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The American elections and the Stock Market

« Don't boldly assert anything, don't deny anything lightly. » Montaigne

In 2016, much to his own exhuberance and presumptuousness, Donald J. Trump was elected 45th President of the United States of Americas, on his promise of "America first" that harkens back to 1930s under the Franklin Roosevelt administration. Trump leaves America politically divided and economically weakened by a bad management of the Covid crisis with more than 220,000 deaths and a 4.3% forecasted decline in GDP according to the IMF.

Let’s just for a moment consider the Montaigne assertion above to conceded that Trump cannot be blamed for all of America's troubles. After all, since 1980, America’s national wealth (GDP) has tripled yet its GDP per capita has only doubled, while standard of living for most Americans hardly increased for 40 years with growth slowing from one decade to the next. Inequalities have worsened, life expectancies shortened for the white population, people falling under the poverty line now exceeds 40 million, household debts and student debts are extremely problematic.

From the various useful tools to draw a structural framework, let's follow ***Hannah Arendt's*** advice to ***"Think the event so as not to succumb to current events"*** and, before November 4, let's review the elections from different angles: stock market, economy, budgets as well as the industrial, political and international affairs angles.

Under the Stock Market angle:

The S&P500 index's performance excluding dividends was 42% during Obama's first term, 46% under the second term and 67% during the Trump era. Should we conclude that a Republican administration is superior for the stock market performance? No, the market performance is the consequence of economic situation rather than the administration or party. Obama began his term in the middle of a stock market crisis that lasted until March 2009, while Trump is experiencing a similar misfortune at the end of his term.

If Trump has long associated his achievements with the performance of the stock market, there are many reasons to have doubts about it:

First, the reduction in corporate tax from 35% to 21% has not translated into an increase in the rate of investment and productivity of companies, in fact corporate margins have eroded in 2019.

Secondly, of the 80% market gain recorded since the Trump win, nearly 40% gain is attributable to *the technology sector*, 10% to the communications sector (including Alphabet 2.7%, Facebook 2%, Netflix 1%), 13% from growth in the consumer discretionary sector driven by a 320% price jump of Amazon share, contributing 5.7% to overall performance. And yet, these are the very sectors often criticized by Trump. Such sector performances are better explained by the nation’s organic structural dynamics which can also explain the 357% & 300% of Apple & Microsoft share price gain in 3 years contributing to 9% & 7.3% of the index's performance over the same period.

On the other hand, *oil industry stocks*, particularly those of shale oil, much favoured by Trump, are falling sharply with many companies heavily indebted, forced to merge (e.g. Pioneer) or even exposed to bankruptcy. Reputable solid stock such as Schlumberger has lost 77% of its market cap since Trump's election. A lesser player Occidental Petroleum has seen its share price lose 80%. Exxon has given up 50% of its capitalization and has been removed from the Dow Jones index. Because of the collapse of crude oil prices and the abandonment of many wells, the great Trump theme of energy independence has been damaged. The entire oil industry, representing 5% of GDP and 7 million employees, is weakened and several pipeline projects have recently been abandoned. US is no longer exporting crude oil from 2021, instead, tracing back its steps towards 2006 resource dependency, when 60% of the country's energy need was imported.

The same applies to industrial stocks. Trump stay committed to his incantations for a reindustrialization of America by lifting customs duties multi-fold against China or the European Union in favour of American players to reindustrialize but in vain. General Electric, long being an emblem of the American industry, has lost 71% market cap since Trump, Raytheon's lost 12%. Even if you have Caterpillar gaining 121%, its contribution to overall index performance is but less than 0.3%. Finally in spite of the aluminium tariffs, Alcoa's share price appreciation is only 24%.

The financial sector gained an upper hand over its European counterpart as Trump relaxed regulatory constraints on the banks. The sector gained 40% over the period but contributed 6 points of the 80 points appreciation of the index.

The healthcare sector appreciated by 73% (with dividends) during Trump's presidency which accounts for 13% of the S&P500 index performance, but Trump has no obvious contribution to the sector performance other than a negative influence at the end of his term to call for the reduction in drug prices.

The record $1.43 trillion corporate dividend payouts in 2019, continued share buybacks and the continued reduction in the number of listed securities played a role in the market appreciation. Whether on dividends or share buybacks, one can have two readings: one favourable, that Trump facilitated the repatriation of capital invested abroad with tax cuts, while the other unfavourable, that Trump's tax cut did not induce the corporates to increase investments.

