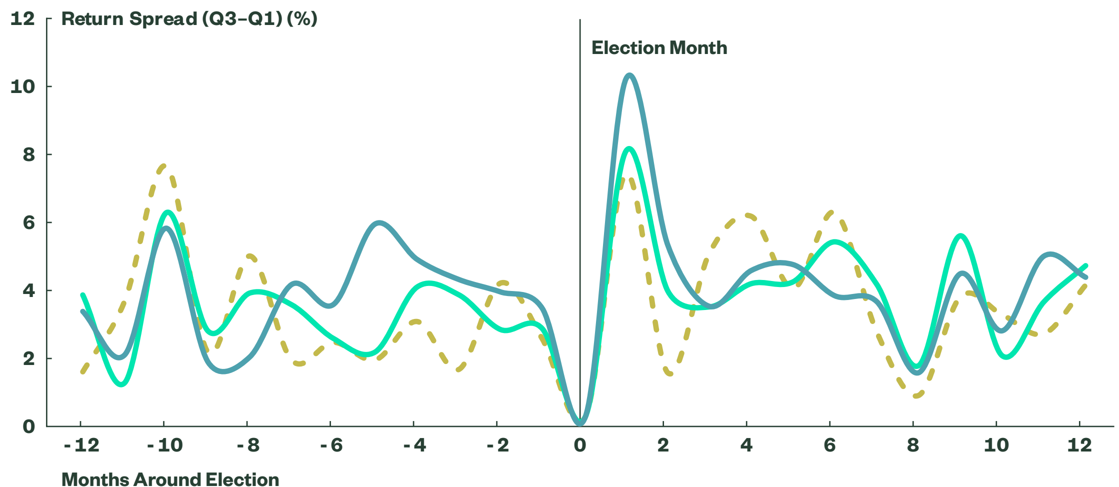


Source: State Street Global Advisors, Bloomberg Finance L.P., as of July 2020. Numbers in parentheses shown in the legend relate to the annualised return during the period. US Value, US Growth, US Quality Div, US Low Vol, US High Div are represented by S&P 500 Value Index, S&P 500 Growth Index, S&P High Yield Dividend Aristocrats Index, S&P 500 Low Volatility Index, S&P 500 High Dividend Yield Index, respectively.

In terms of broad equities, the dispersion of mid- and small-cap equities appears to be roughly in line with that of the S&P 500 index (see Figure 4). Interestingly, the dispersion of small caps starts to rise six months prior to the election and the spread reaches its zenith (10%) immediately after the election, indicating that small caps may be most sensitive to the outcome of the presidential elections.

However, this fluctuation subsides roughly two months after the election and remains at a low level thereafter. Compared to sectors, style and market cap factors have been less powerful determinants of equity return[2] and this may be why there is lower dispersion in factor and cap strategies than the benchmark. As for the return over the period in question, the S&P 500 offered the highest level of return, followed by mid caps and small caps.

Figure 4
Average Mid Spread of Select US Broad-Based Equities Since 1993



Source: State Street Global Advisors, Bloomberg Finance L.P., as of July 2020. Numbers in parenthesis shown in the legend relate to the annualised return during the period. US Mid Cap and US Small Cap are represented by the S&P Mid Cap 400 Index and S&P Small Cap 600 Index, respectively.

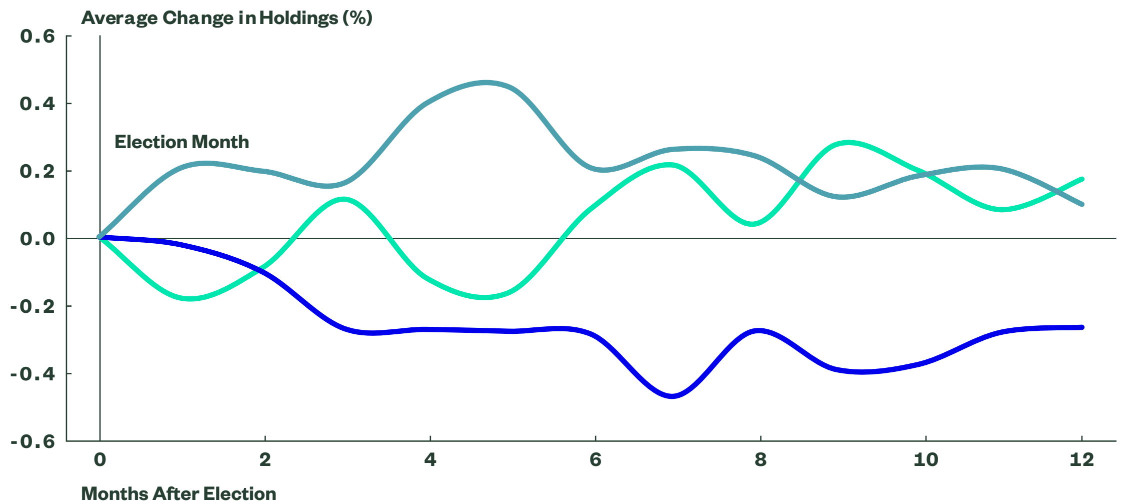
Institutional Investor Flows

In addition to examining the dispersion of returns, analysing institutional investment flows can be equally instructive. Indeed, investors follow elections very closely as major shifts in policies can have a direct impact on their investments and asset allocation.

Analysing behavioural data from 1998, we note that institutional investors increase their allocation to bonds and cash and decrease their equity allocation after the elections (see Figure 5). The risk-off sentiment implied by low equity allocation comes into direct conflict with the fact that the performance of equity markets is generally positive for 12 months after the election. Looking beneath the surface, we notice that these results are somewhat skewed by the 2008 election, which coincided with the Global Financial Crisis.

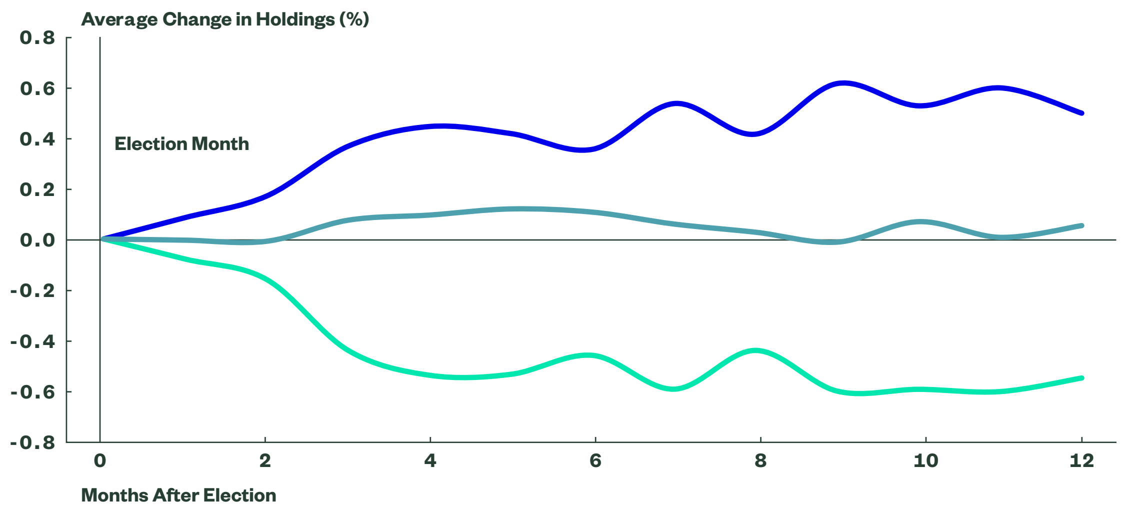
Figure 5
Asset Allocation Around Presidential Elections Since 1998

- Equity
- Bonds
- Cash



Asset Allocation Around Previous Elections Since 1998 (Excl. Recession years 2000, 2008)

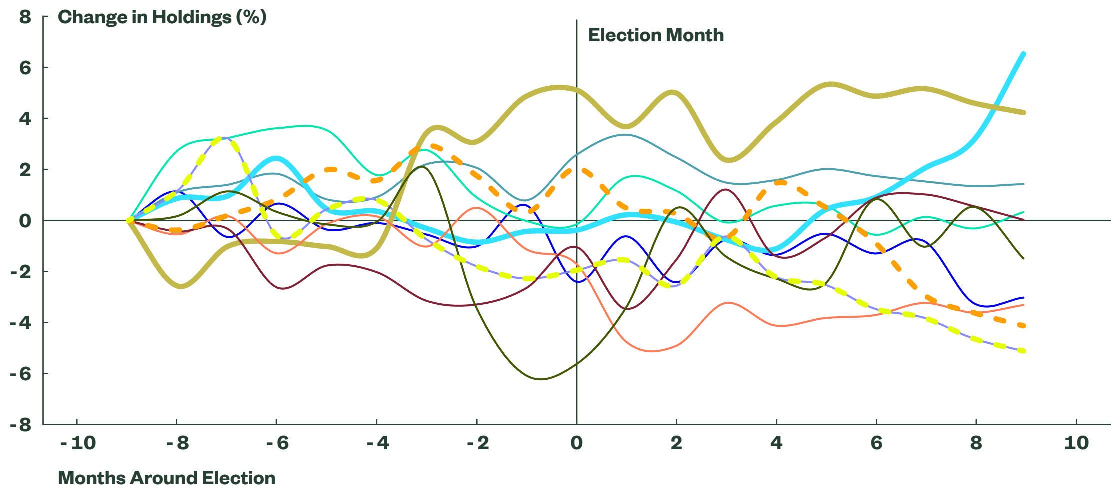
- Equity
- Bonds
- Cash



Source: State Street Global Markets, as of July 2020.

If that data point is removed, investors appear to be more cautious initially in their asset allocation choices but only slowly venture back into equities after the election when there is more optimism in the market. Once they do return to equities, procyclical sectors, such as Consumer Discretionary and Financials, frequently see the largest increase in institutional investor portfolio holdings while defensive sectors, such as Consumer Staples and Utilities, suffer (see Figure 6).

Figure 6
Sector Winners and Losers During Previous Elections Since 1998



Source: State Street Global Markets, as of July 2020. Thick lines represent the best sector performers over the entire period while thick dashed lines represent the worst sector performers.

Media Sentiment

While media sentiment is not directly related to investment returns or investor behaviour, it does offer a barometer of the mood in the country. Opinion polls have recently given Biden a consistent edge in the race to the White House, but there are shortcomings with traditional polling methods.

In this context, we use alternative data sources to glean additional insights on the current presidential election race. In this paper, we utilise data sourced from MKT MediaStats, which trawls through a range of media sources by way of natural language processing techniques. We also apply the same technique to articles published in the New York Times (to avoid any potential bias in this publication, we also look at state-level media sentiment later in this section). This should enrich the analysis in this research paper, given the increasing amount of coverage that the media dedicates to elections.[3]

To do this, we analyse how president Trump is faring in the current election cycle by tracking the spread of the sentiment of the eventual winner against the eventual loser between April and November in presidential elections since 1972. Figure 7 shows that the sentiment spread on the election day itself was historically instructive in predicting the winner, with the exception of the 2000 and 2016 elections when the popular vote winner did not secure the presidency. We exclude the 2000 and 2016 elections from our analysis because, historically, the winner of the popular vote has generally also secured the presidency.

Negative Media Sentiment Towards Trump is Seen Even in Swing States

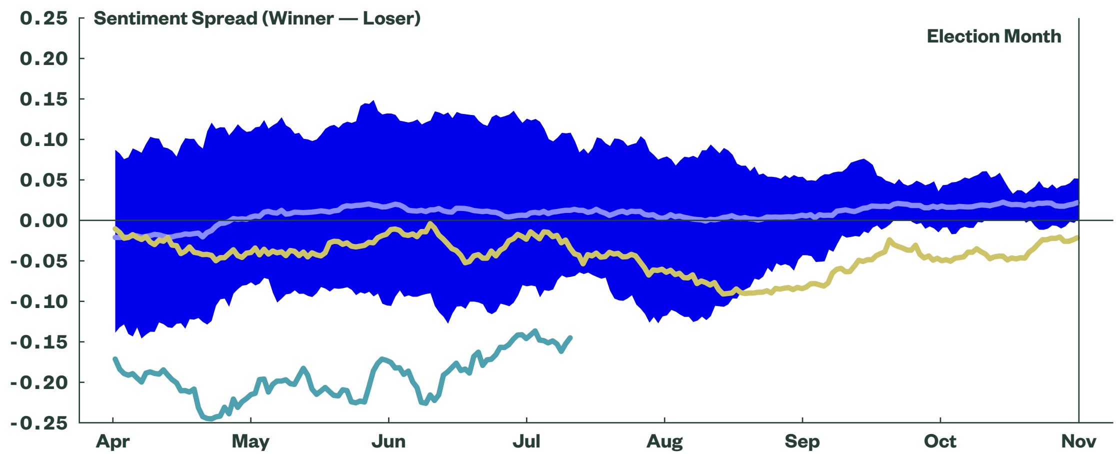
Of course, some candidates managed to win even when they registered a poor sentiment spread in the months preceding the election. However, no candidate managed to win the presidency with as large a sentiment deficit as the one Trump is currently experiencing. Perhaps even more encouraging for Biden, he maintains a positive sentiment advantage over Trump at a level that has not been seen by any winner since 1972 and outperforms Clinton at a similar stage during the 2016 election.

Of course, there remains a possibility that this election turns out to be the same as the 2016 election when the popular vote winner did not win. In addition, according to MKT MediaStats, media coverage on a national level may give rise to biases. For this reason, it is also important to examine state-level media coverage as well. Yet, a similar conclusion can be reached when the sentiment spread between Trump and Biden is examined from a local media perspective as a whole (see Figure 8) or just in swing states (see Figure 9), using MKT MediaStats state-level reservoirs.[4]

Figure 7

Sentiment Spread of Eventual Winner and Eventual Loser Since 1972, Excluding Presidential Elections Lost by Popular Vote Winners

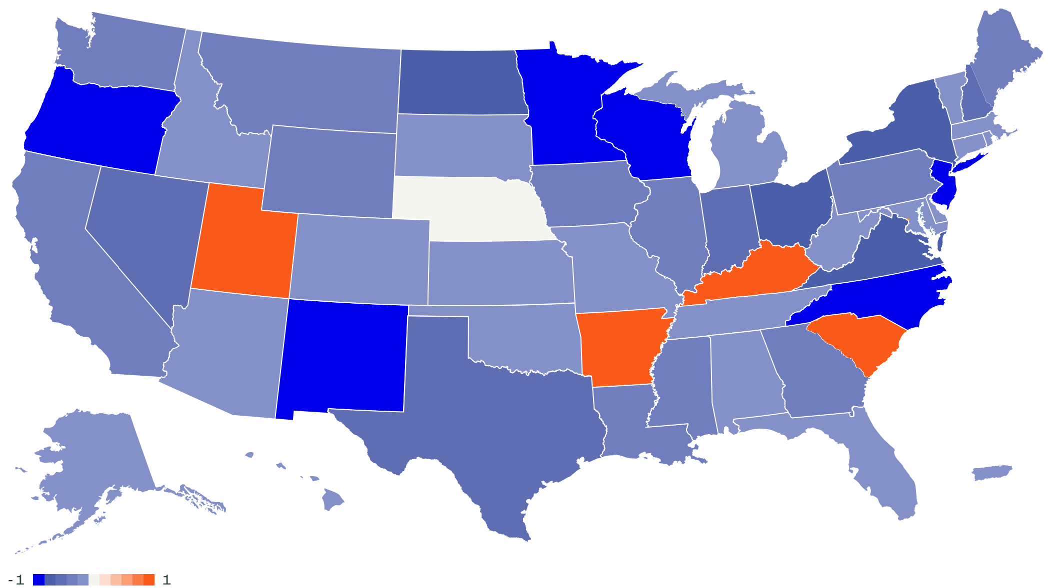
Min/Max Uncertainty Region
Trump-Biden (2020)
Average
Trump-Clinton (2016)



Source: MKT MediaStats, State Street Global Markets, New York Times, as of July 2020.

