Insights & Strategies

PRIVATE CLIENT SOLUTIONS

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US Election 2020: Biden Time?

- Four years ago, we characterized the 2016 election as "one for the ages", and it most certainly was, with Trump pulling out a shocking win in the Electoral College. The 2020 election, with a backdrop of COVID-19, massive unemployment, and economic and cultural upheaval, will be a worthy challenger for that title.
- With three months until the election, Joe Biden shows a significant lead over Trump in most polls. Hilary Clinton was also well ahead at this point four years ago but was ultimately defeated. Will 2020 follow a similar path? The poll numbers in swing states and less tangible dynamics (incumbency, recession, bungling of COVID-19) point to a more hopeful picture for Democrats and an uphill battle for Trump.
- It is still early but Democrats look like strong favourites to maintain their control of the House of Representatives, but breaking the Republicans' slim hold on the Senate will be a much harder task. Looking at the different possibilities of control of the Presidency and Congress provides different outlooks for investors.
- Dealing with the COVID-19 pandemic will undoubtedly take centre stage for this election, but many other familiar issues will frame the political debate leading up to November 3rd. We expect health care, taxes, environmental issues, infrastructure and trade to be major touchpoints on the candidates' platforms and to have some impact on investor behaviour.

Whether Trump is re-elected or not, his four years at the helm of the US government will go down as some of the most controversial in modern times. Current polls are favouring a Biden victory, and if they prove correct, it would represent one of the few times that an incumbent US President fails to secure a second term. Although the two candidates' policies have yet to be fully fleshed out, there are some obvious points of differentiation (taxes, health care, environmental) that could impact equity markets, and others where the two converge (deficit spending, infrastructure). Many investors will be watching the Senate election with just as much attention. Our research suggests the House of Representatives is likely to remain in Democrat hands, but there is a chance that the Senate could be flipped from Republican to Democrat control. This scenario, coupled with a Biden victory, could create a united Democrat government that would be in a position to enact policies and change that would be significantly more impactful than with a Republican Senate holding up bills and providing a strong check on the executive branch. In this month's Insights & Strategies, we look at potential outcomes of the election, impacts on policy, and how investors may react.

Please read domestic and foreign disclosure/risk information beginning on page 9.

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Biden His Time

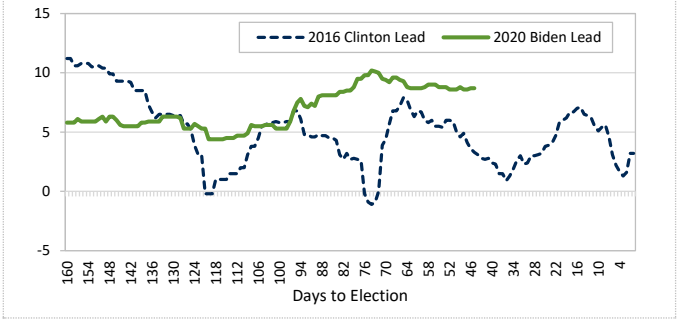
Many Republican politicians and right-of-centre commentators have criticized Democrat Presidential nominee Joe Biden for avoiding the campaign trail and "hiding in his basement". Whether true or not, it seems to be working as the former Vice President is leading in every national poll and, in many cases, by a wide margin. Donald Trump's handling of the COVID-19 pandemic and the major recession it has caused has hurt the President's overall approval ratings and, most importantly, cut into his appeal to independents, who are crucial in determining his election fate. In the last week of July, Trump's approval rating was 39%, which is very low going into an election. Going back to 1940, only one Presidential incumbent with an approval rating less than 45% went on to win and that was over 70 years ago.

