What Investors Need to Know About the Next US President

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Not long after this historic election is over, one of the candidates will actually start governing. Kristina Hooper analyzes Trump's and Clinton's views on fiscal spending, taxes, regulation and more to help investors position their portfolios.

Key takeaways

- Clinton shares many of the Democratic Party's traditional views on spending and taxes, but Trump is generally not as fiscally conservative as a typical Republican
- Regardless of who wins, Congress will decide which policies become reality – and the vast majority of Congressional seats are in play
- A Clinton victory could result in a sell-off of pharmaceutical, biotech and possibly financial-services stocks
- A Trump win could result in a short-term sell-off in stocks, a flight to gold and a rise in the US dollar

The 2016 US presidential election is just around the corner, and it has been a most extraordinary and unusual race – not least because its outcome holds significant implications for the US economy and for investors. To understand the impact a Hillary Clinton or Donald Trump win could have on these areas, we must first examine the platforms of the two candidates in a variety of key areas – albeit with the caveat that their platforms have changed over time, particularly Trump's.

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Platform details

Government spending

Clinton shares the Democratic Party's traditional views on spending: She plans an increase in government expenditures in a variety of areas, including education, clean energy and health care. Most notable are her plans for infrastructure spending: She plans to spend USD 275 billion on infrastructure, including establishing a USD 25 billion national infrastructure bank and issuing USD 250 billion in infrastructure grants. All told, the National Taxpayers Union Foundation (NTUF) projects that Clinton's proposals would result in increased spending of USD 169 billion per year.

Trump's spending plans are not as fiscally conservative as those typically found on a Republican Party platform, given his plans to spend more in certain areas. For example, Trump says he will spend on infrastructure at least double the amount of money that Clinton has proposed, although he has not provided much in the way of hard numbers. Trump also plans to spend more on other areas, such as defence, while maintaining Social Security spending. But while he has outlined some broad proposals, he also wants to make significant cutbacks in current government spending. At the same time, he has not been specific on where those cuts would come from, instead suggesting that significant cost savings can be found by eliminating fraud. As a result, the NTUF projects that Trump's proposals would result in a net decrease in spending of USD 56 billion per year.

The NTUF says Clinton would increase government spending by USD 169bn a year, while Trump would decrease it by USD 56bn per year

Taxation

Clinton's tax platform, like her proposed spending initiatives, is also in line with the Democratic Party's traditional ideology. Most of her policies would disproportionately impact high earners by increasing taxes on high-income individuals and estates, and by limiting deductions. She would also disincentivize short-term holdings of securities by changing the requirement to qualify for the lower long-term capital gains rate to a holding period of six years; investments held for a shorter period of time would be taxed at a higher capital gains rate.

In terms of corporate tax policies, Clinton's plan uses a "carrot and stick" approach, which would incentivize what is perceived to be responsible corporate behavior and penalize that which is not. For example, her proposals discourage activities in the financial markets that are "non-productive", such as high-frequency trading, and they also disincentivize tax-inversion mergers through the use of an "exit tax".

Clinton would offer tax credits for businesses that share profits with employees and hire apprentices. Moreover, she plans to eliminate tax benefits that are currently in existence for traditional energy; instead, she would provide those benefits to clean energy. In total, the Tax Foundation estimates that Clinton's tax proposals will result in a net increase in revenue to the US government of USD 1.1 trillion over 10 years.

For his part, Trump has proposed a fairly traditional Republican platform on taxation: In general, he plans to simplify and lower taxes. In terms of income taxes for all households, he would like to move from seven personal income-tax brackets down to three, streamline deductions and repeal the estate tax.

Clinton plans to increase taxes on high-income earners and limit deductions, while Trump plans to simplify and lower taxes – especially for corporations

In terms of the corporate tax rate, Trump proposes to reduce it from 35 per cent to 15 per cent, which would be a dramatic decrease. Trump also proposes a one-time repatriation tax of 10 per cent on corporate profits held overseas. Trump's corporate tax platform would significantly improve the tax competitiveness of the US relative to other countries. However, his tax cuts would cause a substantial drop in tax revenue; the Tax Foundation estimates that Trump's tax proposals will result in a net decrease in revenue to the US government of USD 23.9 trillion over 10 years.