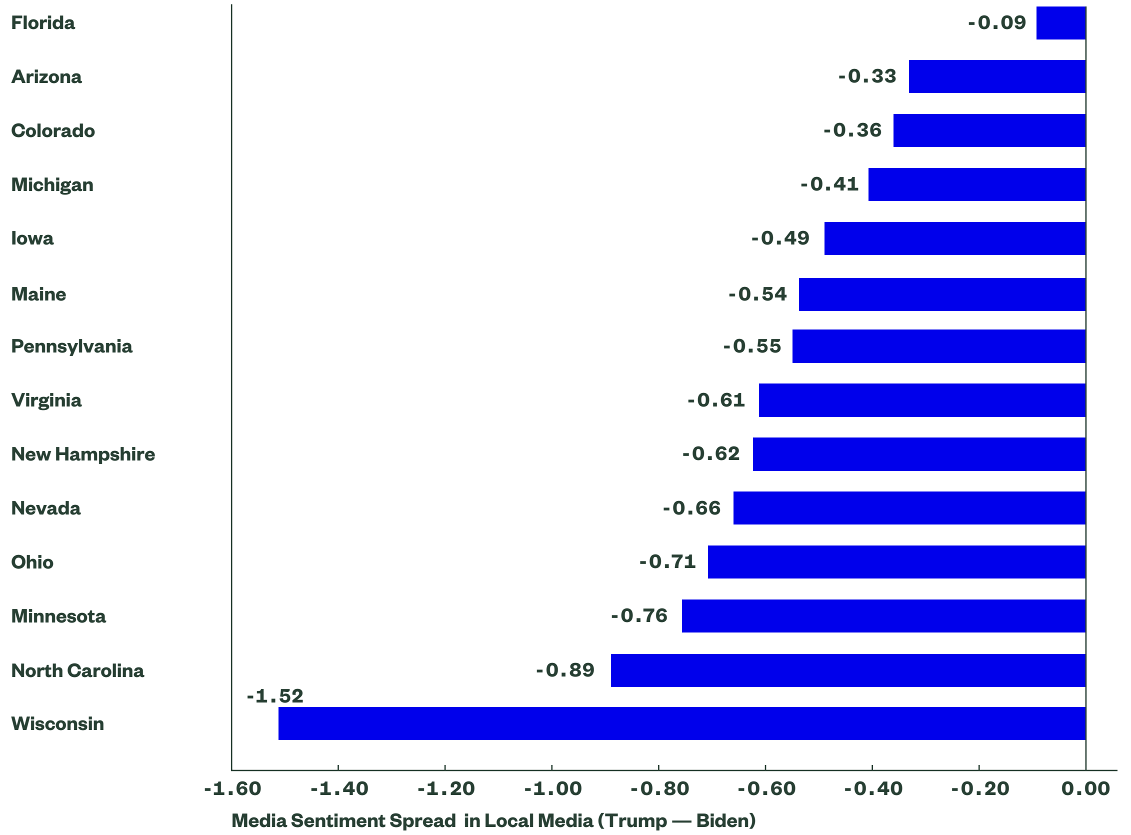
Figure 8

Heatmap of Media Sentiment Spread by State



Source: MKT MediaStats, State Street Global Markets, as of July 2020. Blue in the heatmap above indicates positive local media sentiment advantage for Biden and red indicates positive local media sentiment advantage for Trump.

Figure 9
Media Sentiment Spread of Trump and Biden in Key Swing States



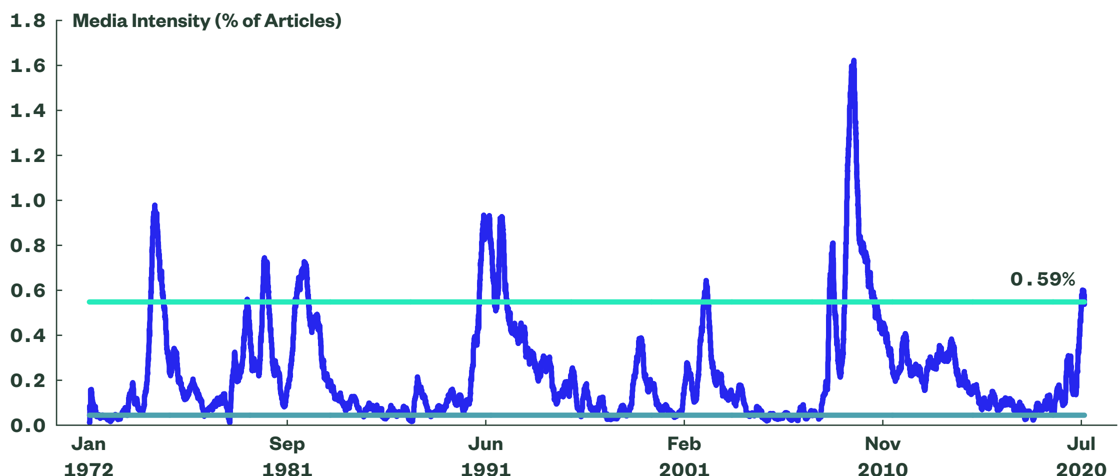
Source: MKT MediaStats, State Street Global Markets, as of July 2020. Negative media sentiment spread means that Trump is trailing Biden in the named states.

The Intersection of Macroeconomics and the Presidential Election

Overview

"It's the economy, stupid!" is the classic phrase about US presidential elections, and macroeconomic strength is clearly correlated with better electoral performance of the incumbent party. Currently there is a concern over the US economy, with the media mentioning the possibility of a recession more than in many previous elections (see Figure 10). Nevertheless, the question that arises is, which are the important election-relevant macro indicators and whether the election itself is a marker of the economic cycle.

Figure 10
Media Coverage Intensity on Recession Currently Over 90th Percentile



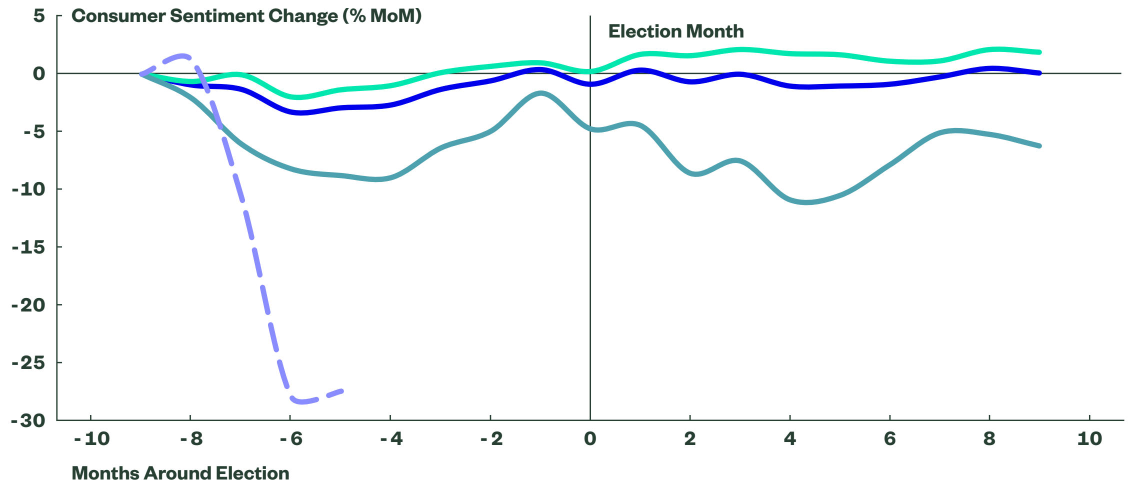
Source: MKT MediaStats, New York Times, State Street Global Markets, as of July 2020.

Macro Momentum Matters More than the Actual State of the Economy in Presidential Elections

To answer those questions, we examine the behaviour of key macroeconomic indicators around previous election dates and find that the election is more of a mirror of the economy than a signpost. Moreover, macroeconomic momentum matters more than the actual state of the economy, as voters appear to behave in a forward-looking manner.

Our first example is the Michigan Consumer Sentiment Index,[5] given the longstanding assumption of consumer welfare correlating with presidential approval. Figure 11 shows that the election itself does not appear to influence US consumer sentiment. While the current data does not look positive for president Trump, a major improvement in the consumer sentiment would support momentum going into the election. Even better news for Trump is that this indicator has lost much predictive value over the course of the past decade, so low levels may be less damaging for him than suggested by the indicator.

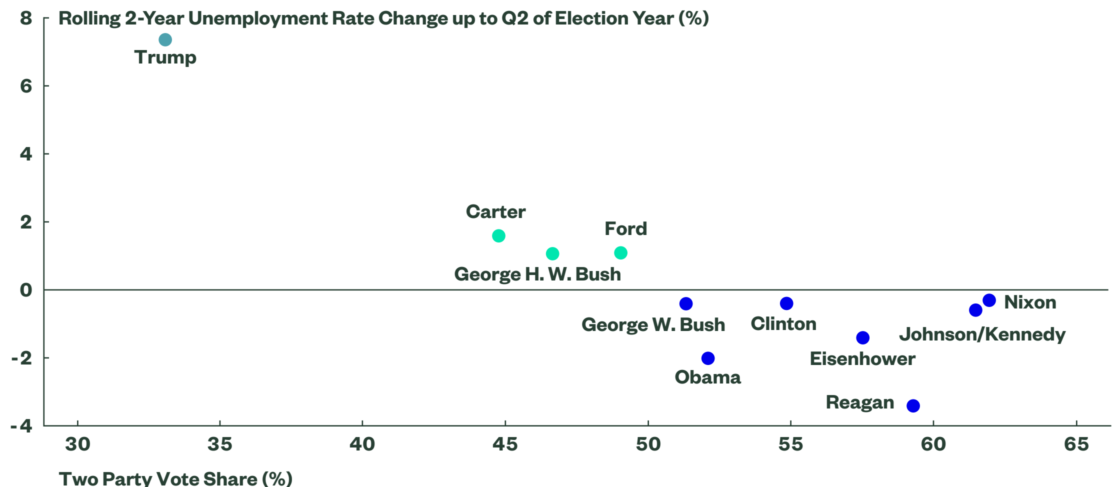
Figure 11
Michigan Consumer Sentiment Around Election Months Since 1978



Source: Federal Reserve Economic Data, State Street Global Advisors, as of July 2020.

The other common viewpoint is that the labour market may be a better reflection of US consumer (and voter) health. For this analysis, we examine the change in unemployment rate,[6] for the presidents who are seeking re-election after World War II, against the two-party vote share (see Figure 12). It shows that defeated incumbents are generally blamed for the deterioration of economic conditions, especially a spike in the unemployment rate. This would suggest that president Trump's prospects look decidedly negative. The only consolation here is that the rate seems less predictive than payroll figures, i.e. the monthly momentum of new jobs created, so a rapid rebound could still lessen the impact.

Figure 12
Change in Unemployment Rate for Presidents Seeking Re-Election



Source: State Street Global Advisors, FRED, The American Presidency Project, as of July 2020. The two-party vote share for Trump is based on current polls and the rolling two-year unemployment rate change is based on the average up to June 2020.

To summarise, we focus our analysis on the five key macroeconomic indicators that seem to correlate best with a successful incumbent re-election. Moreover, this exercise provides us with a minimum "threshold" for any incumbent since 1960 to win his second-term mandate. Figure 13 underlines that president Trump currently looks very weak on nearly all metrics. This may partially explain why prediction markets see the Democrats winning both the presidency and the congressional majority (see Appendix B).

Figure 13

Select Macroeconomic Indicator Threshold Needed for Sitting Presidents to Win Re-Election Since 1960

Indicator	Minimum Threshold	2016	Pre-COVID	Current	Is Trump Above Threshold?
Real Disposable Income Growth	1.30%	0.70%	2.20%	1.05%	No
Nonfarm Payrolls	127k	208k	176k	-2.11m	No
Real Personal Consumption	2.40%	2.70%	3.90%	-2.90%	No
Real GDP	1.10%	2.05%	2.05%	-1.35%	No
Consumer Confidence	84.80	107.90	109.80	85.5	Yes

Source: State Street Global Advisors, Macrobond, as of August 2020. Note: Threshold indicators only represent historical correlations with incumbent party victory and statistical significance generally peaks for Q2 or Q3 data of election year starting in 1960. Current and 2016 are average of the last two quarters, respectively.

Key Policy Areas

Overview

We now turn to the key policy areas that may affect investors. From an equity investor perspective, most elections are fought primarily over taxation and regulation. This is certainly expected to be the case for 2020, but there are three other areas that are meaningfully different to previous election cycles.

Across the board, most areas are only designated for change in the event of a Biden victory and some rely on a parallel Democratic majority in the Senate. Figure 14 outlines the five key areas of policy discrepancy between the two parties and the main investment exposures affected.

Figure 14
Areas that may be Affected by Policy Changes

Theme	Policy Shift	Sector Exposures	Industry Exposures
Taxation	**Higher corporate tax rate (statutory rate to rise from 21% to 28%) and higher minimum threshold**	This affects most sectors, except for tech and real estate, whose earnings profile will barely move. Energy is impacted half as much as other sectors. Consumer sectors, staples and discretionary will be more impacted than average.	Automotive industry is least affected, with oil & gas, semiconductors, pharma and real estate also on the lower end. Worst hit would be consumer services, food & beverage & tobacco, media, utilities, health care equipment and banks.
	Higher minimum tax rate on foreign earnings	This is a narrow issue, mainly affecting sectors with large offshore earnings, e.g. tech, communication services, health care and materials. Real estate and utilities mainly unaffected with rest moderately impacted.	Similarly, this applies most to software & services, pharma, semiconductors and media. Other industries, such as food & beverage, consumer durables and tech hardware, are moderately affected with the rest largely untouched.
	Higher capital gains tax rate on high income earners (capital income >$1mn) and carried interest	Few sector or industry differences but final plans could affect real estate more than others given its dependency on investor demand.	
	Higher payroll taxes on high earners (>$400k)	Given employer contributions would rise too, high-paying sectors, such as communication services, technology and financials, could be most exposed.	Similarly, this would apply most to software & services, banks, diversified financials, pharma and biotech.
Regulation	**Climate: encourage shift away from fossil fuels and toward lower carbon emissions**	Energy would be most directly impacted, but other carbon-intensive sectors could incur costs, e.g. materials and industrials. In contrast, utilities could benefit from a shift toward renewables.	Any fossil fuel-light industry would benefit, and carbon-heavy industry would struggle, such as oil & gas, aerospace & defence and metals & mining.
	Consumer protection	Communication services most exposed through Facebook and Google, followed by financials. Consumer sectors would be moderately affected.	Software & services and banks look exposed, but regional banks and other financial services are unlikely to be meaningfully impacted. Media could perhaps even benefit from a more competitive advertising framework.
	Net neutrality	Communication services here exposed via telecoms.	Telecoms.
	Health care pricing	Health care looks vulnerable, but worries are likely overdone and it will potentially have a narrow impact.	Health care equipment to be unaffected. Health care services carries more exposure, and biotech/pharma even more, but there could be positive offsets due to pandemic. Headline risk may be overdone.

Theme	Policy Shift	Sector Exposures	Industry Exposures
Labour Market	**Increase federal minimum wage**	Labour-intensive sectors to contend with wage pressures, e.g. consumer discretionary and consumer staples. But technology business models relying on gig economy are also at risk.	Hospitality, retail and health care services rely on large pools of low cost labour.
	Changing labour bargaining power		
	Easing of immigration rules, especially higher-skilled immigration	In contrast, this could facilitate the growth of the technology and communication services sectors.	
Antitrust	**Revival of antitrust investigations and legislation: abuse of power and promotion of competition**	Tech, communication services (mainly due to Facebook and Google) and consumer discretionary (due to Amazon).	
Public Spending	**Boost in overall capex and infrastructure expenditures, especially for 'greening' energy infrastructure, more science research spending, as well as education. Only area of cuts will be defence.**	Broad spending could help materials and industrials. Health care could also leverage R&D support. Consumer discretionary could draw on higher early education dollars and utilities may enjoy tailwinds in water and power reform.	Aerospace & defence could suffer unless we see an increase in geopolitical risk. Winners include semiconductors, metals & mining, health care services, pharma and biotech, electric utilities, and renewable electricity producers.

Source: State Street Global Advisors, as of July 2020.

Democratic Administration Could be Mixed for Markets with Winners and Losers for Each Policy Choice

The above table surveys the wide range of policy shifts that could reverberate in equity markets, but the fundamental principle is that the policy mix of the Trump administration provided tailwinds for the broader stock market. In contrast, any future Democratic administration could be more mixed, with a series of winners and losers for each policy choice, as indicated in Figure 14. We have previously likened this to a regime shift from a 'beta' to an 'alpha' environment where sectoral, industry, thematic and firm selection become more important.

Overall, we see changes in a number of significant areas between the last and this election. First, one of the outcomes of the Trump tax cuts was the continued rise in stock buybacks and dividend pay-outs. The mix of corporate and personal tax policies in a Biden administration might reverse this trend, even in a post-pandemic economic recovery.

Second, the aim to strengthen the working and middle classes suggests that overall consumer demand should enjoy government support. In this regard, it is the combination of the policy mix above as well as other initiatives (e.g. student debt relief) that could free up discretionary income. The downside risks are borne by companies employing either large shares of low-income or high-income earners.

Third, the shift of fiscal activism away from tax cuts toward spending creates new demand for select sectors, industries and firms aligned with the new policy objectives of low carbon intensity, research acumen and stronger human capital.

