

Letter n°25

What can we expect from President Biden ?

« *It is the act of a wise man to take advantage of his enemies* » Xenophon.

The only real precedent to the Capitol's invasion at the beginning of January was the 1814 assault launched by British troops leading to the burning of government and military buildings during Madison's presidency. This was a foreign invasion and not that of a fraction of opponents. In other words, this polarization of American society finds no equivalent in the history of this country, and one can understand the priority and saliency of a return to unity enunciated by Joe Biden who was perhaps inspired by Xenophon's maxim at the beginning of this Letter. In addition to this ambition, there are two more to look at - one, the economy, to do everything possible to overcome the recession, the other geopolitics, to do everything possible to pacify the Western camp and restore multilateralism. These three points deserve to be developed and will allow us to think about the American stock market, rates, inflation and the \$.

1. The economy :

The average economic growth during the first three years of Trump's mandate was 2.5%, which was comparable to the 2.3% recorded during the Obama era. Job creation was similar too - 12.2 million under Obama and 6.6 million under Trump. The crisis however, has broken this dynamic and today, the challenge is two-fold: to correct the mistakes of Trump who, behind a liberal rhetoric, implemented protectionist measures and to get the country out of the recession caused by Covid.

- *Fixing Trump's economic policy mistakes :*

There are mainly two things to look at: in the short term, to abandon protectionism and, when possible, to return to balanced budgets. By advocating for protectionism, Trump had challenged the Republicans, the traditional advocates of free trade. By imposing customs duties on steel, he had acted against the universal credo of liberalism, namely the uselessness of defending industries that would eventually be condemned, especially if inevitable retaliatory measures penalize high value-added industries with a promising future, such as aeronautics or high technology.

The disappointments in the results are obvious: the customs duties imposed on Chinese products have at best led to the relocation of factories from China to Vietnam or Bangladesh, but hardly any repatriation of factories to the United States. The customs duties on $\frac{3}{4}$ of American imports from China have not slowed Chinese exports to the United States. Trump was loud and clear in his determination to reduce or even eliminate the trade deficit with China. On the contrary, it increased in 2020 by 7% to \$317 billion. The steel industry that he wanted to protect accounts for only 150,000 employees for a working population of 165 million. The relocations desired by Trump have been modest, industrial jobs have decreased by 165,000 since January 2017, the desired revival of coal industry has not prevented any further closures ... Still, from a trade perspective, Trump's withdrawal from the TPP (Trans-Pacific Partnership), signed by Obama with a plethora of countries representing 45% of international trade, proved to be a big mistake. Initially intended to encircle China economically, it only caused China to lose tariff concessions from the US. On the other hand, China skilfully rerouted to negotiate directly bi-lateral trade agreements its Asian peers. Biden who is an advocate of a liberal international order, is expected to change the situation.

Restoring a budgetary equilibrium, when the economic situation allows it, must be a stated objective. Trump lowered taxes, abolished the tax floor for individuals and companies, to satisfy the Republican camp, but yet he did not cut spending. So in 2019, at the top of the cycle, the United States posted a record deficit of 4.6% of GDP. The Trump administration has racked up \$7 trillion in federal public debt before federated entities (of which \$4 trillion was in 2020), to \$21.6 trillion, which is 101% of GDP. This is before taking into account the

recent plans of \$900 billion, then \$1.9 trillion, and the pending one expected to be announced in February 2021. According to congressional estimates, the debt ratio this year will increase significantly due to the budget deficit, from 16% of GDP in 2020 to \$5.3 trillion, which is 25% of GDP, similar to what it was in 1945.

Once the economy recovers, Biden could, in accordance to plan, and with a view to balance the budget, increase the corporate tax rate from 21% to 23% or 25%, impose a floor rate to prevent certain companies from avoiding taxes, and increase social security levies on salaries above \$400,000. It will require a majority in the Senate, but these measures would not have any impact on the stock market.

- *Bringing the country out of the crisis :*

Between 2009 and 2019, the United States managed to create 22 million jobs and, in February 2020, the unemployment rate of 3.5% was at an all-time low. Today it is at 6.7%, or 10.7 million unemployed, a figure higher than its peak in 2009, to which 6.2 million in imposed part-time workers and 7.3 million who have left the labor market but willing to return to it must be added back. Retail sales in December declined while weekly unemployment registrations have been increasing (it was at 965,000 on January 9), but we expect an improvement in a few months and believe that unlike the 2007-2009 crisis, it will not take six years to return to the pre-crisis unemployment rate. In the meantime, the exceptional level of saving rate, 12.9% in November compared to 7.5% a year earlier, and the stability of income in 2020, made possible thanks to budgetary aid, offer the potential for a rebound in consumption.