Year	Incumbent Party	June Approval Rating (%)	Incumbent Win
1940	Democrat	64	Yes
1944	Republican	66	Yes
1948	Democrat	39	Yes
1952	Democrat	32	No
1956	Republican	73	Yes
1960	Republican	61	No
1964	Democrat	74	Yes
1968	Democrat	40	No
1972	Republican	56	Yes
1976	Republican	45	No
1980	Democrat	31	No
1984	Republican	53	Yes
1988	Republican	48	Yes
1992	Republican	38	No
1996	Democrat	52	Yes
2000	Democrat	55	No
2004	Republican	48	Yes
2008	Republican	28	No
2012	Democrat	47	Yes
2016	Democrat	50	No
2020	Republican	39	-
Total Average		**49**	
Average for a Win		**56**	
Average for a Loss		**42**	

Source: Raymond James Ltd.

Incumbent US presidents have an impressive track record of winning second terms. In fact, only five incumbents running for re-election have lost a second term since 1960. In most cases where the incumbent lost, the US economy was in downturn. Although the current recession is the result of a unique cause, the typical pain of a recession (job losses, bankruptcies and fear) are present and are working against Trump and his poll numbers. Supporters of the President and Trump himself point to the 2016 polls, which also showed him behind through most of the election period before his victory in the Electoral College. However, digging deeper into the numbers shows that there are some material differences between August 2020 and August 2016. As the chart below shows, the magnitude of Biden's lead vs. Clinton's is significantly higher and more consistent so far. Clinton's lead averaged ~4% over Trump in the five months leading up to the election and never rose much above 7% (she even briefly trailed Trump by a slim margin in July), while Biden has flirted with double-digit leads for much of the time since Bernie Sanders dropped out of the Democrat primary race.

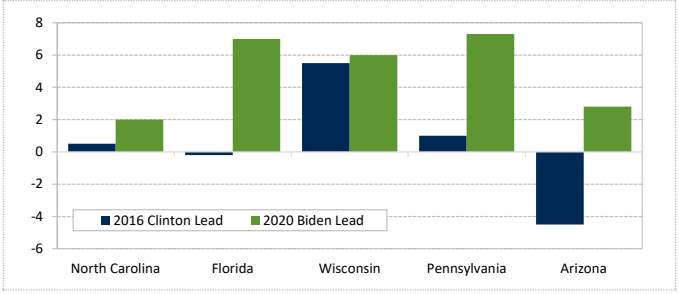
2016/2020 Presidential Election



Source: RealClearPolitics, Raymond James Ltd.

Secondly, as we drill into the infamous "battleground" states, the numbers also demonstrate another Biden edge. The path to the White House for either party will run through these states, which can swing to either party. The most important states this year include Florida, Arizona, North Carolina, Pennsylvania, Wisconsin and Michigan. In 2016, Clinton's large win in the popular vote was upset by Trump eking out narrow victories in these states. In 2020, Biden holds materially higher leads in Pennsylvania, Florida and Arizona. Flipping these three states would be enough to clear his path to the Presidency.

Battleground State Polling (July 2016/2020)



Source: RealClearPolitics, Raymond James Ltd.

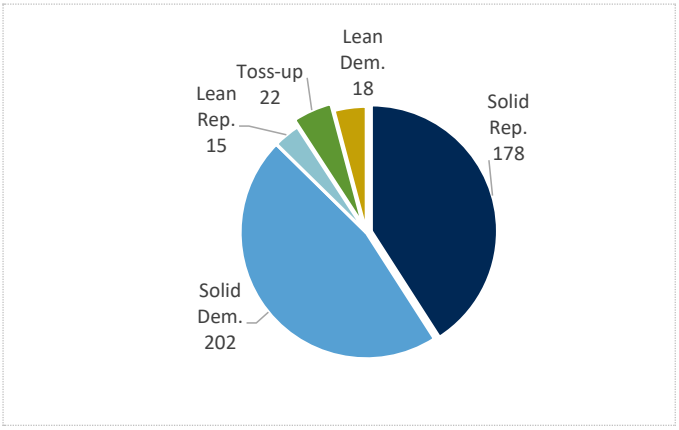
Finally, another factor working against Trump in 2020 that he did not have to deal with in 2016 is his record. Four years ago, Trump was a political neophyte running against a prototypical

"establishment" candidate reeling from an email scandal and protracted primary race. This time around, Trump's political warts are on display alongside his personal ones. Whereas many independent voters and some Democrats were willing to take a chance on a unique candidate offering a blank slate to "drain the swamp" and reshape Washington, the incumbent Trump has a record to defend, which includes mishandling a pandemic that has created the biggest recession since 2008 and killed over 150,000 Americans (and counting). Winning the independent vote will be significantly more difficult as he goes up against a centrist Democrat with higher favourables in many key demographics and battleground states than the 2016 candidate.