Finally, business models that are rent-seeking or rely on oligopolistic pricing are at greater risk of regulatory disruption if their profits are perceived to be built at the expense of consumer welfare. In the next section, we analyse some of these key themes in greater detail. This is done based on mainly historical data and, where applicable, the way in which this election may be similar or different from previous elections is also appropriately highlighted.

Key themes

Overview

Here we primarily focus our attention on the aerospace & defence industry, share buybacks, climate change, corporate tax, foreign revenues, health care, infrastructure and minimum wage, as well as small and mid-cap companies.

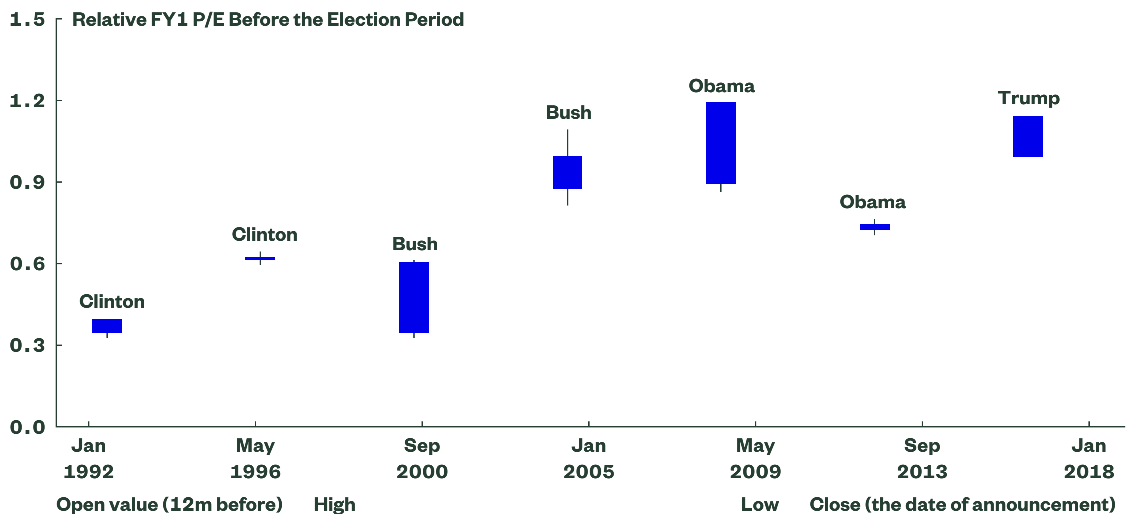
Aerospace & Defence

Historically, earnings in the aerospace & defence industry appear to be driven more by heightened political risk than by the US presidential elections. Figure 15 demonstrates that there is no visible pattern on how P/E multiples changed around election periods, even though Democratic administrations seem to be more disposed to restrict spending on defence than their Republican counterparts (see Appendix C.1).

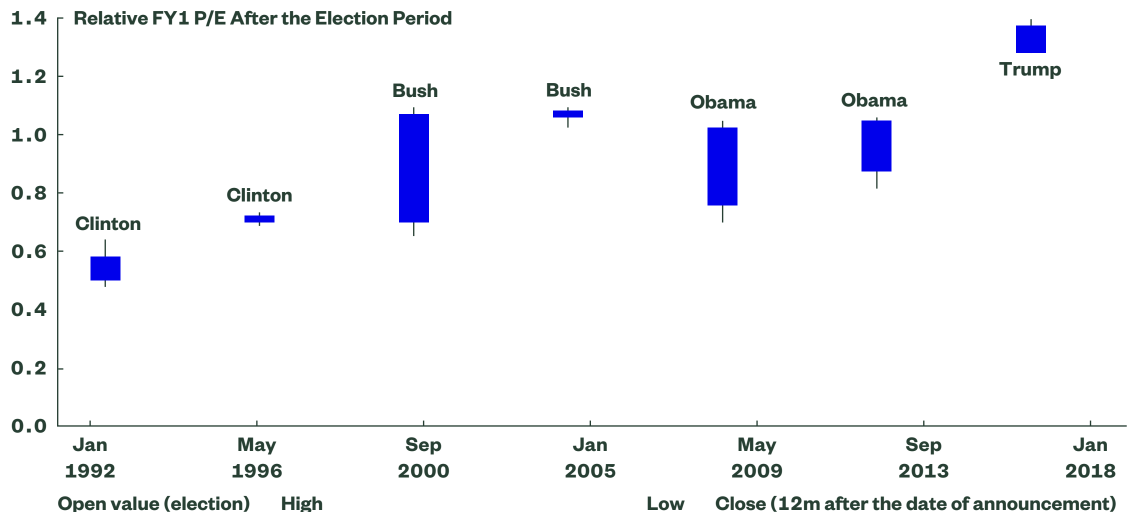
However, defence spending as a percentage of GDP did grow very slowly, or even shrank, and this occurred even during steady economic growth environments (see Appendix C.2). Currently, it is near its lowest in more than 50 years (see Figure 16). One of the reasons for this is that an increasing amount of the federal budget is being dedicated to "mandatory" spending — such as Medicare, Medicaid and Social Security — rather than on discretionary spending, like defence.

Figure 15
Relative FY1 P/E 12 Months Before and After the Election period

Before Election period



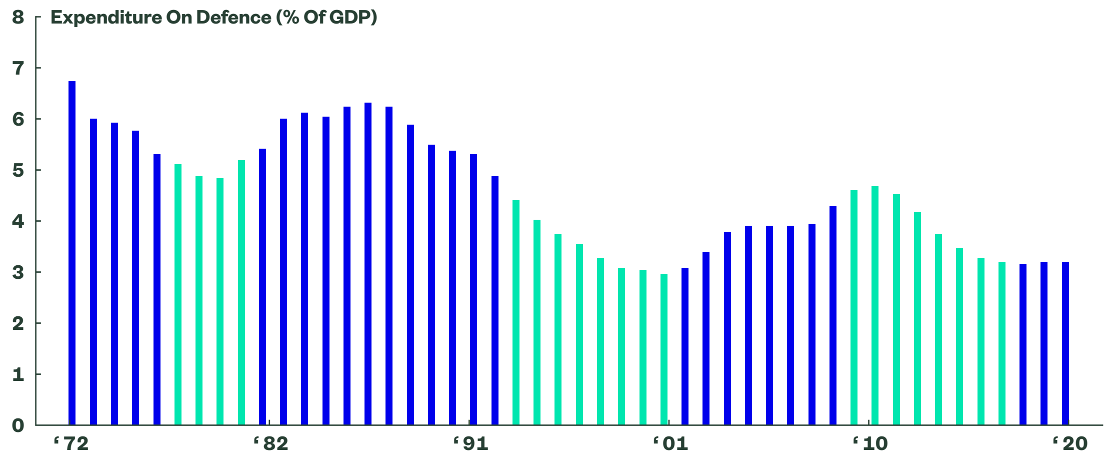
After Election period



Source: State Street Global Advisors, Bloomberg Finance L.P., as of July 2020.

So far this year, the aerospace and defence industry has lagged the broad US equity market by 25%. The underperformance initially was caused by fears that Bernie Sanders would come to power and radically decrease the defence budget. With Sanders dropping out of the presidential race, those fears are no longer justified but the industry's fortunes are once again challenged by the onset of a pandemic and, subsequently, a recession. This led to the worst performance of these equities compared to any previous elections (see Appendix C.3).

Figure 16
Defence Expenditure as a % of GDP



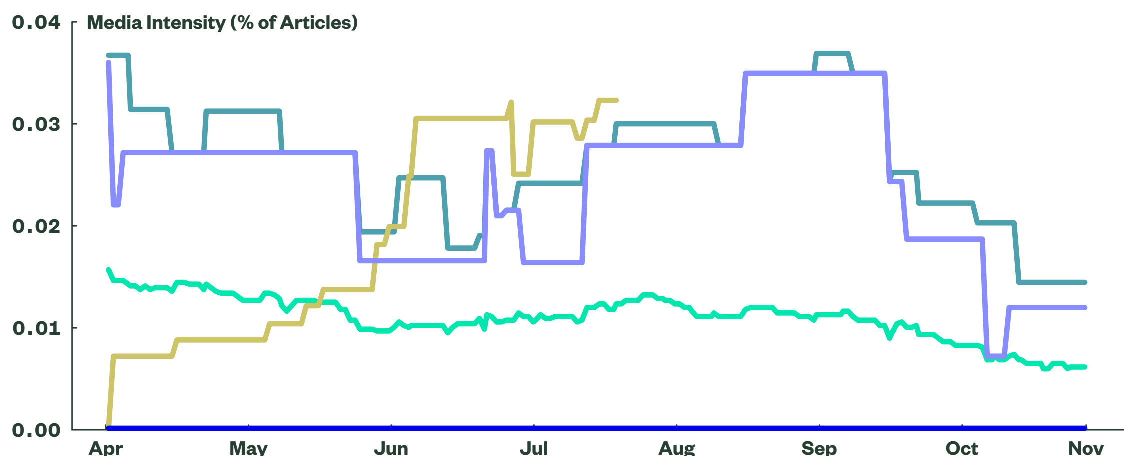
Source: State Street Global Markets, Datastream as of July 2020.

Even though defence spending fell as a percentage of GDP, the defence budget did go up in absolute terms. Indeed, it often rose immediately after recessionary periods. A case in point was the Global Financial Crisis, when the industry fared better than the broader equity markets.

More recently, in view of heightening geopolitical tensions with China and Russia, defence R&D spending has gone up[7] and may continue to do so, following years of decline under the Obama administration. Added to this is the increased public interest in the aerospace & defence industry, given media coverage is at its highest since the 1972 election (see Figure 17). Together, these factors may spur company performance, especially given that these stocks are currently under-owned by institutional investors.

Of course, an absence of geopolitical pressures may mean that a Biden administration is more inclined to limit defence spending as he concentrates on boosting the domestic economic recovery and middle-class household incomes. This is because defence spending is highly discretionary and is often one of the first areas to experience a major reduction in response to the evolving priorities of a new government.

Figure 17
Media Coverage the Highest it has Ever Been Since the 1972 Election



Source: State Street Global Advisors, State Street Global Markets, MKT MediaStats, New York Times, as of July 2020.

Share Buybacks

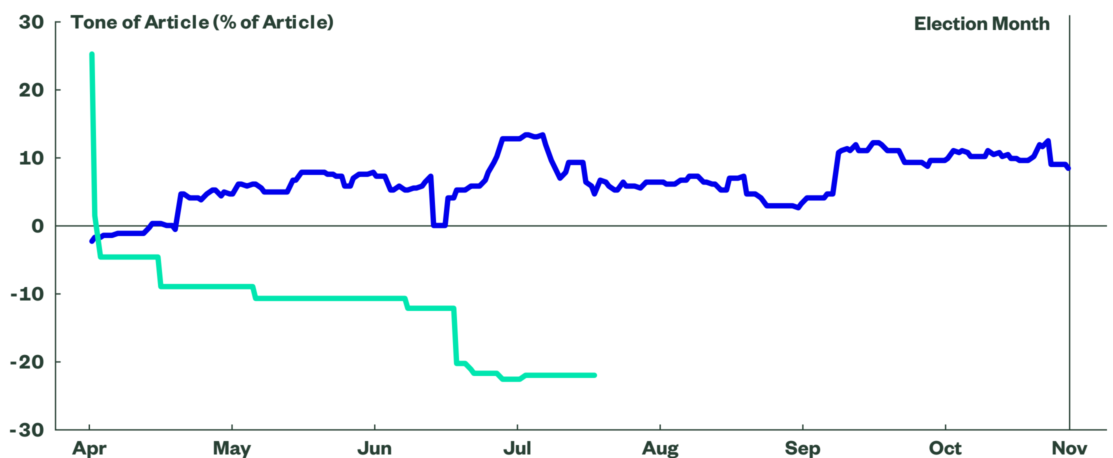
Company repurchase programs have become an increasingly contentious subject. The amount of media coverage has intensified and assumed an overwhelmingly negative tone (see Figure 18). Exactly what the policy of the two candidates is towards buybacks remains unclear. On occasions, president Trump has claimed that he would not oppose restricting buybacks, especially on companies that request a government bailout.

Biden's criticism of buybacks is much more vociferous[8] and has gone as far as publicly calling for all the CEOs in the US to commit to suspending[9] them this year. He also advocates barring buybacks for companies that receive taxpayer bailouts through the Coronavirus Relief Bill. On that, Trump agrees, and it has been suggested[10] that he has grown more hostile to buybacks ever since he incentivised companies to repatriate foreign earnings, which would have been parked as cash overseas, in order to create more jobs and boost investments. While companies also did that, they redirected much of the tax savings to repurchasing their own stocks.

Figure 19 suggests that there may be some truth in that. Following the tax cuts in 2018, companies increased their buybacks by 46% during the year and reduced their cash holdings by 12%, while dividend pay-outs remained near average historical levels. From the same figure, it is also noteworthy that dividend disbursements are much more stable than buybacks. This may be so, possibly because the former are often used as a mechanism to signal to the general market that the company is financially strong, as opposed to the latter, which are wholly discretionary and therefore volatile.

Figure 18
Tone of Media Articles on Company Buybacks Since 1972

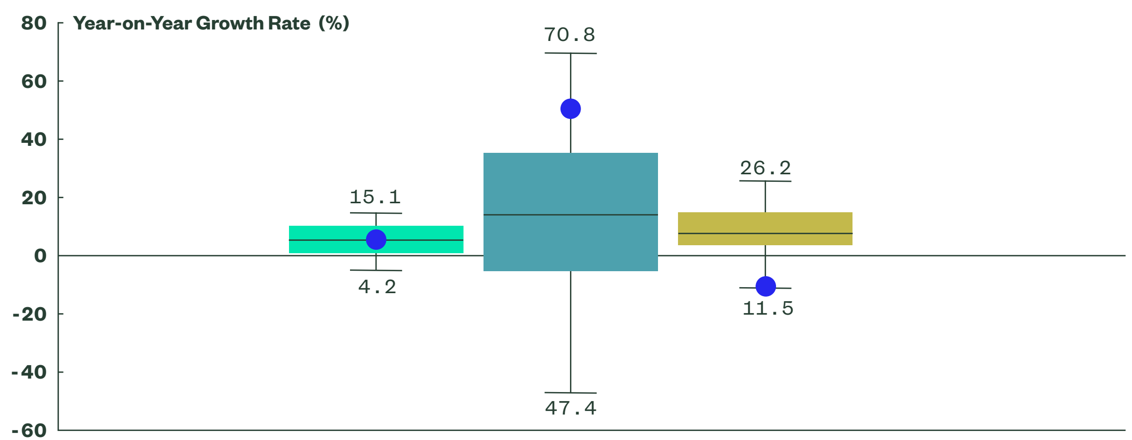
Average (1972 to 2016)
2020



Source: MKT MediaStats, New York Times, as of July 2020.

Figure 19
Year-on-year Growth of Company Buybacks, Dividends and Cash Holdings on the S&P 500 Since 1990

2018 TCJA Act Tax Cuts (2017)
Cash Dividends Paid
Buybacks
Cash Holdings

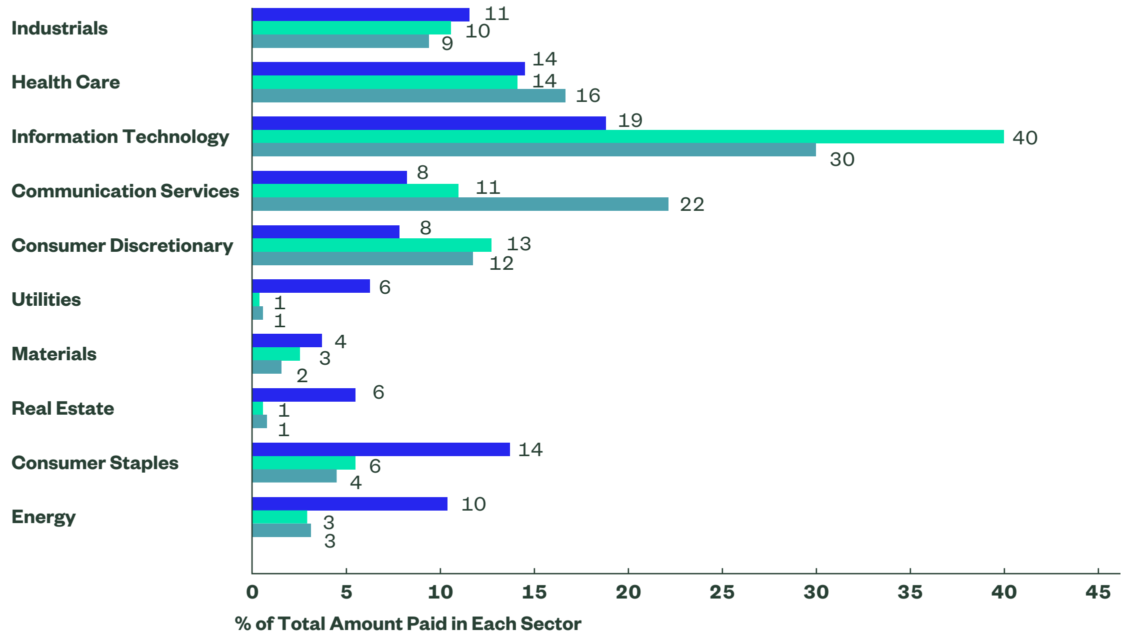


Source: State Street Global Advisors, FactSet, as of July 2020.