Regulation

Under Clinton, there would in general be a higher level of regulation, particularly with regard to the financial-services industry. For example, one Clinton proposal is to assess a new "risk fee" on banks with assets of more than USD 50 billion. In addition, Clinton plans to raise minimum wage to USD 12 per hour. If the minimum wage is raised, expect industries with a high percentage of minimum-wage workers to get hit hardest: largely restaurants, retail and hospitality. However, an increase in the minimum wage is likely to result in higher spending among lower-income

groups, who typically spend most of what they earn. Trump has made reducing regulation a cornerstone of his campaign.

Immigration

The two candidates' positions on immigration are starkly different. Clinton favours a pathway to citizenship for the 11.3 million undocumented immigrants living in the US, while Trump has said he plans to deport these 11.3 million people from the US. However, it is important to note that these immigrants represent 3.5 per cent of the US population and 5.1 per cent of the labour force, and their deportation would incur significant costs for the US economy – hurting the housing, construction and agriculture industries, in particular.

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Trade

While Trump's proposals are fiercely protectionist and at odds with traditional Republican views, Clinton has also recently come to favour protectionist policies. Most notably, her switch from supporting to opposing the Trans-Pacific Partnership (TPP) underscores a fundamental change that was likely brought on by the popularity of the anti-trade Bernie Sanders, whom she defeated in the primary elections. However, if elected, Clinton will likely end up adopting a more moderate stance than Trump, who regularly takes swipes at China and has proposed dismantling the North American Free Trade Agreement. Trump could potentially ignite a trade war with his commitment to impose tariffs on US trading partners.

Analysis

Central bankers, including those in the US, have lamented the absence of fiscal stimulus over the past decade, as it left a vacuum that has to a certain extent been filled by monetary stimulus. Yet monetary policy can only do so much; it is a blunt instrument, not a surgical tool. Fiscal spending, on the other hand, can boost an economy in a way that monetary policy alone cannot.

John Maynard Keynes was an early and strong proponent of exercising fiscal policy to help stimulate growth and attain full employment. Keynes said that "opportunities for employment are necessarily limited by the extent of aggregate demand" – which means that aggregate demand needs stimulus from a source such as fiscal policy in order to increase employment. Many economists have come to believe in Keynes' theory that fiscal policy can be effective in reducing unemployment. More specifically, in a recession, expansionary fiscal policy can be stimulative: Increased public spending can help boost private spending and investment.

Yet although fiscal spending has a positive multiplier effect, it varies by type of spending. The Congressional Budget Office (CBO) has done significant research on this topic and provides a range of multiplier effects for each type.

- Government purchases can have a multiplier effect as high as 2.5.
- Benefit payments to individuals (including Social Security) have a multiplier effect as high as 2.1. They are typically very effective ways to boost aggregate demand – and presumably employment – because many lower-income Americans are recipients of such benefits payments, and they are more likely to spend disposable income rather than save it, putting that money back into the economy.
- Infrastructure spending can have a multiplier effect as high as 2.2, meaning that every 1 dollar spent on infrastructure could produce 2.20 dollars in economic benefits. A 2005 research paper by Isabelle Cohen, Thomas Freiling and Eric Robinson is even more positive: "In better economic times, spending on infrastructure construction generates a larger return. Yet even in a recession, the overall effects of initial spending still double output as they ripple through the economy."

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It is important to note that multiplier effects can vary greatly; they are not stable over time or over regions, and they depend on a variety of factors. Therefore, the economic impact of any particular type of spending can at times be far lower than its multiplier estimate.

Not surprisingly, as is the case with government spending, tax policies have different multiplier effects depending on the type of taxation and the people the taxes benefit. However, it is important to note that, like monetary policy, tax cuts have an indirect impact on the economy and employment because they are dependent upon market-participant psychology. In other words, people may or may not spend the savings they receive from tax cuts. In the case

of the tax cuts implemented in the wake of the Great Recession in the US, some of their effectiveness is believed to have been limited because they were used for the purposes of deleveraging rather than spending.

In addition, the efficacy of tax cuts depends on who receives the benefits. Typically, when people with lower incomes receive tax cuts, there is a greater likelihood that money will be spent rather than saved. This is borne out in statistics from the CBO: One-year tax cuts for higher-income people have a multiplier effect as high as 0.6, while two-year tax cuts for lower- and middle-income people have a multiplier effect as high as 1.5.