Eyes on the Senate

Whether Trump or Biden wins the election, their ability to implement their mandates will have a lot to do with the make-up of the two houses of Congress. Our analysis shows the House of Representatives is unlikely to switch from Democrat control but, with only a three seat majority in the Senate, there is a possibility Republicans could lose control. In the House election, all ridings are contested but of the 435 seats up for grabs, estimates are that only 54 will be competitive races, with 202 Democrat and 193 Republican seats unlikely to change hands. Among the competitive races, our US colleagues show that 18 lean Democrat, 14 lean Republican and 22 are true "toss ups". With 218 seats needed for a majority, these numbers point to a high probability that Nancy Pelosi will remain the House leader in January.

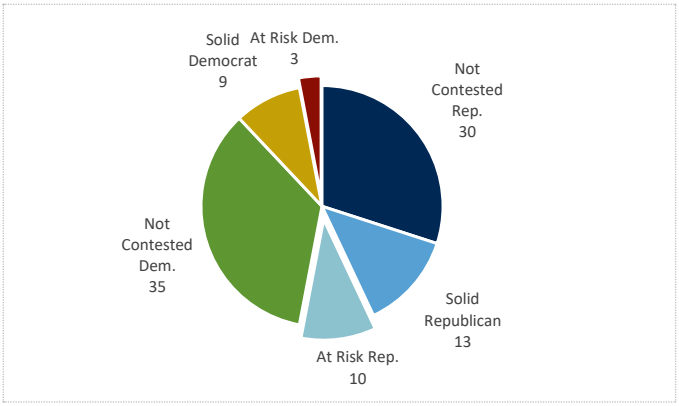
House Race 2020



Source: Raymond James Financial

When we look at the match-ups in the Senate races, there is a real opportunity for the current minority. In this election the Democrats are defending only 12 seats while the majority Republicans are defending 23. Our colleagues in the US believe that of the 35 Senate seats up for election, 13 will be competitive, with 10 having Republican incumbents. With a Biden win, the Democrats would only have to flip three seats to gain control; under a Trump win, they would need four (the Vice President holds the Senate's tie breaking vote).

Senate Race 2020



Source: Raymond James Financial

Policy Projections

In the table on the following page, we compare the policy platforms of the two Presidential candidates. The widest divergences are on taxes and health care; where they are similar is on the topic of infrastructure. A Trump win would likely promote a status quo scenario for equity markets, regardless of the results from the House and Senate races. The impact from a Biden win could differ depending on the results from the Senate vote. A split Congress would likely maintain the positive tone in equity markets, while a Democrat sweep could create greater consternation from investors, as it would create a scenario of greater impact on tax rates and potentially impact the health care (greater government control) and technology (more regulation) industries.

Regardless of the current polling, investors typically have been rewarded for looking past short-term election issues and focusing on the long game. There is a lengthy history of evidence showing that making major changes to the US economy is very difficult and small incremental alterations are more typical. This supports an investment stance that focuses on smart diversification of high quality companies and paying less attention to the election issue of the day. The one potential exception to the rule this time around could be the candidates' attitude about dealing with COVID-19. Globally, it is clear that a strong federal plan to deal with infection rates and flatten the curve tends to work better than a patchwork, regional approach. Unless Trump makes a course correction, Biden's COVID-19 plan should continue to give him an advantage on this key election topic.