The uncertainty surrounding the next administration's policy on company buybacks means it is important to gain an understanding on the sectors that are most active in conducting stock repurchases. Figure 20 shows that tech actually pays the highest amount of both buybacks and dividends, followed by communication services and health care.

While the sectors that pay high dividends often coincide with those that offer the most buybacks, it is the mix of buybacks and dividends that varies substantially between sectors. For instance, tech prefers buybacks to dividends as a way to return cash to shareholders (partially due to high share of equity plans as part of employee compensation). Therefore, investors seeking income may want to focus on a dividend strategy, rather than a buyback or sector strategy, which look politically exposed.

Figure 20
Percentage of Total Amount Paid by Sector in USD by S&P 500 Companies



Source: State Street Global Advisors, FactSet, as of July 2020. Dividends, buybacks and cash holdings are aggregated on the basis of S&P 500 GICS sectors.

Climate Change and Green Investments

Climate policy offers a stark contrast between both candidates: Biden fully embraces green and carbon-neutral policies, while Trump is a staunch opponent of such policies. Moreover, Trump has rejected the Paris Climate Accord and supported the fossil fuel industries. As such, fossil fuel-light companies would perform better under the Democrats while fossil fuel-heavy companies would fare better under Republicans.

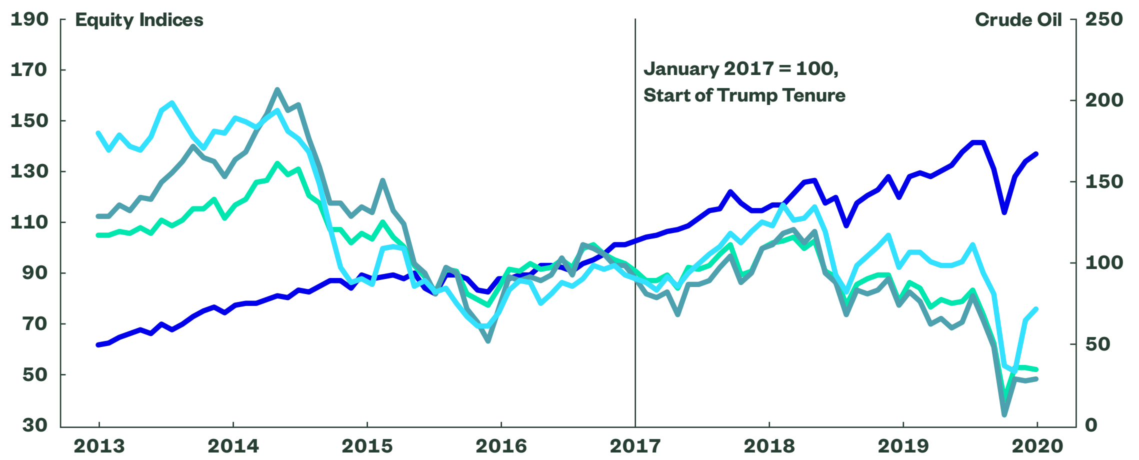
To assess these views, we study the performance of fossil fuel-free stocks; this includes companies that have not owned fossil fuel reserves[11] between 2013 and 2020, which coincides with Obama's second term and Trump's first term in office. At the same time, we also compare the performance of this group of stocks with that of crude oil as well as that of energy and oil and gas exploration stocks, in terms of both volatility and correlation.

Contrary to our initial instinct, fossil fuel-free companies outperformed steadily under both Obama and Trump, despite their policy differences. These companies did not seem to be associated with the vagaries of crude oil prices either, unlike energy stocks, which seem to move in line with the prices of crude oil and with a similar level of elevated volatility (see Figure 21). Interestingly, there may be a premium attached to holding fossil fuel-free stocks (or a discount in holding fossil fuel stocks) over the sample period, as indicated by the strong linear relationship of the excess return of fossil fuel-free stocks since 2013 (see Figure 22).

The short history of fossil fuel-free stocks means that a formative conclusion cannot yet be drawn. However, there is research indicating that concerns about future climate policy means that an increasingly significant discount rate is likely to be applied to oil reserve assets that may end up becoming stranded.[12]

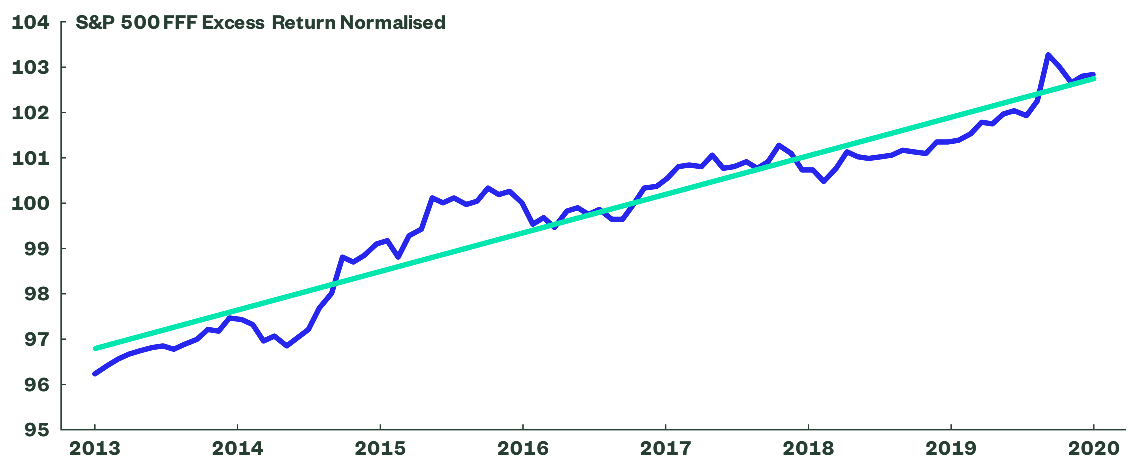
Regardless of the explanation, it is clear that the Trump presidency did not fuel a move away from fossil fuel-free stocks and any future increase in green investments as suggested by Biden can only be a boon for these companies.

Figure 21
Performance of Fossil Fuel-Free Stocks as well as Select Energy Stocks and Crude Oil Since 2013



Source: Bloomberg Finance L.P., State Street Global Advisors, as of July 2020. Fossil Fuel Free, Energy, Oil & Gas Exploration & Production, Crude Oil are represented by the S&P 500 Fossil Fuel Free Index, S&P 500 Energy Index, S&P 500 Oil & Gas Exploration & Production and WTI Crude Oil Spot Price Index, respectively.

Figure 22
Fossil Fuel-Free Excess Return and its Linear Trend



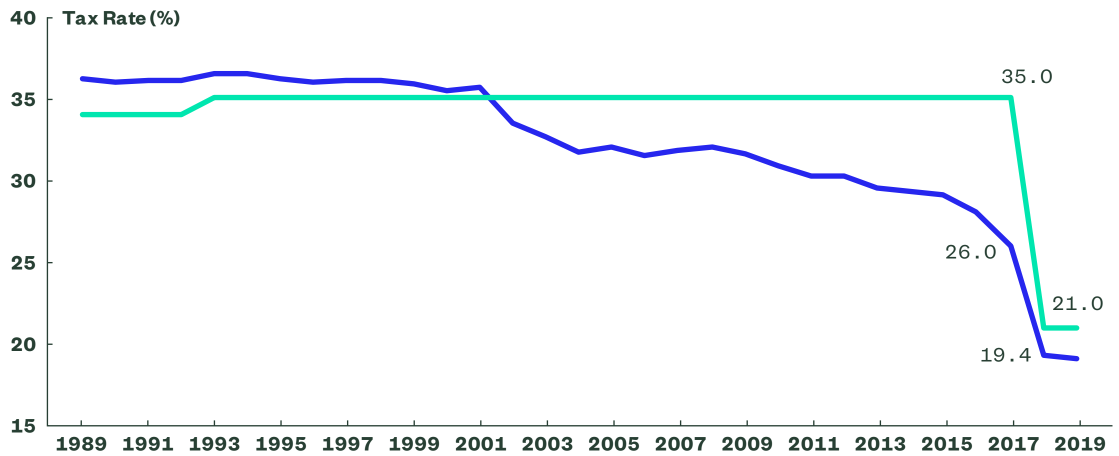
Source: Bloomberg Finance L.P., State Street Global Advisors, as of July 2020. The Fossil Fuel Free Index is represented by the S&P 500 Fossil Fuel Free Index. The S&P 500 Fossil Fuel Free Index was incepted on 28 August 2015. Results prior to this date were calculated by using data available at the time in accordance with the index's current methodology.

Corporate Tax

Through the Tax Cuts and Jobs Act, Trump reduced statutory corporate tax rates from 35% to 21% and this, in turn, saw an appreciable fall in the median effective corporate tax rates applied to S&P 500 companies (see Figure 23). In contrast, Biden favours raising corporate tax rates to pay for additional government expenditure.

If Biden were elected, the companies that had previously benefited most from Trump's corporate tax cuts would likely be most adversely impacted. We estimate here how much benefit S&P 500 companies obtained through the tax cuts implemented in 2017 and examine which sectors and industry groups gained most. This may suggest which sectors are likely to be negatively affected by any reversal of the tax cuts.

Figure 23
Statistical Corporate Tax Rate and Median Effective Corporate Tax Rates of S&P 500 Companies

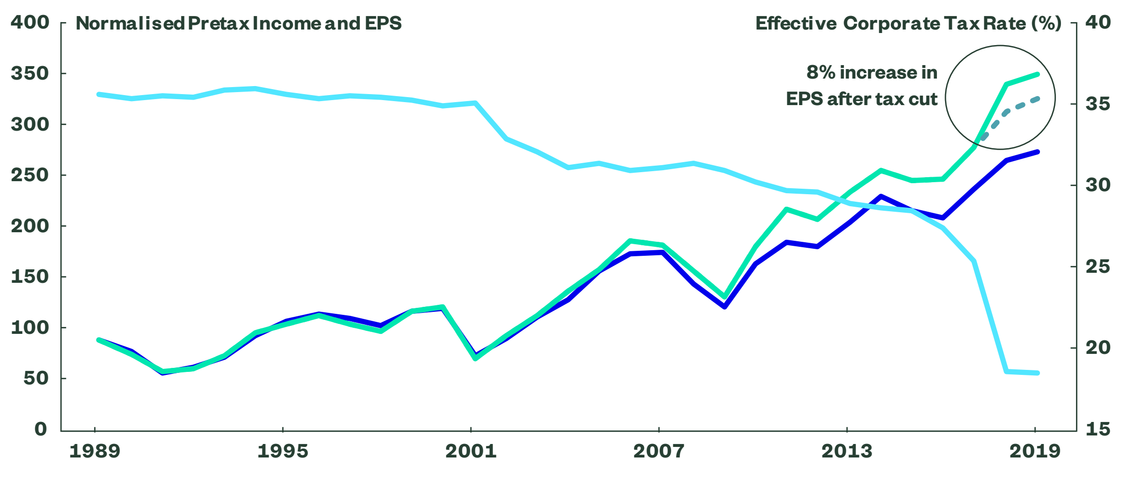


Source: Tax Policy Center, FactSet, as of July 2020. Median corporate tax of S&P 500 companies may have been higher than the statutory rates because of taxes paid overseas.

To determine the estimated tax benefit derived from the tax cut, we conduct a regression analysis between the change in the median pre-tax profit against the change in the median earnings per share between 1989 and 2017. We use the analysis to estimate the median earnings per share in 2018, assuming that no tax cuts were applied. We then compare this estimate against the actual earnings per share to determine the estimated value of the tax cut (see Figure 24).

Analysis shows that the tax cut added 8% to the earnings per share growth of S&P 500 companies. Communication services, utilities and consumer staples were by far the largest beneficiaries, seeing a diminution in median corporate tax rate by 20%, 14% and 13%, respectively. Within the communication services sector, the media industry gained the most (14% tax cut) and within the consumer staples sector the food, beverage and tobacco industry reaped the most benefit (c. 15% tax cut). Conversely, real estate benefited the least (see Figure 25).

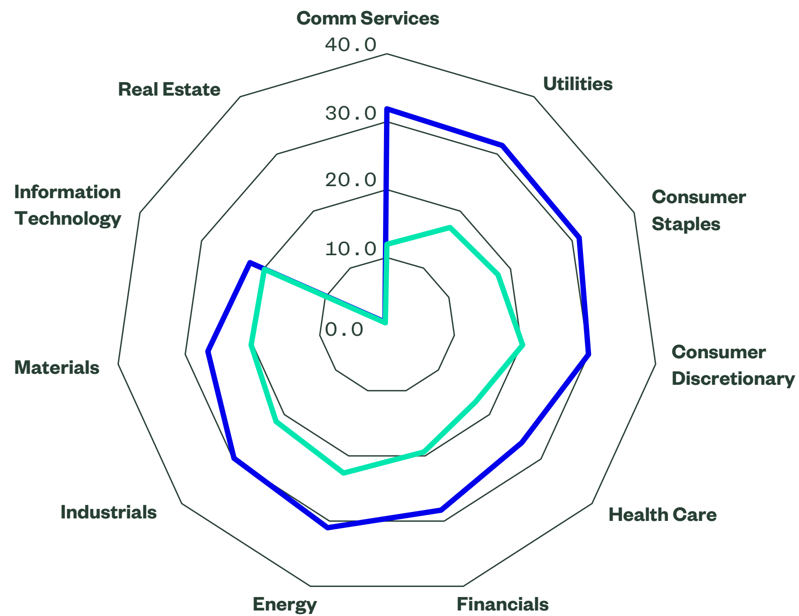
Figure 24
Pre-Tax Income and Estimated Impact of EPS Before and After Tax Cuts as Implemented by TCJA



Source: State Street Global Advisors, FactSet, as of July 2020. Pretax income, EPS and effective corporate tax rates represent the median of S&P 500 companies.

Figure 25
Median Tax Rate of S&P 500 Companies in 2017 and 2018 by Sector

2017
2018



Source: State Street Global Advisors, FactSet, as of July 2020.

Foreign Revenues

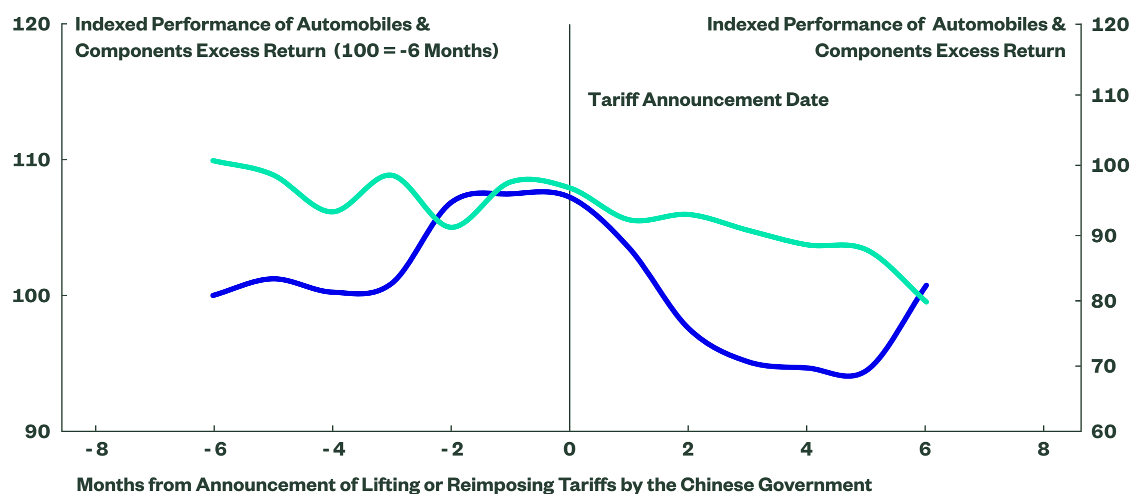
While Trump has prioritised trade relations, any future US government is likely to continue encouraging re-shoring and profit repatriation. As a result, companies' foreign earnings are subject to two distinct risks.