Tax cuts for lower-income people have a potentially higher multiplier effect than those for the wealthy

Clinton's proposed platform would result in higher fiscal spending across a broad range of categories, some of which – particularly infrastructure spending – have historically had a significant impact on the overall US economy. While Trump's proposed government spending would be much less, and therefore provide less of an economic boost, he actually proposes a higher level of infrastructure spending. One caveat for both candidates' proposals is that it could take time for infrastructure spending to be transmitted into the economy, given the bureaucratic requirements – such as environmental impact statements and contract bidding – these projects involve.

In terms of personal tax policies, Clinton's proposals should be economically stimulative given that her tax cuts would go to lower-income individuals who are more likely to spend the funds. With regard to corporate tax policy, Trump's plan would be stimulative: Cutting the corporate tax rate would make the US more competitive and business-friendly, which should help attract and retain companies that can then employ workers.

Clinton's policies on trade and immigration are likely to be more stimulative than Trump's policies, which could usher in a recession if they sparked a trade war and triggered mass deportations. According to Moody's, Trump's trade policies alone could result in USD 85 billion in lost US exports by 2019; they could also cause a 3 per cent jump in US consumer prices due to materially higher import tariffs.

Clinton's personal tax policies should be more economically stimulative than Trump's, but his corporate-tax plan should make the US more competitive and business-friendly

However, Clinton's emphasis on higher regulation, including her proposed increase in the minimum wage, would likely be a drag on economic growth. Conversely, Trump's ideas about regulation would probably not create a drag on growth and could be stimulative.

In terms of public finances, the federal deficit – which is already set to accelerate due to baby-boomers aging and retiring – would grow far more dramatically during a Trump presidency. That's because he plans to cut tax revenues dramatically while maintaining a similar level of spending. He has vague plans to pay for spending through cost savings that will come from stamping out fraud; however, there is not enough fraud to achieve the cost savings he would need.

It is important to stress that these platforms are just proposals, and that they require negotiations and the approval of the US Congress before they come to fruition. Moreover, the composition of Congress will be critically important in determining whether these policy stances become reality – and 34 Senate seats and all 435 House of Representatives seats are in play.

The US Congress will determine which policies become reality – and the vast majority of Congressional seats are in play

Given current projections, the most likely scenario under a Clinton presidency is a divided Congress, which may mean that only a few of her proposals – the ones with appeal among both Republicans and Democrats – will likely come to pass. That is most likely to include infrastructure spending, given its broad appeal. In a Trump presidency – assuming a Republican Congress – infrastructure spending and corporate tax reform would have a far higher chance of being passed. But even watered down, his plans would still add significantly to the national deficit, something Republicans have been staunchly opposed to in the past.

Market uncertainty

Stocks typically react positively to predictability, so our expectation is that the market will react more positively – at

least in the near term – to a Clinton victory. This is particularly true if Republicans were to maintain control of Congress, because they would likely block most if not all of Clinton's initiatives – ensuring the kind of gridlock that the market appreciates.

But what we've learned from the UK's Brexit vote is that people may not tell the truth to pollsters if they think their views are unpopular. A surprise Trump victory in November is still possible, even though he is currently behind in the polls, and it seems likely that the market will react negatively to that scenario, given the great uncertainty it entails. A number of Trump's positions are short on details and far from traditional Republican positions, particularly when it comes to trade and Social Security. In fact, the overall uncertainty around Trump and just what kind of president he would be – given his unconventional style and the many changes he has made to his positions since the start of his candidacy – could create longer-term volatility and depress stocks for months.

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In addition, Trump also has a unique position on US debt, which might impact the "safe-haven" status of US Treasuries and could undermine market confidence. Trump suggested this spring that the US could renegotiate its debt obligations to pay its debt holders less than face value on US Treasuries, similar to what Greece has done. This could roil capital markets.

Investment Implications

This commentary is of course not intended to be an endorsement or indictment of any presidential candidate. Where we are focusing our attention is on the market's reaction to this year's ongoing election developments, and we have identified a few key investment implications:

- A Clinton victory could result in a sell-off of pharmaceutical and biotech stocks, and possibly financial-services stocks, on the assumption that her administration would more heavily regulate these industries – regardless of whether or not that assumption is correct.
- A Trump victory could result in a short-term sell-off in stocks, a flight to gold and a rise in the US dollar.
- In this "all bets are off" election, investors might want to prepare for more volatility by increasing their focus on tactical asset allocation and sector allocation – and on downside protection.
- Investors may also want to take a close look at the risk-mitigation and diversification benefits that alternatives provide.
- It continues to be important to pursue alpha with active management, since beta returns are set to be low and volatile, which could undermine cheap index investments.

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