Impact of Differing Policies

	Biden	Trump
COVID-19	Proposes a strong, coordinated federal response to COVID-19 treatment, detection and tracking. Includes free testing countrywide and broad spending plans to ensure proper prevention, tracking and therapeutics/vaccine development. Encourages reengaging with governments worldwide to coordinate plans to mitigate virus spread and reopen the global economy as soon as possible. **Impact:** Anecdotal evidence, particularly in Asia, suggests that a strong, coordinated federal response like the one proposed by Biden has a better potential to control the spread of COVID-19 and allow for a smoother reopening of economies.	Currently supports a more hands-off position from the federal government, leaving states to implement their own individualized policies. Focus on virus treatment and vaccine development over restrictions. Prioritizing reopening the broader economy over virus mitigation. **Impact:** Current evidence in the US points to the Trump plan delaying the economy's ability to return to normal as virus cases continue to spike. Travel restrictions from Europe, Canada, etc., reflect the fact that the US remains a global hot-spot with a surging infection rate.
Taxes	Plans to raise corporate, income, social security and capital gains tax rates and reduce deductions for high-income individuals. Corporate taxes expected to increase to 28%. **Impact:** Increased government revenues are a positive for reducing the fiscal deficit that has skyrocketed post-coronavirus, but a negative for consumption and after-tax corporate profits.	Lowered the corporate tax rate to 21% from 35%. Tax reform 2.0, which will cover the majority of the population (rather than higher income individuals and corporations) with tax breaks for the middle class. **Impact:** Generally positive for equity markets and capital investment. Higher after-tax incomes will also boost consumption, benefitting companies that manufacture computers, automobiles and appliances. Reduced capital gains tax will also benefit brokerages.
Health Care	Health care reform will likely be a top priority under Biden. He is a supporter of the Affordable Care Act (as it was passed when Biden was Vice President) and wants to add a public insurance option. He also supports controlling drug pricing in order to reduce prescription drug costs. **Impact:** Increase the number of covered individuals, which means more demand for physicians, hospitals and ambulatory services. Drug price control is a clear negative for pharmaceutical companies.	Wants to eliminate the Affordable Care Act (after a failed attempt in 2017), but allow for increased competition among health insurance providers to be the driving factor for reducing costs. **Impact:** Lack of government intervention is a positive for health insurance companies. Difficulty to register patents would be a negative for the overall health care sector.
Infrastructure	Spending is expected to be $1.3 trillion to modernize transportation, broadband and infrastructure projects that support a reduced carbon footprint. Will focus on enhancing roads, tunnels and bridges, providing incentives for public transportation and electric vehicles to reduce the country's emissions, and invest in rural broadband infrastructure.	No specific proposal, but aiming for $2 trillion focused on ports, roads and bridges.
	Impact: Both Biden and Trump agree on increased Infrastructure spending. Would benefit construction companies, equipment rental firms and materials producers (especially domestic producers).	
Environmental	Federal investment of ~$1.7 trillion and ~$5 trillion from private/state entities over the next 10 years will be required to fulfill Biden's Clean Energy Revolution, which targets a 100% clean energy economy in 30 years. It is also expected Biden will take action against polluters, re-enter the Paris Agreement and invest in Green infrastructure. **Impact:** A positive for renewable energy, given tax incentives that would benefit the likes of wind turbine producers, solar panel manufacturers, battery storage and utility-scale renewables. Electric vehicle manufacturers would also benefit from incentive programs intended to support electric vehicle adoption. A clear negative for the oil & gas industry due to tougher environmental rules.	Does not consider climate change a threat. Priority on fossil fuels, particularly facilitating drilling/exploration and pipeline construction. **Impact:** Clear positive for oil & gas industry and negative for renewable energy companies.