Of the \$1.9 trillion provided for in the aid plan, half provides for additional income and the other half is intended to manage the Covid crisis and its impact. As the welfare state only represents 18% of GDP as compared to 26% in Germany and 31% in France, this spending is necessary for the US, in the absence of social shock absorbers. According to official figures, one in seven Americans, and one in five among Hispanics and blacks, have difficulties in feeding themselves and, according to the Board of Governors of the FED, 40% of Americans cannot face an unexpected event costing more than \$400. In February, a new plan, "Build Back Better", with a rooseveltian tone, should be presented to invest in infrastructure and the fight against global warming.

The subject of debt is, according to some economists, secondary because the United States has the privilege of taking on debt in its own currency, but one cannot ignore the structural savings deficit of the country, 18.3% of GDP, compared to the investment rate of 21.5% of GDP. There should be no mistrust of the dollar because, with a net external debt, already at 68% of GDP, the currency could depreciate significantly.

To date, the problem has not manifested because the United States attracts global savings: net purchases of shares by non-residents represent 2% of GDP/year and net purchases of bonds by non-residents exceed 5.5% of GDP, which explains the low level of 30-year rates, at less than 2%.

To alleviate the burden of budget deficits, the FED will continue its repurchases at a rate of \$120 billion/month, including \$80 billion of Treasuries and \$40 billion of MBS (Mortgage Backed Securities). Since the beginning of the crisis, the FED's balance sheet has increased by more than \$3 trillion because it has acquired nearly 60% of the issued debt. Thus, we do not believe in a surge in long rates, despite the 10-year rate having gone up recently to 1.15% from 0.50% in July, which has benefitted bank stocks on the stock market.

2. Politics :

The fractures are not new, American history, from Lincoln in 1865 to Kennedy in 1963, has had four assassinated presidents in a century, the Capitol of California was stormed by the Black Panthers in 1967, a federal building was targeted in 1995 in Oklahoma City bombing.

Biden's victory is indisputable whereas Donald Trump, despite all the efforts made, all the pressure exerted and all the allegations disseminated on Twitter, did not win any of his cases brought about in court, which are often controlled by Republicans. 51.3% for Biden, 46.5% for Trump, 81 million votes for the former, 74 million for the latter. This is the largest gap recorded since 2008.

Undeniably, the U.S. electoral system is obsolete, whether it is the granting of all state electors to the winner and not, with the exception of Maine and one other state, to proportional representation, whether it is the advantage given to rural, sparsely populated areas of Republican tradition in the U.S. Senate over populous,

coastal states of Democratic tradition, and whether it is the absence of limits on campaign budgets (\$1.6 billion for Biden, \$1 billion for Trump), which is shocking because it can hinder the freedom of action of elected officials.

Abroad, from Zimbabwe to Putin to China, many have criticized the democracy in America. Undeniably, the reputation is damaged and it will be difficult for Americans to lecture different states on their elections for a long time. However, we must welcome the resistance of American democracy, the alternatives allowed and the rejection of Trump by the public after this sad day in early January. The poll conducted by the Pew Research Center is without appeal. Of all the presidents, Trump leaves the White House with the lowest percentage of satisfaction at 29%, in fact, 68% do not want a new candidacy from him.

Nevertheless, the country is fractured, the majority in the House of Representatives does not exceed four seats, and in the Senate, the vote of Kamala Harris offers a slight advantage to the Democrats. The Republican leader in the Senate, McConnell, has distanced himself from Trump, as have a number of Republicans who are likely to vote for certain Biden measures, but there will be a fraction of die-hard opponents led by Ted Cruz and a few others.

The American dream, a term coined by American historian, *James Adams*, in his 1931 book "Epic of America", which depicts of offering equal opportunities to everyone, is singularly dented. Meritocracy no longer plays a role. According to a Harvard study, children born before 1940 in the United States had a 9/10 chance of earning more than their parents, while those born at the end of the 1990s had only a 50% chance. And, as Nobel Prize winner Stiglitz notes in "People, Power and Profit", per capita income has virtually stagnated in the United States over the past 40 years, while it has increased tenfold in China.