First, continued trade disputes may hamper a company's ability to generate earnings growth in certain foreign markets. This could be affected by mutual tariff escalation or sanctions. For this reason, it is worth examining which industries rely most on other countries, particularly China, for their revenue base. A case in point is the suspension of tariffs that China had applied to the US automotive and auto parts industry in December 2018 (these tariffs were subsequently reinstated some eight months later).

Figure 26 shows how the stocks only reacted when changes to the tariff policies started to be implemented and not when they were first announced.

Figure 26
Excess Return of Automobile & Components industry between 2018 and 2019

China to Lift Tariffs (Dec 2018 — LHS)
China to Reimpose Tariffs (Aug 2019 — RHS)

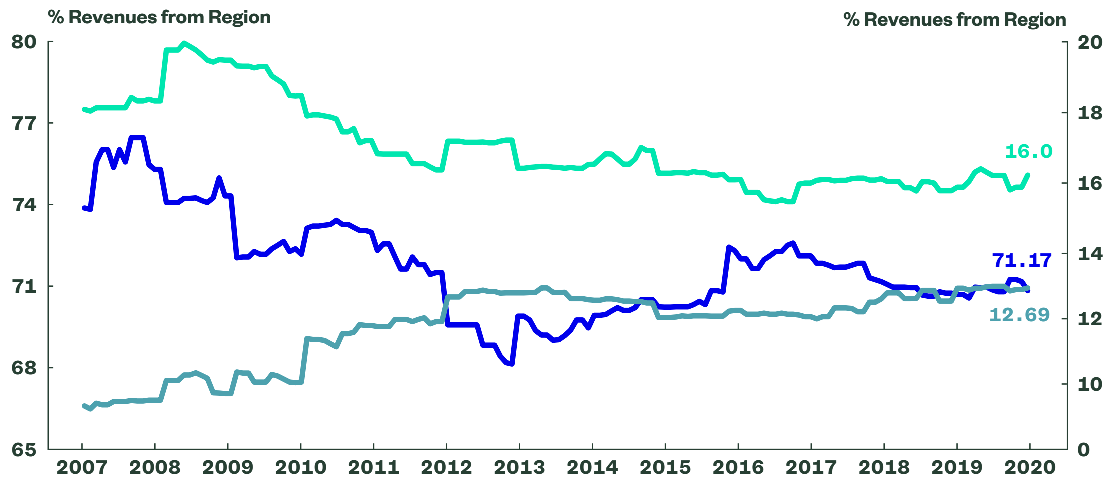


Source: Bloomberg Finance L.P, State Street Global Advisors, as of July 2020. Automobile & Components represents the S&P 500 Automobile & Components Index.

The second risk is that this trade nationalism extends to taxation. Worryingly, there is some bipartisan consensus that US companies with corporate earnings abroad should be channelling tax to their home country. One of Biden's proposals specifically aims at doubling the minimum US tax on foreign earnings, partly to discourage the usage of low tax jurisdictions abroad. Among the market capitalisation of US equities, the S&P 500 has by far the strongest foreign exposure, with around 30% of its revenues generated overseas. Much of that foreign revenue was made from Europe, followed by Asia Pacific, which is becoming increasingly important for US companies (see Figure 27).

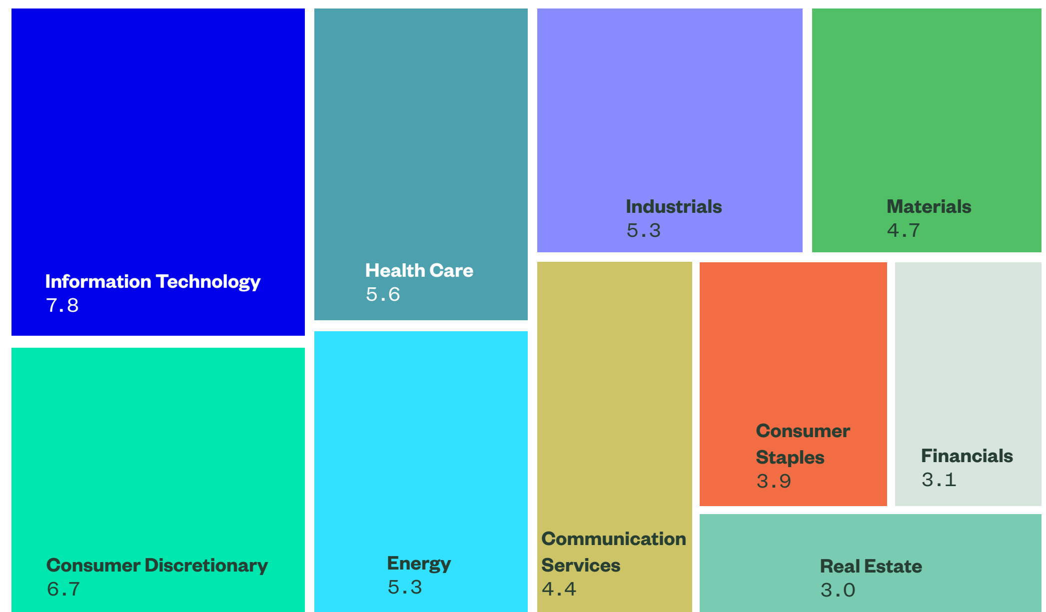
In terms of sectors, tech is the biggest exporter to China, with the semiconductor industry leading the way and generating 25% of its revenue there (see Figure 28). Unsurprisingly, tech is followed by consumer discretionary (especially the consumer services industry and retail), which makes about 7% of revenues from China.[13] On the contrary, only 4.3% of the revenues of the automobile industry came from China, so in this context the tariffs placed on that industry in 2018–2019 had a minor impact on both economies. Small and mid-cap companies are not expected to be impacted as much as their large-cap counterparts because they tend to be more domestically oriented with relatively low exposure to China.

Figure 27
S&P 500 Revenues Generated from Different Regions Since 2007



Source: FactSet, State Street Global Advisors, as of July 2020.

Figure 28
Percentage of Revenues from China by Sector

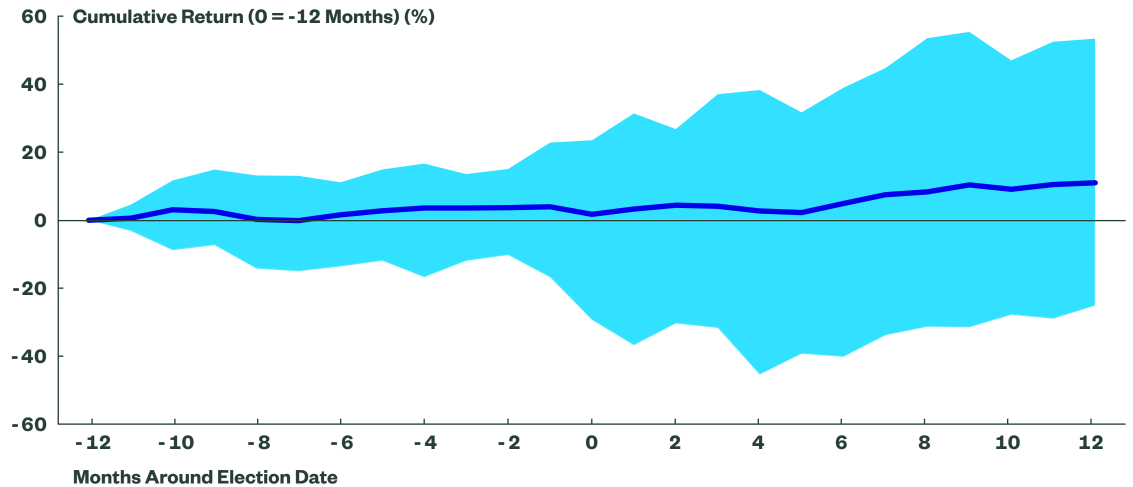


Source: FactSet, State Street Global Advisors, as of July 2020.

Health Care

Health care is among the most politically sensitive sectors, not least because of the amount of money companies, especially pharmaceuticals, spend on lobbying (see Appendix D.1). We often see much more uncertainty in the performance of the health care sector right before and after elections, particularly with respect to the S&P 500 (see Figure 29).

Figure 29
Performance of Health Care Companies

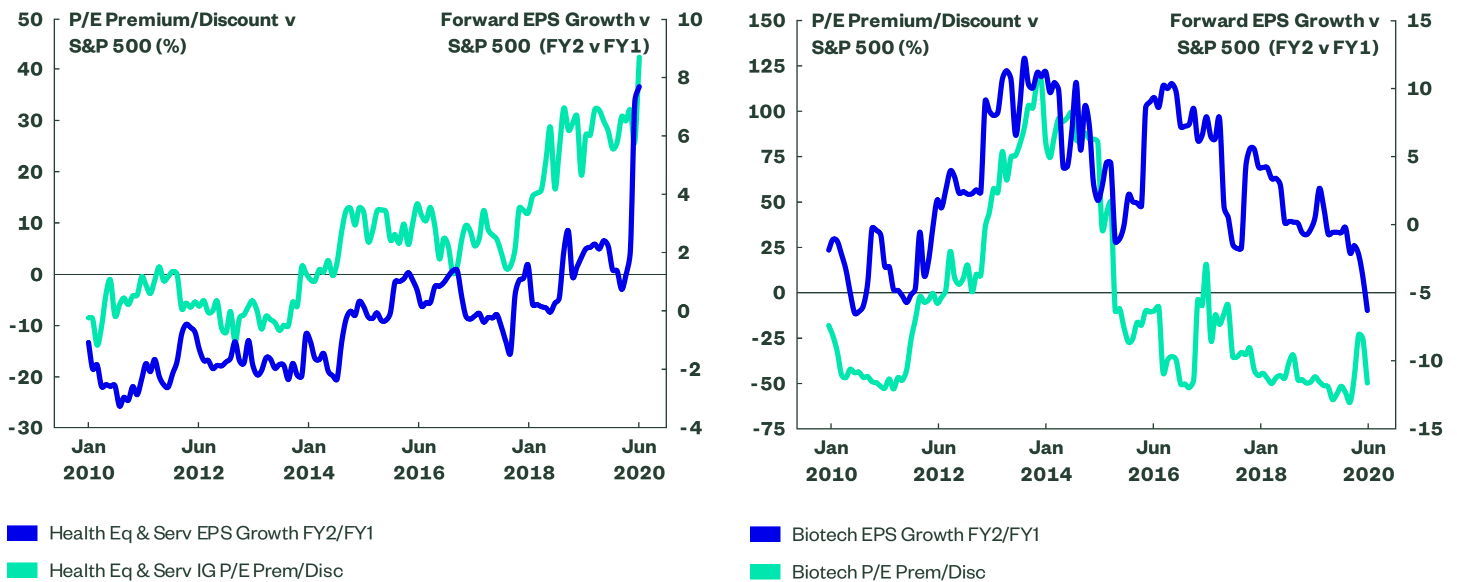


Source: State Street Global Advisors, Bloomberg Finance L.P., as of July 2020. Health care companies are represented by the S&P 500 Health Care Index.

However, not all segments within the health care sector are subjected to the same level of political risk or the whims of the political parties in charge. Specifically, the health care equipment & services industry has frequently traded at a valuation premium compared to its consensus forward growth rate, as this segment enjoys strong innovation in areas such as medical technology and health diagnostics solutions.

In contrast, the biotech industry has often traded at a significant discount to its consensus forward growth due to the constant political debate on drug pricing reform (see Figure 30). The same reasoning goes for the health care providers & services industry, which suffers from uncertainty over whether managed health care providers will encounter more regulation or cost pressures (see Appendix D.2).

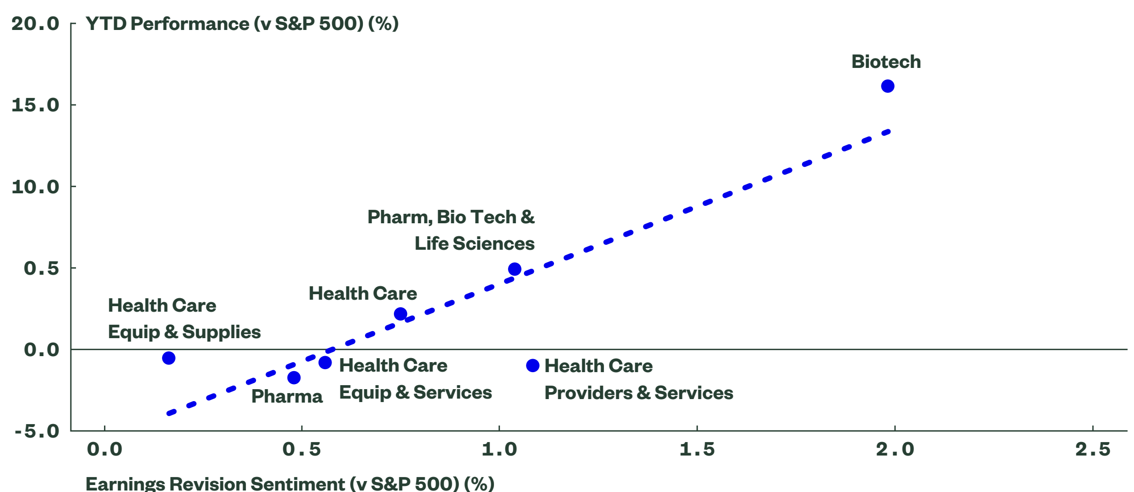
Figure 30
EPS Growth Differential and Price-Earnings Premium of Healthcare Equipment & Services and Biotech



Source: Bloomberg Finance L.P., State Street Global Advisors, as of July 2020. The Health Care Equipment & Services and Biotech are represented by the S&P 500 Health Care Equipment & Services Index and S&P 500 Biotechology Index, respectively.

So far this year, the solid performance of the health care sector has been largely driven by the health care equipment & services industry group, which makes up just under 50% of the sector. Overall, the various health care segments are largely performing in line with their earnings revision sentiment (see Figure 31). This suggests that markets may therefore have concluded that with the nomination of a moderate Democratic candidate, the tail risks of negative policy intervention are absent in the current election cycle. This may be correct with regard to the details of health care policy but could understate the exposure of pharma and biotech to broader corporate tax and regulatory changes in a Democratic administration.

Figure 31
Health Care Segments Year-to-Date Performance and Earnings Revision Sentiment (vs. S&P 500)



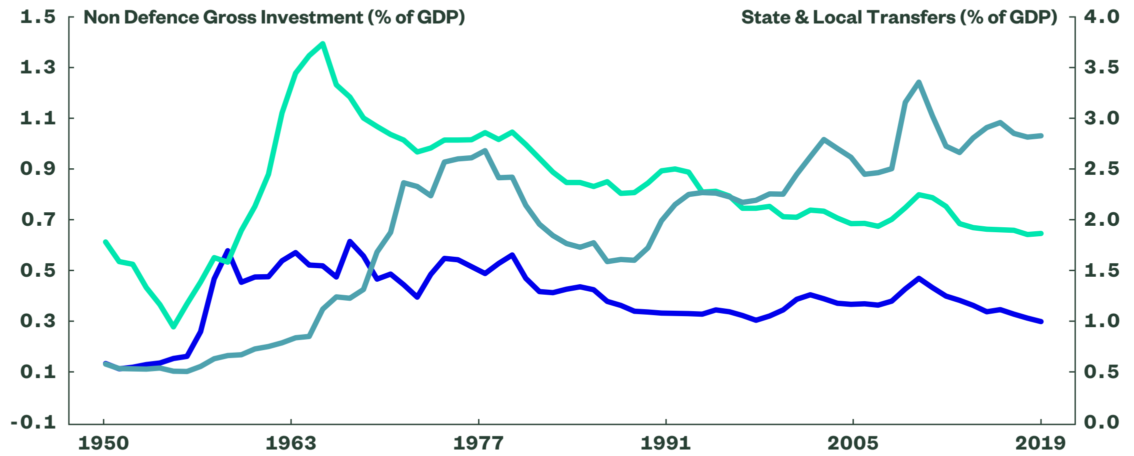
Source: Bloomberg Finance L.P., State Street Global Advisors, as of July 2020. Biotech, Pharma, Bio Tech & Life Sciences, Health Care Providers & Services, Health Care, Health Care Equip & Services, Pharma, Health Care Equip & Supplies are represented by the corresponding sub-indices in the S&P 500 Health Care Index.

Infrastructure

Improving ageing infrastructure has been a key plank of the last few presidents' "rebuilding America" agenda. There is broad consensus across the political spectrum that infrastructure spending, as a percentage of GDP, has been largely neglected since World War II (see Figure 32). There was a brief exception in the aftermath of the financial crisis, when Obama introduced a massive stimulus program, which involved boosting infrastructure expenditure as a percentage of GDP from 2.8% before 2008 to 3.25% in 2009.