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Portfolio Manager

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US Presidential Elections & Funds

Like it or not, the outcome of the US presidential election typically has an impact on the global economy. Investors around the globe infer the highest probability outcome, and we expect their interpretation of the president-elect's platform will be priced into the market leading up to the election, or shortly thereafter. These market movements are driven, in part, by large campaign promises for new program spending or tax reform. The election provides a great macro event for investors to re-evaluate their portfolio and position themselves for success - hopefully regardless of the election's outcome. That might sound like having your cake and eating it too; however, the goal is not to find the absolute best performing sectors or investments, but rather those that should do well regardless of who wins in November 2020. To understand what those areas could be, we look at two buckets. The first bucket is specific themes we believe have a positive long-term uptrend, and second, what is a more broad-based way to position for success after the election.

From a thematic perspective, we think there are two clear winners regardless of the candidate and one more long-term play. The clearest winner seems to be infrastructure. Both candidates have pledged to spend trillions on new infrastructure when in power. Infrastructure spend has the added bonus of helping during recessionary periods, by putting people to work at the same time as strengthening the foundational building blocks of the economy, e.g., roads, bridges, ports and now broadband. The only catch with infrastructure is these projects takes years to materialize, so it's a long-term play. To gain access to listed infrastructure, we would suggest looking at the **Desjardin Global Infrastructure Fund**, sub-advised by First State Investments. The philosophy of this fund is buy quality companies from a long-term perspective in order to preserve capital. The objective of the fund is to provide reliable income built off structure growth in the economy.

The second sector we believe is positioned to continue its run is anything to do with working from home, a theme that was put into hyper drive thanks to COVID-19. We have slowly been developing the capabilities for a more remote work environment for decades. COVID-19 presented a unique and forced real-world testing environment for essentially the entire globe over just a few weeks. The magnitude of that fact is staggering. Not too long ago, it would be inconceivable that companies around the world could transition their workforce to remote environments so quickly. The point is stressed because it seems logical that post COVID-19, companies will re-evaluate their positioning on remote work, and it will become much more integrated with our "new normal" lives. This means that the areas of the economy that support remote work will see a strong potential runway into the future. A caution concerning this sector play is the fact that many of these companies and indices have run up significantly in the past few months. Perhaps a pullback could provide a more attractive entry point. To gain access to the working from home theme, you can either go with an index approach in the newly launched **Direxion Work From Home ETF (WFH-US)** which looks at four key market areas including cloud technology, cybersecurity, documentation and remote communication. Alternatively, you could look at an actively based manager who integrates this theme within their portfolio. One such manager is Mark Schmehl with his **Fidelity Global Innovators Fund**. Mark has the flexibility to invest around the global and market cap spectrum looking for innovative and disruptive companies leading change in our rapidly evolving world.

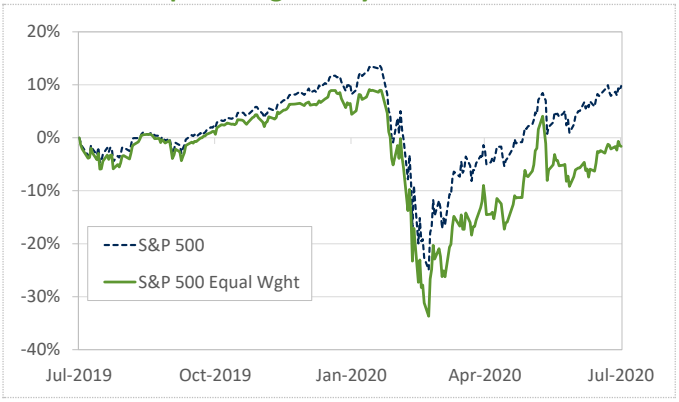
Renewable energy and environmental stewardship have garnered growing interest as of late. We believe there is more uncertainty and risk with environmental theme given the two candidates' stances, and therefore potential for torque in returns. As highlighted in 'Biden his time' earlier in this issue of Insights, the democratic platform looks to invest trillions to modernize the US energy sector towards 100% renewable energy. Trump does not share a similar enthusiasm towards this shift, so how does this fit into our win, win, win scenario? Environmental, Social and Governance (ESG) principles are now formally integrated into almost all asset managers' processes. Institutional investors have led this shift in thinking, given their long-term investment horizons. They believe companies that fully assess their ESG impacts are more likely to perform well over the long-term than those simply focused on the next quarter. We strongly agree with this for a few reasons. We feel this way foremost given the structure of the renewable industry. While there are high research and development costs, the source of energy is renewable, opposed to finite, and typically free, at least in the traditional sense. There are also significant positive externalities that come from the government's investment. First, most renewable energy projects require ongoing technically focused maintenance. This means permanent and good paying jobs, typically in areas that need them the most, i.e.. outside of major urban centres. Win. Second, there are now clear linkages to air-quality and health outcomes. A cleaner source of energy will improve the health of citizens and reduce soaring costs of health care. Win, win. Therefore, whether we see a decided 'pop' in environmentally sound companies post-election, we think the group, and renewable energy in particular, has the potential for strong long-term gains. NEI has been a leader in the environmental space for some time and