In short, Biden is right to preach unity and he is probably very good in this role, armed with an experienced team of moderates, but it's not a foregone conclusion. He has one hundred days of grace and in a year's time will start the race for the mid-term elections. The stated priority is the fight against Covid, 100 million people vaccinated within a hundred days because the US, which represents only 4% of the world's population, has had 400,000 deaths, which is 20% of total Covid-related deaths in the world and by mid-February, there will be 100,000 more deaths to deplore. More fundamentally, he will have to reconsider America's health policy. It will soon be known if the Supreme Court follows Trump in its will to dismantle the Obamacare law. However, the world's leading economy, which is also the country with the highest health expenditure, at 17% of GDP, cannot tolerate a decrease in life expectancy to 75.8 years for the 330 million Americans, compared to 77 years for the Chinese and even higher for Europeans. With such high expenses, we cannot tolerate having 30 million people without health insurance. Health insurance must be promoted, generics must be developed, and operating costs must be reduced. Then, investment will have to be made in education because the United States, despite high costs inflation, is losing its primacy.

As for the fates of GAFAM, considering Biden's electoral support, it is unlikely to see a dismemberment, but there may be raised requirements on data protection or platform control for foreign intrusion, calls for violence and disinformation. With regards to the topic of climate, a carbon tax is unlikely, and measures to reduce fuel consumption are possible. Significantly, the two best sectors on the stock market since the election announcement are technology and energy.

As mentioned in our November 9 Letter, we believe that Trump will not be on the ballot in 2024 because other faces will appear in the Republican Party, but in the meantime, with the \$250 million in support he has received recently, he could fuel debate and controversy. "Without the tweet I wouldn't be here," he told the Financial Times in 2017. Today, having been cut off from the link with his supporters, abandoned by Fox News which judged Biden's speech as the best in history, he will have to find another channel of expression.

3. Geopolitics :

Undoubtedly, Biden's team is eager to renew ties with its Western allies, Europe and Asia. But, let's not dream because the economic war for market share is a reality and Western countries are the first competitors of the American groups. If, since 2008, for example, European banks have had to pay \$16 billion in fines to the Americans, if Airbus has had to pay \$3.6 billion, if Alstom has had to pay \$800 million, tomorrow will not be without the risk of new fines. This is already pointing to the credit of this new administration, the favorable opinion for a tax on GAFAM in the framework of the OECD, America's re-entry into the Paris agreements on climate change, the return to the various multilateral bodies of the UN. All these initiatives are welcomed and appreciated by the financial markets, which are hostile to untimely fuss.

Towards China, one may wonder if Biden will succeed in forging a united front, if the American partner will be considered reliable, if it will take the risk of depriving itself of the potentialities of the Chinese market? What are the prospects for customs duties on \$370 billion of imports from China? What about the unfulfilled Chinese agreement for increased purchases of American products? What about the list of participants in the summit of democratic nations that he wants to organize? Should Taiwan be invited, should India be included, as it is increasingly flouting democracy.. Many questions remain too early to answer.

Another of Biden's ambitions is to bring Iran into the 2015 nuclear agreement, amended to take into account the evolution of the situation. The impact on the oil market will soon be measured.

Conclusion: « *I have a clear idea of the Americans after the war: a strong concern for security, a fight for democracy, the intention to be the chairman of the international economic system* ». De Gaulle in 1942.

Such seems to be, 80 years apart, Biden's ambition for the years to come. On the horizon of 2022, two factors will come into play:

- Macroeconomic optimism for American growth in 2021 and 2022 :

In the short term, Covid will impact the economy but if one third of the population is vaccinated within four months, then the oldest people and the most at risk, will be immunized, mortality caused by this disease will drop and hospitals will be decongested. Growth, close to 5% should be easily attainable with savings accumulated in recent months and given an unprecedented scale of stimulus plans; let's remember the Obama plan in 2009 was "only" \$1.9 trillion. All of these factors will benefit companies and consequently the stock market.

- Micro-economic optimism for American responsiveness :

America was the fastest to produce vaccines and the companies that have benefited from this change in capitalism, digital companies for example, especially Amazon and Zoom, are American. The strong performance of the Nasdaq since the beginning of this crisis is no fluke. One can criticize the oligopolistic inclination of the American capitalism, but it remains a breeding ground for innovation remains and, with \$3.4 trillion in cash, one ought to expect corporates to accelerate acquisitions. These are all factors that animate the stock market.

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