From an economic point of view:

Trump was elected on several promises:

The promise of 4% annual GDP growth. Even excluding 2020, the average growth of 2.5% is much similar to the 2.4% during Obama's second term. In fact worse yet, after the 2017 tax cut, GDP growth slowed in 2018 and 2019 as the trade war with China cost approximately 1% of GDP, a purchasing power of American households cut by an additional 0.5 point of inflation resulting from customs tariffs, and an erosion of the margin and competitiveness of American companies affected by the same tariffs. These, are the consequences of Trump's policy.

The President's promise to erase trade deficit has given way to worsening of deficit, particularly with its two key trade partners of Mexico and Canada, and undermined multilateralism. US trade deficit to the World went from $480 billion in 2016 to $577 billion in 2019.

Today, it is difficult to expect a consumption boom because household debt excluding real estate is high at $3.8 trillion, of which $1.3 trillion is student loans, $1.4 trillion car loans and the rest for from credit cards.

It is also difficult to expect a resumption of investments because corporate debt has increased significantly and the credit rating of companies has been greatly deteriorated. Over the last ten years, the BBB debt burden has doubled to $3 trillion, BB debt to $1.2 trillion, B debt to $1.6 trillion whereas quality debts shrank by similar proportion to $1.6 trillion for A, $300 billion for AA, and only $70 billion for AAA.

A weak dollar is also hard to avoid with a twin deficit. Current account deficit went from 2.1% to 3.5% of GDP; budget deficit of more than 16% of GDP in 2020 is now record level, both of which underlines country's insufficient savings and its dependence on international savings. These declines will be at best slowed in the short term if Biden's elected and launches a vast stimulus plan, putting pressure on long rates.

From a budgetary and financial point of view:

Trump, during his four years in the White House, raised debt by $4.8 trillion, more than 20% of GDP! His 2017 tax cut not only failed to stimulate sustainable growth, but will cost $1.9 trillion over the next 10 years.

Budget deficits have skyrocketed because of tax cuts and increased military spending. As a result, the United States has the largest deficit in the Western world. The federal government collected revenues equivalent to only 16% of GDP, the lowest level since World War II. Budget deficit is high, but US spending on social programs is among the lowest in the OECD and there are still 29 million Americans without health insurance.

There was the mistake of a stimulus at the top of the cycle, a budget deficit of more than 6% of GDP according to IMF calculations. This is unprecedented as usually at the top of the cycle, governments seek to generate surpluses and reduce debt. Subjugated to this budgetary heresy, the country finds itself today obliged to increase its federal debt by more than $2.2 trillion in 2020, triple its budget deficit to $3.1 trillion, 16% of GDP, a new record on the back of Trump's policy in recent years.

From a global public and private perspective, the US debt exceeds 3xGDP to approach $65 trillion and, according to ***Attali***, 63 of the 75 largest cities are unable to meet their borrowing costs. Let’s not forget there is still 50% pension fund debts unprovisioned, a figure that was less than 15% in 2000.

From an industrial and employment perspective:

As much as protectionism is conceivable in emerging countries anxious to protect a fledgling industry, and ***List*** was one of such proponents of the theory, protectionism is meaningless in a dominant economy like the United States. This is why we have always opposed to the measures recommended by Trump, because it is futile to believe in the rebirth of doomed industries and it is more appropriate to support promising sectors. At best, protectionist trade wars slow down the destruction of jobs in dwindling sectors, at worst, it attracts the wrath of countries like China, which will buy Airbus instead of Boeing to retaliate.

After 4 years of Trump's presidency, we can see the market's verdict on this policy and the figures are in line with our apprehension in 2016. The protectionism Trump administration introduced in certain industrial sectors has not led to reindustrialization, and manufacturing employment is only 12.1 million out of more than 150 million employees. The decline in industrial employment continues in Wisconsin and Pennsylvania. Since Trump's election, coal production in Wyoming, home to 40% of US production, has fallen by 30%. These are states where Republican candidates could lose their seats in the elections because promises have not been kept.

On another note, the tax breaks did not translate into an increase in operating margin which sat around 13.4% for S&P500 companies in 2017 and was less than 13% in 2019 while productivity growth, 1.8% in 2019, remained modest.

The only positive light on Trump's report card, but one shared by all the major countries and in fact initiated in Obama term, is that the longest growth cycle since the post-war period allowed for unemployment rate to fall to 3.5% in February 2020, consequently made it possible to raise the salaries of the least qualified people for the first time in many years. In terms of job creation, Trump did worse than Obama: 2.6 million jobs created each year during Obama's second term and only 2.2 million a year during Trump's first three years. By 2020, these accomplishments are lost and the unemployment rate shot up to 7.9% in September.

From the Covid management perspective:

The budgetary effort, more than $2 trillion, has already reached 12% of the GDP, a percentage substantially higher than that of the European Union because the weakness of social protection, the duration of unemployment compensation, which varies from one State to another but always less than 26 weeks, the low ceiling of compensation, for example $2200/month in New York in the most generous State, the absence of social shock absorbers of the crisis require additional support measures.