their **NEI Environmental Leaders Fund** could be a great starting point. The fund is sub-advised by IMPAX Asset Management, a specialist in the world of ESG. The fund combines growth at a reasonable price investing with a robust 10 step due diligence process that interweaves ESG throughout.

Going Global

For a more broad-based solution to the US election, we think going global makes sense. For a Canadian investor, "global" typically means the inclusion of both US and international securities. Generally the weight in the US versus the rest of the world is determined roughly by market capitalization, so you can expect anywhere from 45-60% of the portfolio in US-domiciled securities with the remainder in developed and emerging markets. From an asset allocation perspective, we believe that US companies have a strong foundation. Global equity managers are able to leverage this, but also introduce the best names they know from around the global. Should Biden win in November, we believe that he could strengthen international relations, helping these economies perform well. We also feel a good global active manager makes sense given the mounting US debt and the market breadth in the US to date. Only a few companies are driving the positive return in the S&P 500. To highlight how prominent this is, the S&P 500 is up ~1% year to date (as of June 30th) for a Canadian Investor. Meanwhile, the equal weighted S&P 500 is actually down ~6.5% - same companies, different weights.

S&P 500 vs Equal Weight – 1 yr Performance



Source: FactSet, Raymond James Ltd.

While having more choice means making more decisions, we believe that when it comes to picking equities ahead of the presidential election, managers with the flexibility to allocate capital globally are best positioned. Our focus list fund**, Capital Group Global Equity** does just this. Capital Group offers a unique portfolio construction process compared to its peers. They have multiple "portfolio teams", each with dedicated Portfolio Managers (PMs) and analysts who work autonomously on their own portion of the fund. These subsections are managed as discrete portfolios, wherein, the PM focuses only on their area of expertise, investing in only their best ideas. This combination of individual managers' investment styles complement each other, leading to broad diversification. A group of research analysts typically manages one portion - as much as 25% of the assets - bringing additional expertise to bear directly on results. The independence afforded by this structure means that PMs can focus on sectors and companies they know best. In turn, teams do not need to allocate capital outside this area simply to provide diversification because other teams provide ample diversification by investing in their own areas of expertise and highest conviction names.

Regardless of how things turn out in November, we believe that you can position yourself for long-term success by prudently investing today.

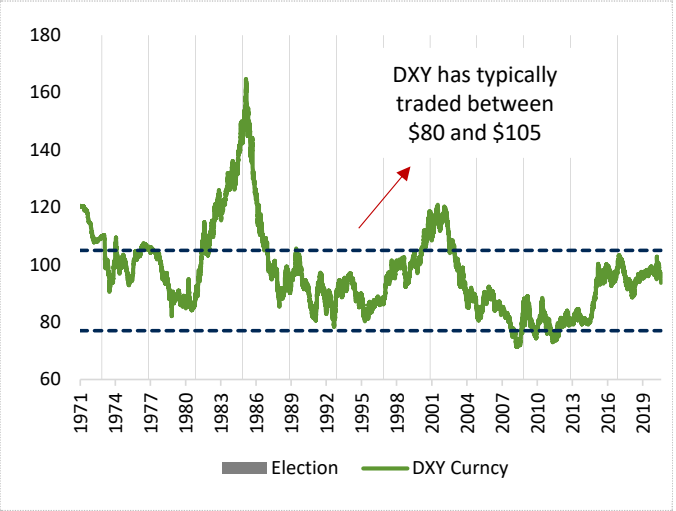
Spencer Barnes, MSc., CIM
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Can a Red or Blue Ballot Influence the US Dollar?