Figure 32
Annual Federal Non-Defence Spending, as a % of GDP, 1950–2019

US Capital Transfer
Non Defence Gross Investment
State and Local Transfers



Source: State Street Global Markets, Datastream, as of July 2020.

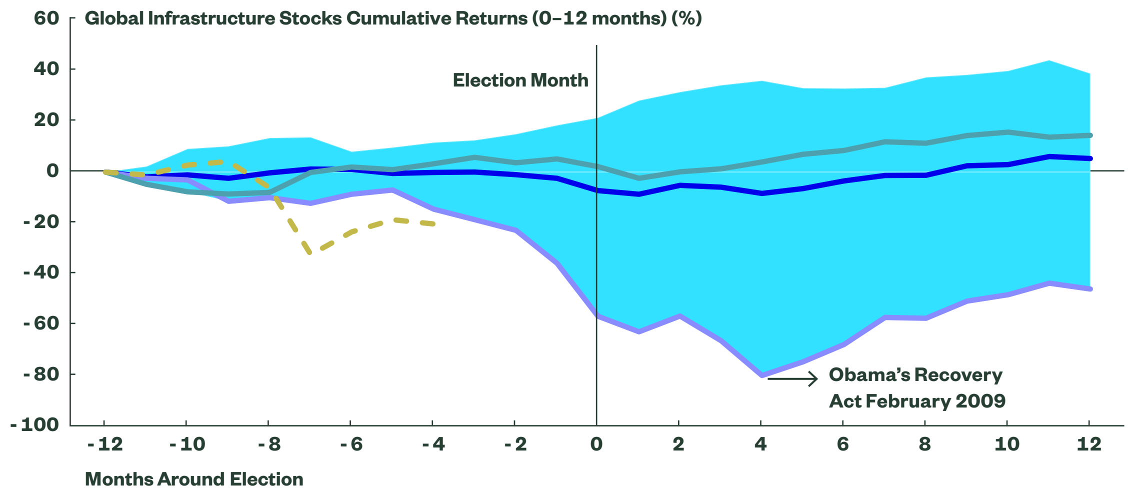
Although, the headline figures understate the secular decline in infrastructure spending as they include operations and maintenance costs, which have taken the majority of overall spending.[14] To complicate the matter further, most of the infrastructure spending is carried out by state and local governments, rather than by the federal government. In 2016, Trump promised substantial infrastructure spending but failed to deliver anything during his first term, nor did he endorse higher transfers to state and local governments.

Given the consensus on the need to improve the state of public infrastructure, infrastructure-related equities could benefit from any electoral shift. To assess this possibility, we look to the past and study the behaviour of global infrastructure stocks[15] during the first term of the Obama presidency as well as that of the Trump presidency (see Figure 33).

A central part of Obama's American Recovery and Reinvestment Act of 2009 revolved around providing grants for smart grid investments, with the aim to accelerate the modernisation of the country's electric transmission and distribution systems. Despite steep declines in infrastructure stocks before Obama was sworn in, they recovered soon after he took office and rallied more than 30% over nine months. Most of the strong performance stemmed from stronger earnings growth expectations (-3.6% in February 2009 versus -0.8% in October 2009) but also a strong valuation multiple expansion (price to forward earnings equalled 10.7x in February 2009 versus 14.5x in October 2009).

Equally, in 2016, infrastructure stocks underperformed initially but quickly rebounded as promises of increased infrastructure spending drove optimism in the equity market. However, due to a lack of any concrete spending plans, performance of infrastructure stocks subsequently stalled. So far in 2020, infrastructure stocks have faltered because crisis-related fiscal measures focus on business and household support and not on longer-term infrastructure. This could change over the course of 2021.

Figure 33
Cumulative Performance of Global Infrastructure Stocks (November 2001 to June 2020)



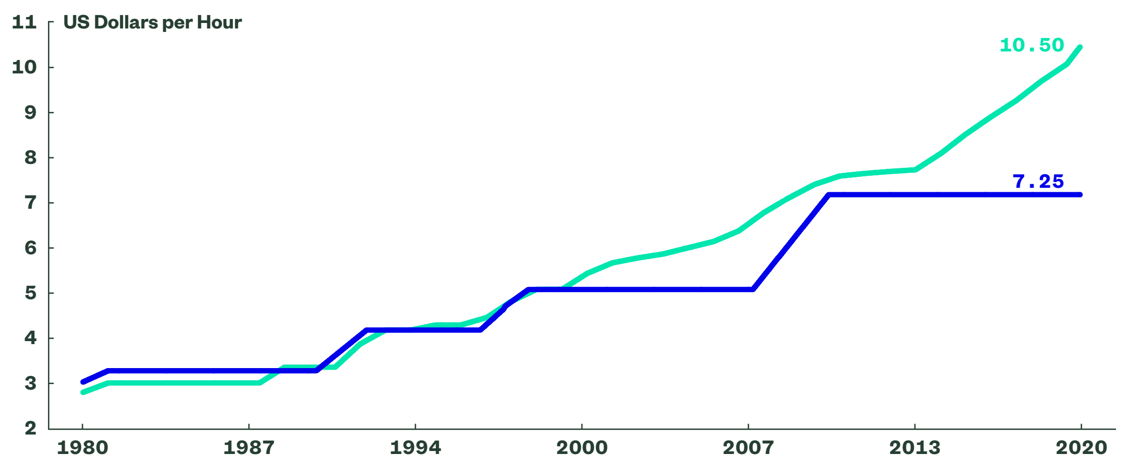
Source: State Street Global Advisors, Bloomberg Finance L.P., as of July 2020. Global infrastructure stocks are represented by the S&P Global Infrastructure Index.

Minimum Wage

The previous two instances of increases in minimum wage were during Democratic presidencies (see Figure 34). Biden supports the Raise the Wage Act, which proposes to raise the minimum wage from $7.25 per hour to $15 per hour. In contrast, Trump prefers retaining the minimum wage at present levels.

Of course, different states already have different levels of minimum wage thresholds while others have none at all. In total, just over 2% of the private sector workforce in the US receives at/or below federal minimum wage. However, the federal minimum wage works as a market and policy signal, thus potentially boosting wage inflation among low-tier workers who are concentrated within a few sectors. Over 60% of them work in leisure and hospitality, while around 8% to 9% work in education services and retail (see Appendix E.1).

Figure 34
Federal Minimum Wage for Covered, Non-Exempt Employees



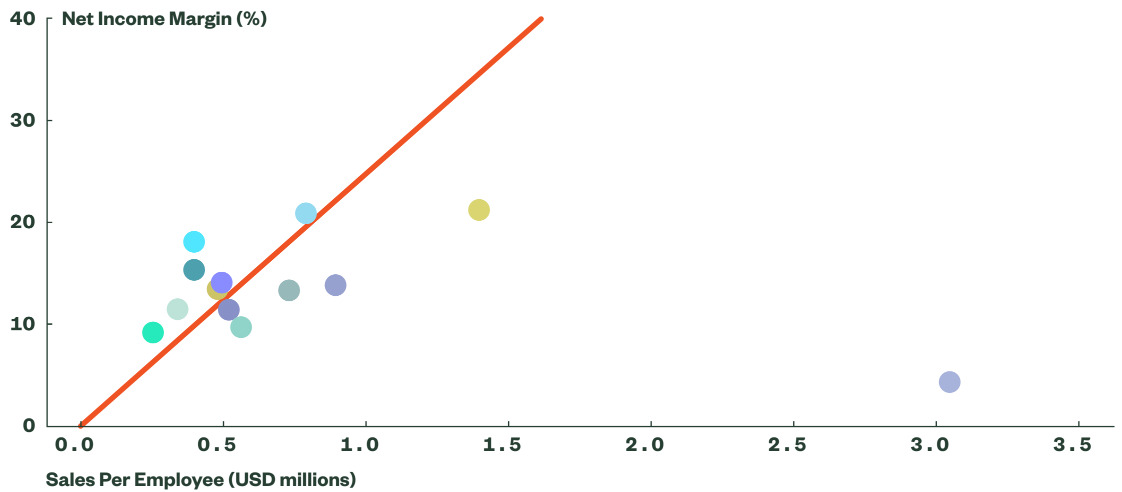
Source: State Street Global Advisors, Department of Labor, as of July 2020.

Any substantial increase in minimum wage can have a significant impact on the bottom line for a business, as US hourly wages are already rising steadily (Appendix E.2), especially in the retail trade. While Amazon might have already raised its minimum wage to $15 per hour, other companies within the consumer discretionary sector may not follow suit. This is because the sector may be most vulnerable to any increase in costs as it already operates at a low profit margin and generates the least amount of sales per employee (see Figure 35).

A closer inspection in Figure 36 shows that a rise in labour costs may serve as a headwind to the retail industry, given it operates at one of the lowest profit margins within the discretionary sector.

Figure 35

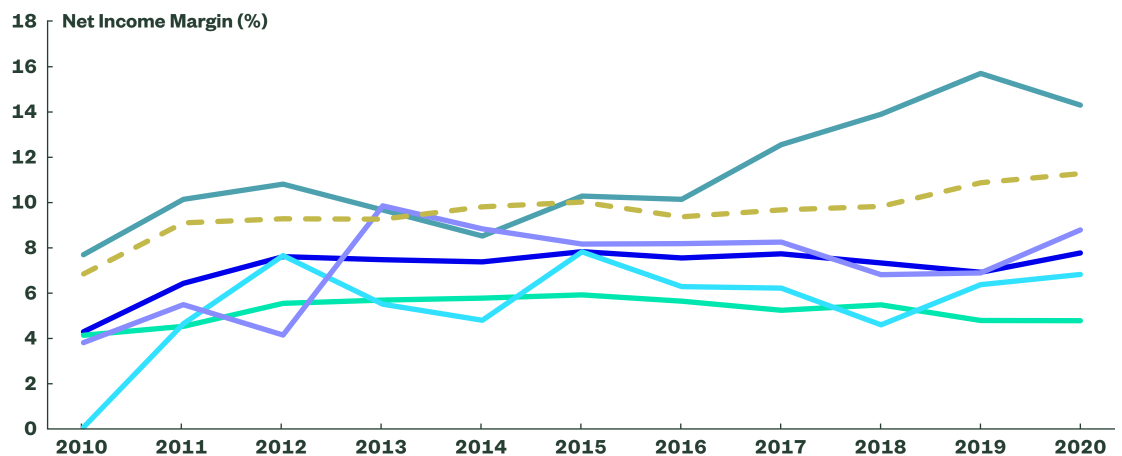
Net Income Margin Versus Sales per Employee in Different S&P 500 Sectors in 2019



Source: State Street Global Advisors, FactSet as of July 2020. The sectors above refer to the GICS sectors within the S&P 500 Index.

Figure 36

Net Income Margin of Select Consumer Discretionary Industries Over the Last Decade

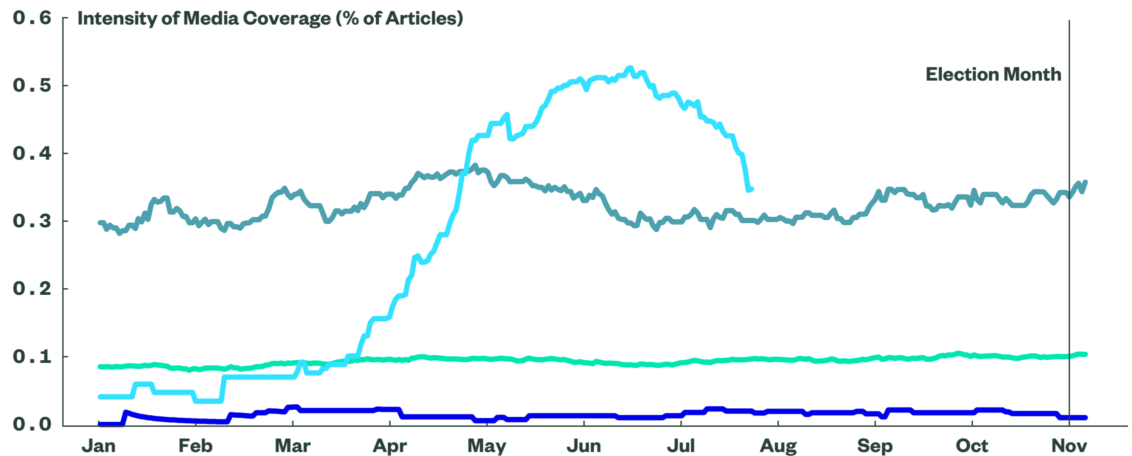


Source: State Street Global Advisors, FactSet, as of July 2020. The industry groups mentioned in the figure above are represented by the GICS industry groups within the S&P 500 Index.

Small and Mid-Cap Companies

Next, we analyse whether political events, such as presidential elections, may have an impact on the behaviour of small and mid-cap stocks. Of note, there has been strong media coverage on small businesses this year versus in previous elections (see Figure 37). This may be because small businesses have been most affected by the COVID-19 pandemic and Biden's proposal to seed a new business opportunity fund worth $30 billion.[16]

Figure 37
Media Intensity of Small Businesses



Source: State Street Global Advisors, State Street Global Markets, MKT MediaStats, New York Times, as of July 2020.

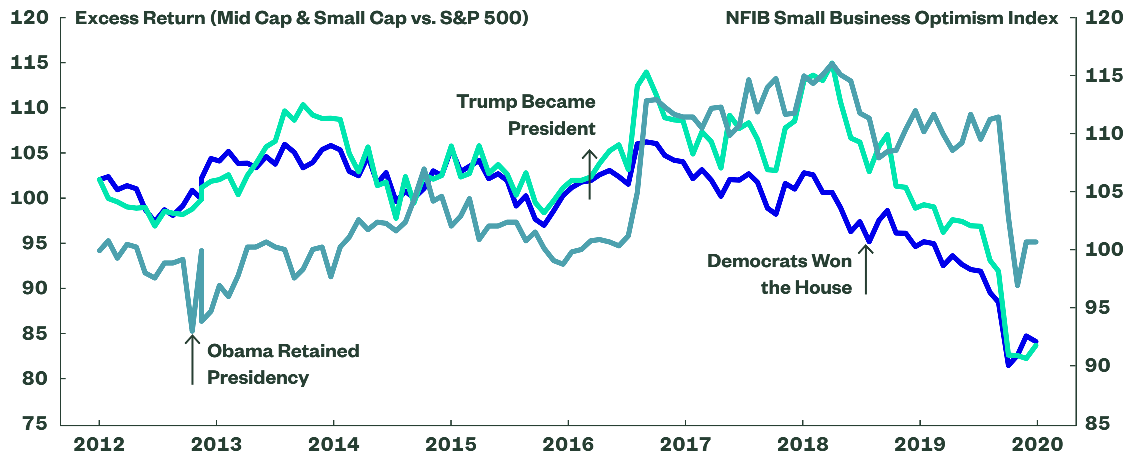
Interestingly, research shows that the historical performance of small and mid-cap stocks often move synchronously with the NFIB Business Optimism Index (see Figure 38). Equally of note is that political events also seem to coincide with the performance of small and mid caps, especially over the past decade.

For example, small-cap stocks fared poorly against their larger-cap counterparts when Obama was elected as president for a second term in 2012 and when Democrats won the House of Representatives in 2018. On the contrary, small caps and, to a lesser extent, mid caps trounced the S&P 500 when Trump unexpectedly won the White House in 2016. This, in our view, is based mostly on sentiment because the outperformance was primarily driven by valuation multiple expansion.

Between October and December 2016, small cap stocks rose by 10.6% and, while forecast earnings growth was revised upwards, the most significant contributor to return during the period was a rise in valuation, with price-to-forward earnings rising from 21x to 24x. The opposite occurred when the Democrats took the House in 2018. At that time, smaller-cap companies plunged as earnings multiples contracted. That said, we certainty do not attempt to argue that political events are the sole source of influence on the performance of such companies.

Figure 38

Performance of Small and Mid Caps Against Large Caps Since 2012



Source: State Street Global Advisors, Bloomberg Finance L.P., as of July 2020. Mid caps and small caps are represented by the S&P Midcap 400 Index and the S&P Small Cap 600 Index, respectively. The S&P MidCap 400 Index and the S&P SmallCap 600 Index were incepted on 19 June 1991 and 28 October 1994, respectively. Results prior to these dates were calculated by using data available at the time in accordance with the indices' current methodology.

From this analysis, one may be led to believe that because small-cap companies appear to "favour" Republicans over Democrats, the owners of these companies are generally loyal to the Republican party. The latter provides broad-based regulatory relief, which helps all businesses but, given a higher cost base, disproportionately helps small and mid caps.

In contrast, large caps can navigate Democratic regulatory initiatives through their large lobbying efforts whereas small and mid caps remain vulnerable to any changes. While their personal political affiliations may be more split, when asked by a recent Gallup poll[17] about their own prospects under a Republican or Democratic presidency, most small business owners believe they will be better off under Republicans (see Appendix F).