The management of Covid was, as in Great Britain, disrupted by the shortage of hospital beds, 2.8/1000 inhabitants, compared to 2.5/1000 in the UK, 6 in France and 8 in Germany, according to OECD statistics. The debate continues on the extension of Medicaid because one in seven adult does not seek treatment for

Covid for fear of high costs and with the increase in unemployment, many Americans are losing their health coverage. Republican states oppose Medicaid expansion, cite falling tax revenues as the reason.

From a political perspective:

The Challenges:

As Jared Diamond reminds us in Upheaval, his latest book, "The United States denies its serious problems: political polarization, low voter turnout, barriers to voter registration, inequality, low socio-economic mobility, and declining state investment in public goods."

What is at stake?

For the presidential election, there are 538 electors (including 435 deputies, 100 senators and 3 for Columbia). It takes 270 to win. With the exception of the states of Maine and Nebraska, which allocate electors proportionally, the others give everything to the winner. At the extremes of population in each state, we have Wyoming with 600,000 inhabitants, Nebraska with 3 electors per 1.8 million and California with 55 electors per 39 million inhabitants.

In 2016, the geographer Kotkin showed that Clinton won in the states characterized by the predominance of the immaterial economy and Trump in the states specialized in the production of tangible goods. In 2020, among the "swing states", the Democrats seem to have a clear advantage in Minnesota and Wisconsin, each has 10 electors and Michigan 16, and a more tangent advantage in Florida 29, Pennsylvania 20, Georgia 16, North Carolina 15, Arizona 11, Nevada 6.

In the Senate, there are 35 seats up for renewal, 23 of which are held by Republicans. Republicans are guaranteed to keep Louisiana, Mississippi, Arkansas, Tennessee, Oklahoma, Nebraska, Wyoming, South Dakota, Idaho and Virginia. On the other hand, Republicans could lose key Senate seats in North Carolina, Texas (38 electors, second only after California) and Arizona, whose demographics have changed with the influx of urban retirees, often Democrats, in Colorado, Iowa, Montana, Maine and Georgia, and thus they would lose control of the Senate. Also highly symbolic was the fight for South Carolina between Republican incumbent Lindsey Graham, who is close to Trump, and African-American Democrat lawyer Jaime Harrisson. Trump did not meet the expectations of the underprivileged but those of the rich. The Democrats are expected to lose Alabama but could win the Senate.

The scenarios:

Given that it seems impossible to conceive of a scenario of total victory for Trump because it is unlikely that he will regain a majority in Congress, the risk would then be, once again, endless discussions to reach financial arbitrages. Given that the economic situation would not allow a re-elected Trump to consider further corporate tax cuts, the best scenario for the stock market would be a large victory for Biden, a victory that would ensure Democratic control of Congress and the Senate, a victory that would allow the implementation of an ambitious $2 trillion stimulus package.

On the other hand, the hypothesis of an undecided result would not be favourable to the Stock Exchange because it would be up to the Supreme Court to pronounce the result of the election as in 2000 for Bush against Al Gore with a second counting of the votes in Florida. Al Gore had however had 540,000 votes more than his rival at the national level. In 2016, Hilary Clinton won by 3 million popularity votes but despite winning California with 3.5 million votes ahead, she lost Michigan, Wisconsin and Pennsylvania for only 80,000 votes. In other words, as ***Umberto Eco wrote in "Don't hope to get rid of books: If the future is the future, it is always unexpected"***. With regard to the electoral system, the Democrats, in order to win, need 4 to 5 points ahead.

Is Biden's program bad for the Stock Market?

Biden's objective is to finance $2 trillion over 4 years for the "green deal" against global warming and to reter Paris Agreement before the current effect exit by 2021. He advocates capital gain tax at 39% versus 24% today for gains over $1million, he plans to increase the marginal income tax rate from 37 to 39.6% and corporate tax from 21 to 28%, or $4 trillion in tax revenues over 10 years. But let's not worry about the stock market because few companies pay tax at the face rate after depreciation and deductions. At the same time, he wants to increase the federal minimum wage from $7.25/hour to $15 where it does not yet exist. Also, he plans $1.6 trillion over 4 years for education and university, a necessity today because US is lagging behind in the PISA rankings. He plans to add ambitious programs in infrastructure. Finally, an extension of the 12% Social Security Tax (used to finance health care and retirement) for those whose income exceeds $400,000.

If the Democrats obtain a majority in the Senate, they could consider adding 3 members to the Supreme Court to temper the 6-3 Republican majority that Trump was able to build with the appointment of 3 members. The Democrats could also consider the creation of 2 new states, Puerto Rico and Columbus, which would give the Democrats an additional 4 seats in the Senate.