US Presidential elections are undoubtedly among the most significant macro events on investors' calendars. Their outcomes have the potential to signal direction of the global economy. Policy changes and trade relationships can impact GDP growth and inflationary trends, particularly in relation to how tight or loose the government coffers are managed. As analysts of the foreign exchange market, we look to see how the US dollar performs around the Presidential election. We will use the US dollar Index (DXY) for our analysis, albeit careful consideration should be given to the composition of the index which is heavily skewed toward the euro (~57%), followed by the Japanese yen and British pound.

Our database allows for daily historical pricing for the DXY going back to the early 1970's, and encompassing the past 12 elections.

US Presidential Election and the USD



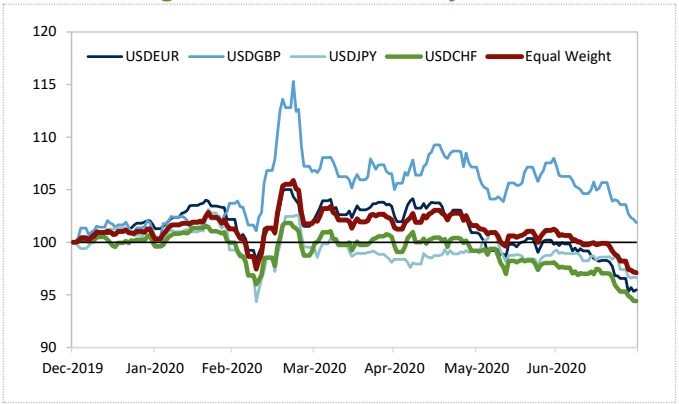
Source: FactSet, Raymond James Ltd.

One pattern we notice is that there has been modestly higher volatility immediately following an election. For example, the absolute 3-day percentage change in the DXY since 1971 has been 0.52%; however, following an election that average increases slightly to 0.75. Furthermore, we notice that markets have not traded the US dollar as favourably when the President-elect's party makes a legislative sweep (i.e., gain control of the House of Representatives and Senate) versus a mixed government. This pattern is persistent across a 30-day, 100-day and even four-year period. Digging further into this effect, we do not see any obvious reason for this. Perhaps the market may be cautious since more extreme policy measures could be passed if a single party controls both the Legislative and Executive branches. Prior to the 2000's, we witnessed a much wider trading range for the DXY following elections; however, the 21st century has not seen the DXY move more than 3% in either direction 100 days post-election.

As we look closer at the data, we conclude there are not many statistically material results investors can use to trade the DXY around Election Day. This naturally makes sense given the fact that currencies do not trade in a vacuum but instead represent the relative value of one currency against another (or basket of currencies). Therefore, while we can analyze idiosyncratic events in the US to help determine fair value, we cannot get a real glimpse of the full picture until we consider structural and cyclical trends in relation to other currencies. Rather than considering the election outcome outright, we look to see how its outcome could affect broader themes playing out in the market, which could very well influence the big dollar's valuation over the long term. The US has lost much of its relative yield premium that it has historically enjoyed courtesy of the Fed, which vowed to continue supporting the US economy by ensuring all lending and liquidity programs remain in place. Fed Chair Powell further declared that the Fed was "not even thinking about raising rates," meaning the greenback will be even more sensitive toward trade fundamentals.

US-China Trade: A Biden presidency would help mend relations between the US and the rest of the world, particularly China, regardless of whether the Democrats manage to flip the Senate. While the US would likely pressure China to address reports of human rights abuses, leveraging trade as a negotiating weapon would largely be off the table. Alternatively, a Trump win would certainly keep the spotlight on simmering US-China trade tensions, which in turn would keep economic slack elevated and effectively put a lid on economic growth.