Possible Election Scenarios and Implementation Ideas

We See Four Possible Election Scenarios

From an investor perspective, we see four possible outcomes in the upcoming election. (Scenarios A to D).

Scenario A: Democratic sweep of all branches of government (including at least 50 seats in the Senate). In recent years, the practice of split-ticket voting (i.e. voting for different presidential and senatorial party candidates) has declined sharply. In fact, 2016 was the first presidential election where 100% of all states delivered majorities for the same party in both the presidential and congressional election.

Even in the three preceding elections, there were still a half dozen states with different outcomes. Moreover, the Senate map has more Republican incumbent seats up for re-election, and that includes three battleground states. In short, the presidential and senatorial outcomes are therefore tightly linked. One can hence use state-level presidential polling as a proxy for the Senate outcome. On this basis, the possibility of a Democratic sweep informs much of our policy analysis.

In this scenario, the Democrats would have a strong mandate to implement their program for government. This would allow them to implement radical changes on, for example, green policies. A main plank of Biden's policy to stimulate economic recovery from the coronavirus pandemic involves spending $2 trillion on investments in clean energy and infrastructure[18] in his first term of office. This increase in investments alongside his objective for the US to achieve net-zero emissions by 2050[19] would be a boon for companies that embrace renewable energy and other fossil fuel-light technologies. On the contrary, oil and gas companies could suffer under his plans, as he calls for a worldwide ban on fossil fuel subsidies and advocates prohibiting the issuance of new drilling permits.

In addition to climate change, health care forms another central policy plank. Biden wants to widen access to the Affordable Care Act and pledges to spend $750 billion over the next 10 years. This increase in spending would support health care stocks, even if his proposal on restricting drug prices may serve as a headwind for the sector.[20] Federal investment in research and development of $300 billion may lend further support to the sector.

Biden has also publicised his opposition to stock buybacks, especially for companies that are receiving federal coronavirus bailout. While it remains to be seen what actions he might take, investors would be well advised to avoid companies conducting high levels of stock repurchases in favour of high dividend paying companies, if they seek income.

Scenario B: Biden victory with a Republican-held Senate. This is a conceivable outcome given that the Democrats start from a de facto deficit of four seats (current 47–53 ratio plus Alabama, which was only won temporarily in a special election). Thus, while Democrats would likely to gain seats, it may not be enough for the net four gains required to capture the Senate majority. The party controlling the White House only needs 50 seats to take the majority, as the Vice President provides the tie-breaking vote. Such a majority would allow for the Democratic takeover and domination of Senate committees, which enable the approval of political and judicial appointees, the setting of the legislative agenda and, crucially, the passage of laws in reconciliation with the House of Representatives where a 50+1 majority suffices.

In other words, failure to win the Senate would limit the magnitude of the policy shift. We believe that, under this scenario, the size of any public investment program would be scaled down; antitrust legislation would be diluted; changes to personal taxation would be limited; and labour market reforms would not take place at all. This would nonetheless leave most of the regulatory pivot intact, as well as a core of the corporate tax increases. Based on historical data and the range of credible scenarios, this would be the most equity-supportive scenario, though equity performance is typically always strong in the post-election year, but especially during Democratic administrations.

In this scenario, Biden would still have a strong mandate but the government would be divided. Policies with broad consensus would not be expected to face hurdles to get implemented. An example of this is infrastructure, where both parties agree that substantial investments are necessary in improving America's crumbling public facilities. On the surface, there also seems to be some level of agreement to restrict stock buybacks, notably for bailed-out firms, and introducing a price ceiling on drug pricing.

However, more controversial policies may be watered down by the Senate, such as the more radical parts of climate policy. Even in this scenario, we would still expect renewables and fossil fuel-free stocks to benefit. Another bone of contention relates to personal tax increases and antitrust enforcement. We believe that they would likely not be implemented and this would in turn benefit the consumer discretionary and communication services sectors.

Scenario C: A disputed victory. Even if Biden's current national polling margin of +7.6% (as of 26 August 2020) were to be sustained, the polarisation of US politics means that the number of states separating winner from loser may only be a handful. Figure 39 illustrates how close US presidential elections have become in the 21st century. And yet, even the only landslide election of 2008, where Obama edged out McCain by 7.2% nationally, translated into a six-state gap, with most of these with a much narrower margin. Entrenched views suggest that the same national poll would only yield a four-state gap and a Biden lead of less than 6% could actually make it come down to only Florida and one other battleground state.

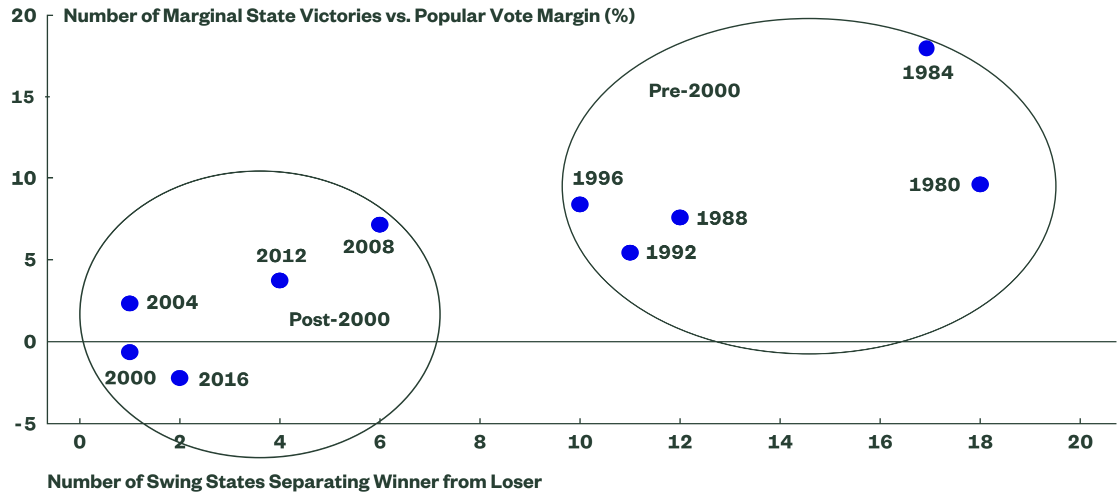
This arithmetic, compounded by COVID-19, which will likely raise early and mail-in voting to an all-time record, could delay the vote count beyond the usual time frame. President Trump has already signalled his intention to reject an electoral loss, which he could conceivably achieve if the disputed results were limited to only two or a maximum of three states.

In such a scenario, would a homemade political crisis alter the safe-haven perception of US securities? There remain few alternatives to US dollar instruments that offer the same safety and liquidity characteristics, but we would nonetheless expect some capital outflows. This would not only mean perceived safe-havens (e.g. yen or gold) would benefit, but there would be capital flows driven by home bias and safety parameters, benefiting most counterparts to the US dollar and generating higher volatility across the board. Depending on the length of the dispute, and assuming it is resolved in an accepted constitutional manner, the incoming administration would be focused on domestic institution-building and a further dilution of the Biden agenda would apply. The same investment conclusion holds if Trump's re-election were to be challenged for irregularities.

In this scenario, a disputed victory may lead to lengthy legal proceedings and prolonged uncertainty over the election outcome. Therefore, defensive strategies could be prioritised. Low volatility strategies, as well as the consumer staples and utilities sectors, could help shelter investment portfolios during this time.

Scenario D: Maintaining the status quo. In this outcome, we expect President Trump's policies to remain largely the same as in the first term, especially given that he does not currently have a genuine agenda for government. As there is much cross-party consensus on infrastructure spending, he may decide to refocus his attention on this but any changes to climate policies will fall by the wayside as he lends his support to fossil fuel-heavy industries. There may also be a continued deterioration of relations with China, affecting international trade. Small and mid-cap companies could outperform large companies with higher international exposure.

Figure 39
Number of Marginal State Victories vs. Popular Vote Margin



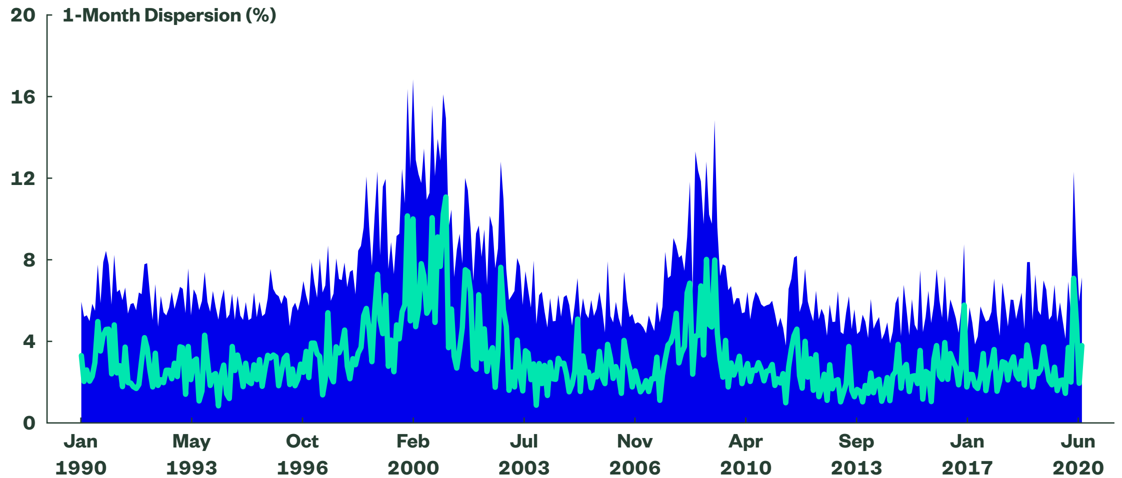
Source: State Street Global Advisors, Macrobond, as of July 2020.

Figure 40
Election Scenarios and Implementation ideas

Scenario	Rationale	Favourable Exposures
A: Democratic Sweep	Substantial investment in renewables and clean energy	Fossil fuel-free and ESG
	Rise in infrastructure spending	Infrastructure, utilities, telecoms
	Additional federal spending and R&D incentives for healthcare	Health care (in particular equipment)
	Anti-buyback stance	Dividends
B: Biden victory, Republican Senate control	Rise in infrastructure spending	Infrastructure, utilities
	Rise in investment in renewables and clean energy	Fossil fuel-free and ESG
	Scaling down of personal tax reforms and antitrust legislation	Consumer discretionary (consumer services, retail)
	Anti-buyback stance	Dividends
C: Disputed victory	Prioritise defensive strategies	Low volatility, utilities, consumer staples
D: Status quo	The status quo will be maintained	Infrastructure, utilities, oil & gas, mid/small caps

Appendix

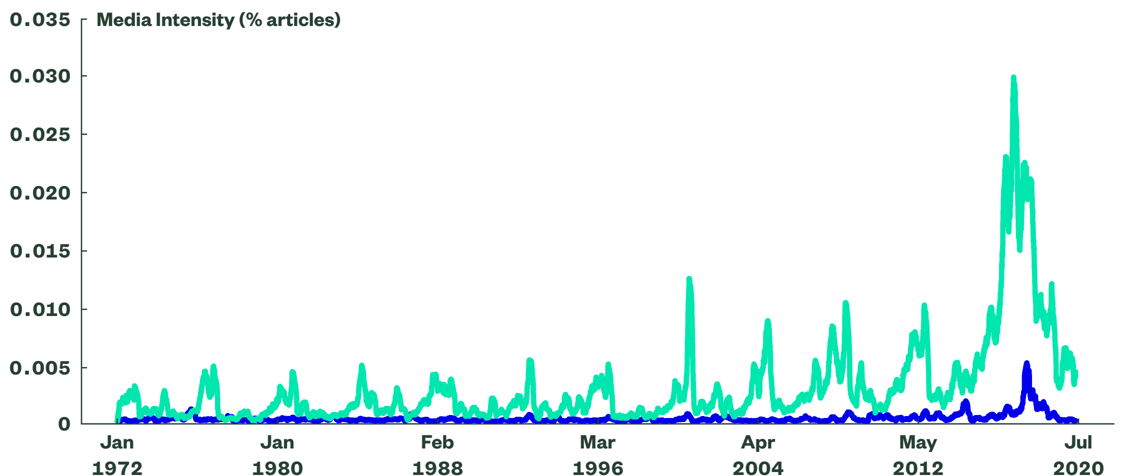
Appendix A.1
Stock Return Dispersion vs S&P 500 Sector Return Dispersion



Source: Indexology Blog: S&P 500 and the US Presidential Election, S&P Dow Jones Indices, as of August 2020.

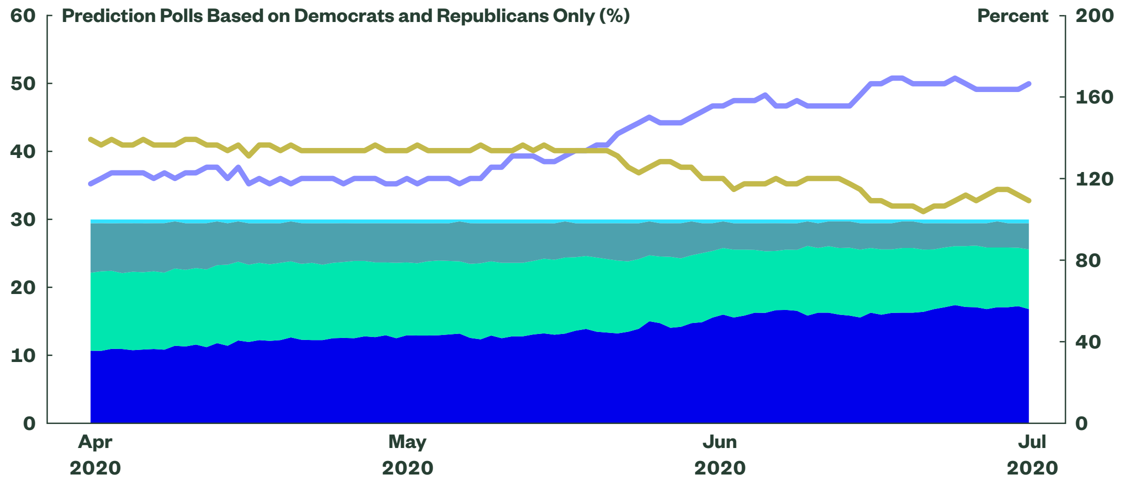
The Exhibit below shows the intensity of media coverage of both presidential and congressional races since 1972. It can be seen that the level of media intensity has been steadily increasing since the early 2000s, with the peak being reached during the 2016 cycle. Meanwhile, intensity for congressional races has also gone up and peaked at the recent midterm elections.

Appendix A.2
Media Coverage Intensity of Federal Elections



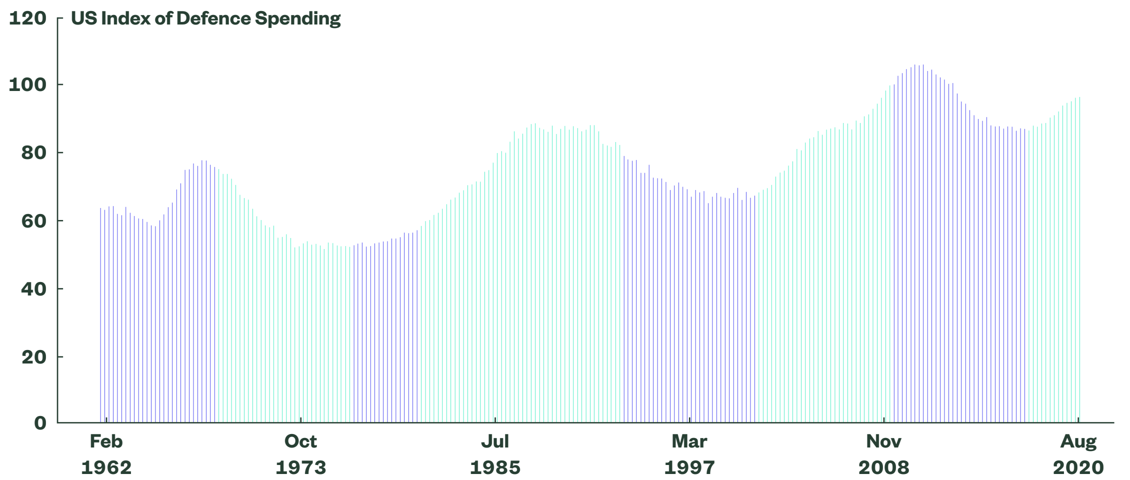
Source: MKT MediaStats, State Street Global Markets, New York Times, as of July 2020.