From an international perspective: "The weakness of strength is to believe only in strength" Paul Valéry.

Such was the approach of a Trump, whimsical, divisive, with all his bravado, all his fads, all his provocations to shake up the international scene. He was quick to boast of his successes but in hindsight one can measure the smallness of his achievements, the extent of the fractures with historical allies and the impact of his failures with China. Let's look at the balance sheet:

Failure in Afghanistan with a withdrawal of troops and a place left to the Taliban, now masters of the game.

Failure in North Korea: denuclearization was desired, Trump was very committed. The American President paid an improbable visit to one of the poorest states and one of the most controversial regimes. Without success and worse yet, just last week Kim took the liberty of taunting the Americans and unveiling a new intercontinental missile.

Failure with Iran: because Trump's policy has strengthened the conservatives and weakened Rohani. If Trump is re-elected, the Iranian conservatives will have every chance of winning over the moderates in the 2021 elections. Trump was unable to secure an extension of the arms embargo at the UN last week. Trump unwittingly pushed Iran to strengthen ties with Russia and negotiate a 25-year partnership with China, an opportunity for the Chinese to acquire cheap oil. If Biden is elected, Iran will make concessions on its presence in Iraq, where it is little appreciated by the new rulers, or even in Yemen, and probably on uranium enrichment, but on the other hand, the country will want to keep its missiles.

Failure with Mexico for the construction of the wall. Less than 200 of the 800 kilometers have been built and the Mexicans have rightly refused to finance it.

Consequences to be considered of a possible Biden victory, less tension with the allies and less troubled relations with China. Nevertheless, let us not dream of an idyllic world. European integration, the ambition of the Macron-Merkel tandem, could be held back by the hope of countries like Poland to once again lean behind the American umbrella. With China, Biden will illustrate the maxim of ***Theodore Roosevelt "Speak softly and carry a big stick"***. The policy will be less brutal but undoubtedly firmer with a possible return to the TPP, the TransPacific agreement initiated by Obama to oppose a united front of all Asian democracies to Chinese ambitions. In the Middle East, the most weakened would be MBS, until now the beneficiary of Trump's unfailing support.

Conclusion: "Not to anticipate is already to moan" Leonardo da Vinci.

From an economic point of view, Trump, penalized by his poor management of Covid, ends with a mixed domestic result and on his fight against China, for China to boast of a recovery and a strengthened relative position in the world economy.

From a financial point of view, the fixed-income markets seem to anticipate a victory for Biden and a substantial stimulus plan, since 10-year long rates have recently become tighter. The weakening of the $ would be limited by the attraction of the credit spread, equity markets would be on the rise, and over the next few months we are still expecting the positive impact of a vaccine.

From a stock market perspective, recent history shows a better performance of the stock markets under Democratic than Republican presidencies, notably with Clinton between late 1992 and late 2000 (+15%/year) and Obama between late 2008 and late 2016 (+12%/year), a negative performance under the two Bush Jr. mandates and a positive performance with Trump.

Under Trump's presidency, 227 stocks in the S&P500 index recorded negative returns (including dividends) or performances that did not cover inflation. This is an important figure to put market performance into perspective. At the same time, the famous 5 GAFAM explain 27.5% of the performance and if we add the sectors of technology, communication and Amazon, classified as consumer discretionary, we capture 57% of the performance of the stock market in the last 4 years. Seen otherwise, if we exclude the 5 GAFAMs and Netflix, the market appreciation would not have been higher than 46%.

The appreciation of the stock market is undeniably concentrated and one can understand the underperformance and disappointments of many investors.

Dividends account for nearly 20% of stock market performance. And to this contribution, let's add the impact of share buybacks, $600 to $800 billion each year.

The rise of the stock market has increased inequalities since 1% of Americans hold 56% of the shares and 10% hold almost 90%.

The best case scenario for the stock market would be a total victory for the Democratic camp, with the control of both chambers and the Presidency allowing the implementation of a bold recovery plan. The tax hikes planned by Biden should be postponed for fear of recession and after international relations smoothed out. The worst-case scenario would be an election result contested by Trump and a conflagration of the country. The recent refusal by Trump to denounce the white supremacists, a "***pact with the devil***" as ***Stiglitz*** put it, has surprised everyone. Between the two sits a grey scenario with no majority in either chamber for Biden or Trump leaving once again, a lame Presidency to get reforms voted, further blockage of the system, leaving the young generation never less inclined to support democracy according to ***Yascha Mounk***, in his excellent book, "***The People vs. Democracy***", there is but a third of youth left standing!

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