USD Trending Downward Versus Majors Since March



Source: FactSet, Raymond James Ltd.

US Lagging the Global Recovery: Europe is leading the recovery out of this global pandemic. Biden winning the Presidency could help the US enact stricter laws and regulations to help combat the spread of COVID-19 and thus close the gap of the trajectory of economic recovery between Europe and the US.

Federal Reserve Independence: As we have all learned from Trump's first term, the President does not have any authority over the Federal Reserve; however, that has not stopped Trump from attempting to influence the Fed's actions. While the President cannot dismiss a sitting Fed Chairperson, he does have the ability to nominate a candidate for the position should the current Fed Chairperson decide to resign. The candidate would serve a term of four years after formal confirmation by the Senate.

Looking homeward, the election outcome of our closest neighbour could have long-term implications for the Canadian economy, and thus the loonie. Of the many issues we are following related to the election, we are focused on the sentiment surrounding Canada's energy patch, which could effectively tip the scales for the Canadian dollar through terms of trade. Correlation between USDCAD and crude deteriorated during the pandemic as broader risk sentiment became the primary determinant for the pair's direction. That relationship is slowly beginning to normalize and crude is making a comeback into the limelight. Sticking to the topic of crude, it is important to note that Biden is staunchly opposed to the Keystone XL pipeline, which is necessary to help get Canada's landlocked crude to key international markets.

In conclusion, while it may be statistically difficult to determine how the US dollar will trade versus global counterparts following the election, that does not discount its important in FX valuation. The outcome can affect structural themes not only in the US but also relative to its counterparts abroad.

Chris Antony, CFA
FX and Fixed Income

Ajay Virk, CFA, CMT
Foreign Exchange

LRCNs: A New Way to Raise AT1

On July 15, OSFI announced that a bank had proposed a new way to raise Tier 1 capital called Limited Recourse Capital Notes (LRCN). The LRCN will have a 60-year maturity and 5-yr call option and the bank would sell to third-party investors and simultaneously issue perpetual, non-cumulative preferred shares to a Special Purpose Vehicle (SPV) for the benefit of the noteholders. OSFI concluded that the structure meets all of the criteria for recognition as Additional Tier 1 (AT1) regulatory capital. Without getting into the actual structure of the LRCN, which can be found here, some of the highlights are:

- It is recognized as a bond but ranks pari passu to preferred shares (i.e., lower in the capital structure than other bonds, but higher than common equity);
- Since it is considered to be debt, an issuer's LRCN payments are tax-deductible and therefore may be more attractive than issuing preferred shares;
- LRCNs are only available to institutional investors.

On July 21, Royal Bank of Canada (RY-T) announced the offering of C$1.75 bln of non-viability contingent capital (NVCC) AT1 LRCN, Series 1. This LRCN will bear interest at a rate of 4.50% annually, payable semi-annually, for the initial period ending November 24, 2025. Thereafter, the interest rate on the LRCNs will reset every five years at a rate equal to the prevailing 5-year Government of Canada yield plus 4.137%. The LRCNs will mature on November 24, 2080. With the success of this offering, we foresee other banks following suit.

Although we don't believe LRCNs will completely replace bank preferred shares issuance, since only up to 50% of AT1 can be LRCNs, this latest development has propped up the preferred share market for the following reasons:

- Bank prefs with high reset spreads may have an increased chance of being called. Banks are one of the largest issuers of preferred shares and given the opportunity to use another avenue to raise AT1 capital through LRCNs, it is highly likely that they will take the cheaper option.
- Potential future supply disruptions. If banks no longer issue preferred shares, or at least not at the same volume, there may be a lack of supply. In addition, if those with high-reset spreads are being called, the existing market will shrink. With the proliferation of preferred share funds and the need for quality income, this could explain why some preferred shares issued by non-banks also traded higher on the news.

Phil Kwon
Fixed Income

Important Investor Disclosures

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