Appendix B
Prediction Polls for Presidency and Congress



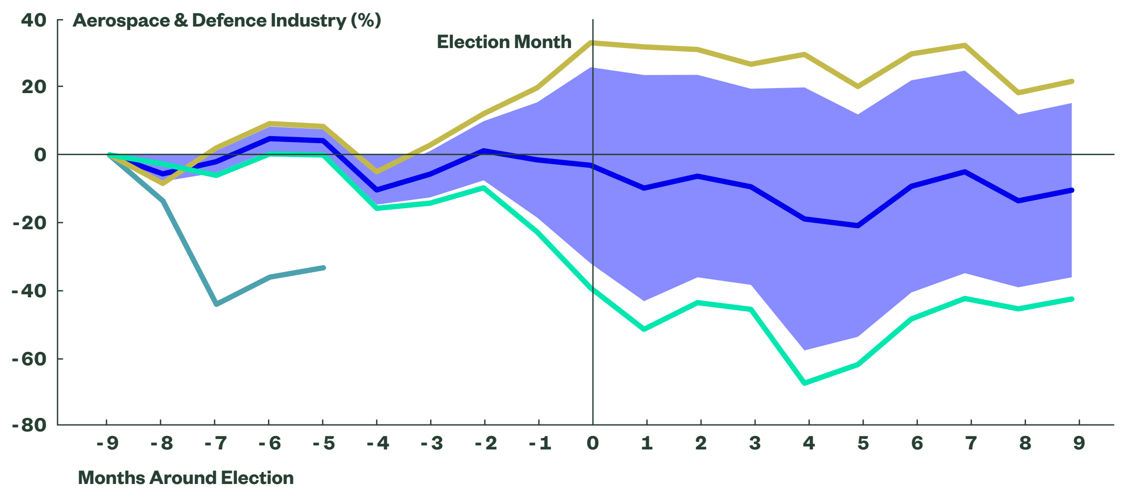
Source: State Street Global Markets, Predictit.org, as of July 2020.

Appendix C.1
US Defence Spending



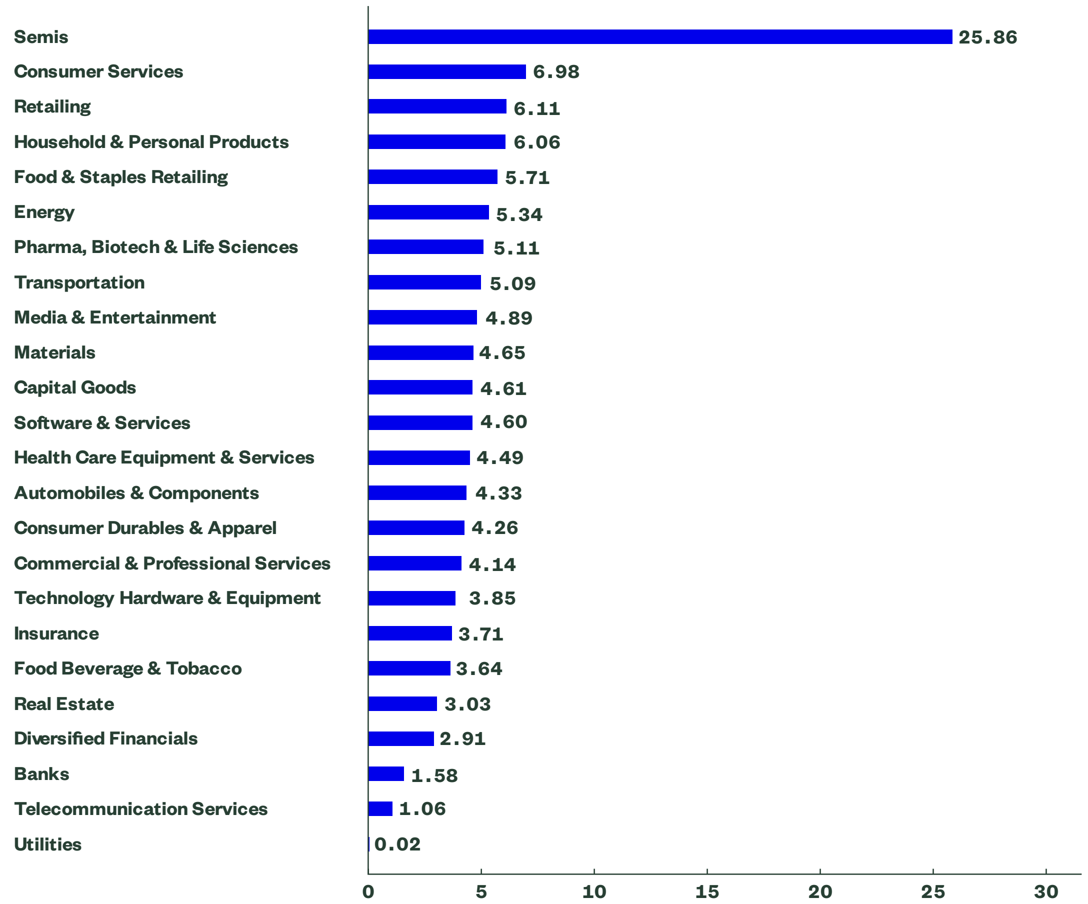
Source: State Street Global Advisors, Datastream, as of July 2020.

Appendix C.2
Aerospace & Defence Returns Before and After Elections During Economic Recessions (Since October 1991)



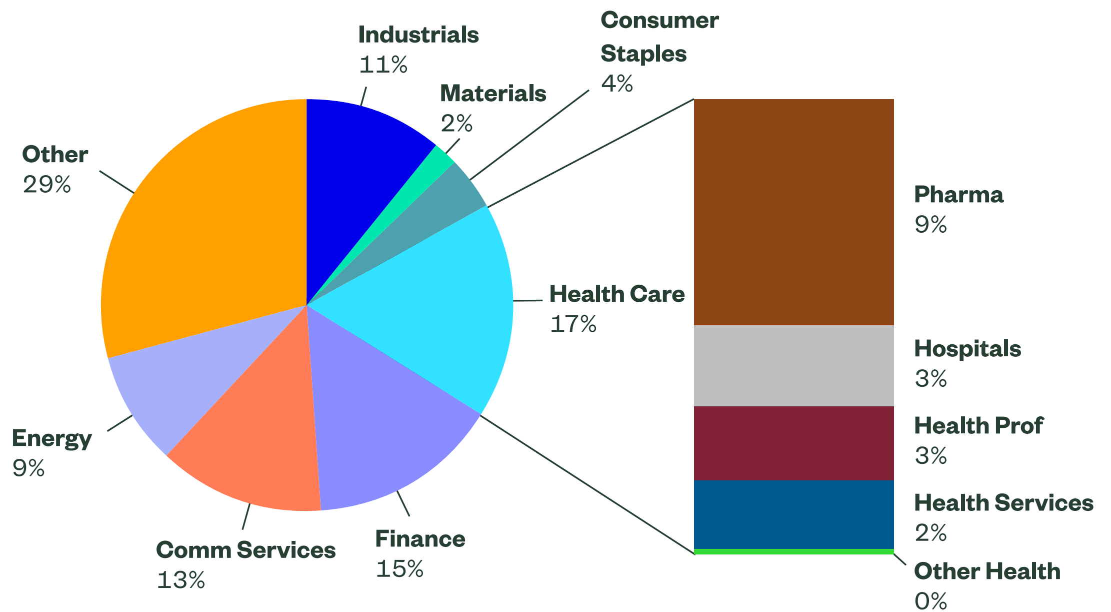
Source: State Street Global Markets, Bloomberg Finance L.P., as of July 2020. The S&P 500 Aerospace and Defence Index was incepted on 19 June 2006. Results prior to this date were calculated by using data available at the time in accordance with the index's current methodology.

Appendix D
% Revenue from China by Industry Group



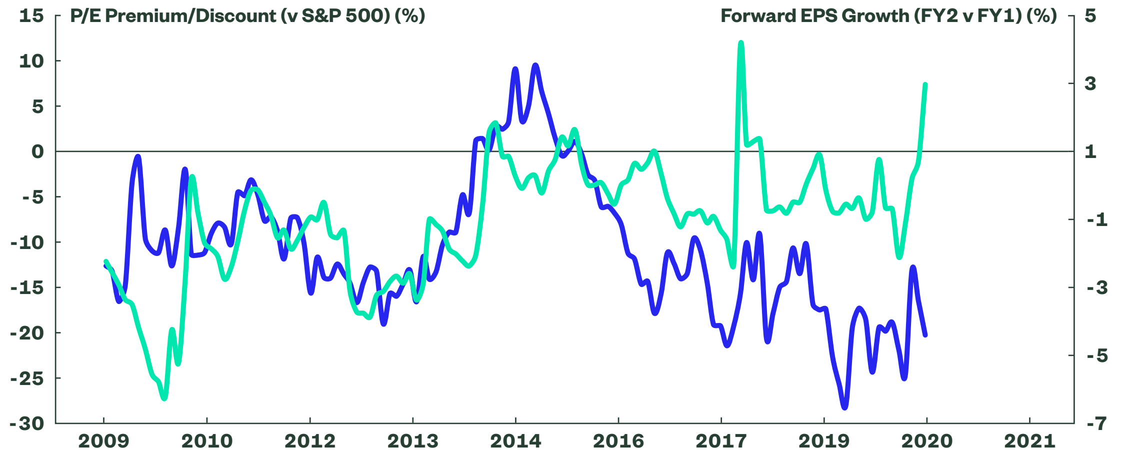
Source: State Street Global Advisors, FactSet, as of July 2020.

Appendix E.1
Amount of Total Political Lobbying Spend in Each Sector in 2019



Source: Open Secrets, State Street Global Advisors, as of July 2020.

Appendix E.2
EPS Growth Differential and Price-earnings Premium of Healthcare Provider & Services



Source: Bloomberg Finance L.P., State Sreet Global Advisors, as of July 2020.

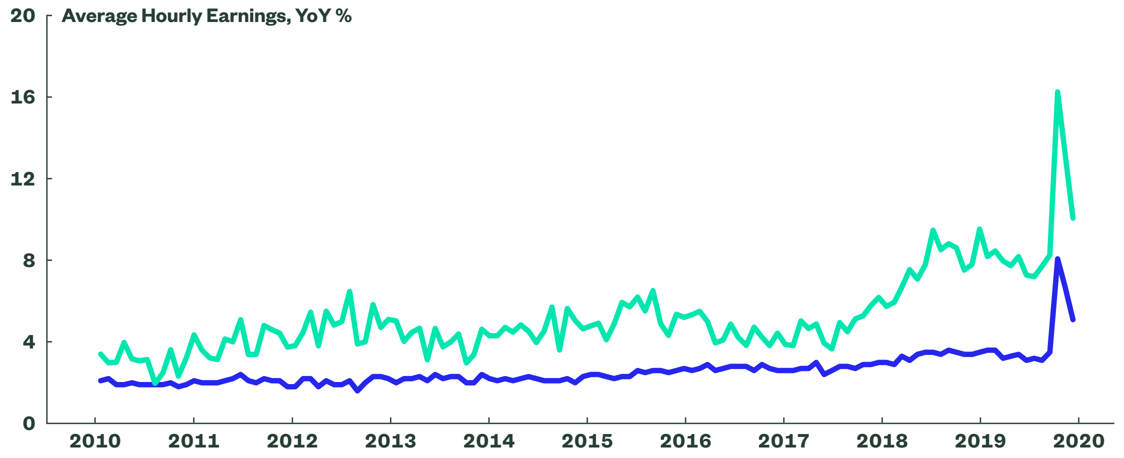
Figure F.1
Percentage of Workers at or Below Minimum Wage by Sectors

Industry	% of minimum wage workers (at or below)
Agriculture and Related Industries	0.6
Construction	0.9
Manufacturing	2.4
Durable Goods	1.1
Nondurable Goods	1.2
Wholesale Trade	0.5
Retail trade	8.3
Transportation and Utilities	2.1
Information	1.0
Financial Activities	1.2
Professional and Business Services	3.5
Education and Health Services	9.3
Leisure and Hospitality	60.9
Other Services	3.9

Source: US Bureau of Labour Statistics, as of July 2020. Characteristics of minimum wage workers, 2019.

Appendix F.2
General and Retail Wage Inflation

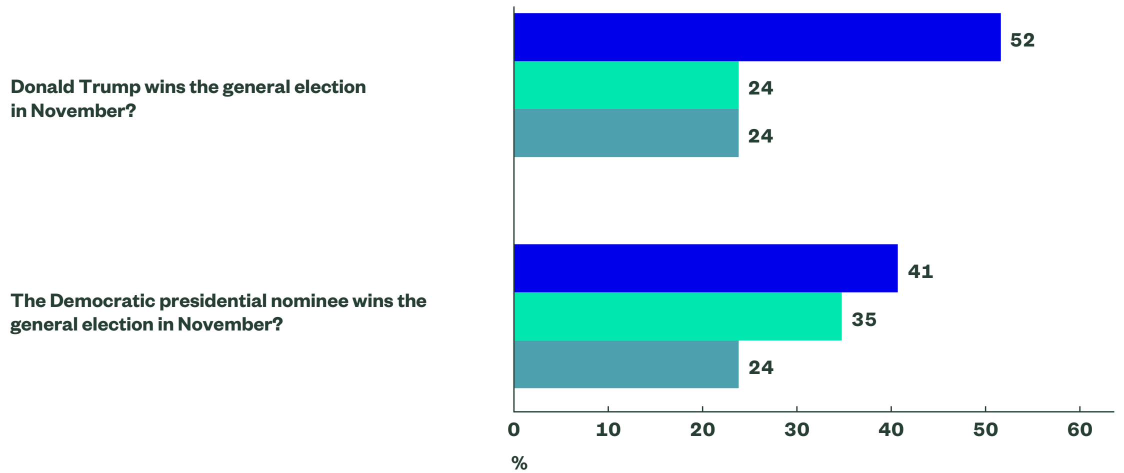
- US Average Hourly Earnings All Employees Total Private Yearly Percent Change SA AHE YOY% Index Last Price
- Retail



Source: Federal Reserve Economic Data, as of July 2020.

Appendix G
Small Business Owners' Expectations of Election Impact

- % My business will be better off
- % My business will be worse off
- % My business will not be impacted either way



Source: Gallup Polls, as of January 2020.

Endnotes

1 Only the sectors which have experienced the highest and lowest H-spreads are shown in order to ensure that the graph is visible.

2 It should be noted that investors often take advantage of sector dispersion in their asset allocation decisions (see Appendix).

3 Please see Appendix A for further details.

4 MKT MediaStats maintains a reservoir of articles published by local media sources and organised by state. It includes approximately 13 million articles from 390 sources, representing all 50 states.

5 During our research, we scrutinised other macroeconomic indicators, including three-month Treasury rates, inflation, unemployment rate, ISM indicators, private non-residential fixed investments, among other indicators.

6 As part of our research, we also looked at the unemployment rate but did not find it particularly instructive.

7 Federal R&D Budget Trends: A short summary, American Association for the Advancement of Science, January 2019.

8 https://wsj.com/articles/president-trump-joins-democrats-in-calls-to-block-share-buybacks-11584876823.

9 Joe Biden urges 'every CEO in America' to commit to no stock buybacks for a year, CNBC market, Mar 2020.

10 Buyback blowback: Why politicians on the right and left are targeting stock repurchases, Mar 2020.

11 Fossil fuel reserves include reserves of thermal coal, oil and gas as defined by the S&P 500 Fossil Fuel Free Index.

12 A Run on Oil: Climate Policy, Stranded Assets, and Asset Prices, University of Chicago 2019, Michael Barnett.

13 Appendix 1 shows the amount of revenues generated in China by each of the industry groups within the S&P 500.

14 Brookings report claimed this share rose to 60% in 2017, up from 54% a decade earlier. https://brookings.edu/research/shifting-into-an-era-of-repair-us-infrastructure-spending-trends/.

15 There are few investable products that exclusively track US infrastructure stocks. For this reason, we focus on global infrastructure stocks. With a correlation of 0.61 from Dec 2001 to June 2020, we found that US infrastructure stocks correlate most with the global infrastructure index. Other sectors, such as US Industrials, US Materials and US Transportation have a negative correlation with US infrastructure stocks. Indices containing solely US infrastructure stocks are also rare.

16 Source: Joe Biden unveils racial economic equity plan that calls for investment in minority businesses, workers CNBC, July 20.

17 https://news.gallup.com/poll/284396/small-business-owners-highly-engaged-2020-election.aspx.

18 This involves building renewable energy infrastructure and climate resiliency industries and includes increasing funding for such programmes as the New Markets Tax Credit, the Community Development Financial Institutions (CDFI), amongst others. (Source: joebiden.com).

19 https://joebiden.com/climate/#.

20 Joe Biden's Health Care Plan Would Spend $750 Billion More On Obamacare And Cap Drug Price Inflation, Forbes, March 2020.

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