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What's on the candidates' policy menu?

Candidates offer divergent agendas that could impact markets.

From T. Rowe Price Investment Professionals

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Key insights

- Investor anxieties are running high in an election year already fraught with tension amid the economic damage from the coronavirus pandemic.
- Salient policy differences between the presidential candidates could have important implications for investors, particularly involving taxation.
- T. Rowe Price investment professionals provide their views on potential implications for the IT, health care, financials, industrials, and energy sectors.

There are salient policy differences between the presidential candidates in the 2020 US. election that could have important implications for investors. Political races further down the ticket are significant, too, as the balance of power in the Senate will influence the extent to which the next president, whether it is Democrat Joe Biden or incumbent Republican Donald Trump, can accomplish his agenda.

Investor anxieties about politics are running high in an election year already fraught with tension amid the economic damage from the coronavirus pandemic, which triggered enormous market swings earlier in 2020. However, David Eiswert, portfolio manager of the Global Focused Growth Equity Strategy, contends that many postelection policy and regulatory risks "came off the table" after Biden, considered more of a moderate Democrat compared with his chief competitors, emerged as his party's presidential nominee.

Stark Contrast in Tax Policy

Taxation illustrates one of the widest policy divergences between the two candidates. Biden has proposed raising corporate taxes to halve the tax cut enacted by the Tax Cuts and Jobs Act (TCJA) of 2017, which was a key policy victory for the GOP. Biden's plan would involve increasing the corporate income tax rate—currently a flat 21%—to 28%. That would still leave the rate meaningfully lower than the pre-TCJA rate of 35%. The Democratic candidate would also boost taxes on the foreign income of US companies and institute a form of alternative minimum tax for corporations.

Biden has earmarked his tax proposals as revenue-raisers for his spending plans, which include funds for research and development, education, health care, and child-care. According to a Penn Wharton Budget Model analysis of Biden's spending and taxation policies,[1] the new outlays would total USD 5.4 trillion over 10 years versus USD 3.4 trillion in new revenue, potentially resulting in USD 2 trillion in deficit-financed spending in the next decade.

Tax Hikes Could Weigh on Earnings

These tax hikes could reduce after-tax corporate earnings, and it's unclear whether current equity and corporate bond prices are discounting the possibility of a Biden win and higher taxes. "Biden's tax increases would impact equities more directly than corporate credit, probably hitting the wildly profitable giant tech stocks the hardest," says Mark Vaselkiv, T. Rowe Price's chief investment officer (CIO) for fixed income.

Candidate Policy Menu

Fiscal and trade proposals of Biden and Trump*

	Joe Biden	Donald Trump	
Taxes	■ Would raise corporate tax rate, but not to pre-2017 levels, to help fund several stimulus initiatives	■ Could push for further tax cuts	■ Higher taxes under Biden would weigh on corporate earnings, though fiscal stimulus could help to moderate this effect ■ If elected, Biden would likely need a Democratic majority in the Senate to pass his tax proposals ■ If GOP maintains Senate majority, Biden's tax plans would face significant obstacles
Spending	■ Fiscal stimulus to support the economy during the coronavirus pandemic and to aid recovery ■ Spending on research and development, education, health care, and child-care. ■ Fiscal support for municipalities facing revenue shortfalls is a priority	■ Possibility of fiscal stimulus to support the economy	■ Further deficit spending appears likely under Trump or Biden ■ Chief US Economist Alan Levenson says he is less concerned about the growing ederal debt because low interest rates are keeping debt service costs manageable and the Federal Reserve's massive purchases of US Treasury securities help to offset new supply
Trade	■ Less of a focus on the trade balance and punitive tariffs ■ Tensions with China likely to continue, particularly in areas like critical technology development and supply chain security	■ Focus on using tariffs to try to reduce US trade deficit ■ Tensions with China likely to continue	■ Biden could take a more multilateral approach to dealing with China ■ Protecting US intellectual property and addressing tech-related national security risks posed by Chinese companies likely to be a priority for Trump or Biden

*Proposals may shift leading up to the election or afterward. The balance of power in the Senate and other factors will likely determine the next president's success in accomplishing the parts of his policy agenda that require legislation.

[1] https://budgetmodel.wharton.upenn.edu/issues/2020/9/14/biden-2020-analysis

A tax hike would not necessarily hold back growth, Vaselkiv adds, noting that US corporate earnings and the broader US economy both continued to grow after tax hikes during the Bill Clinton and Barack Obama administrations.

David Giroux, T. Rowe Price CIO of equity and multi-asset, and head of investment strategy, estimates the tax rate hikes proposed by Biden could collectively reduce after-tax profits for companies in the S&P 500 Index by 9% to 11%. However, some industries could benefit from increased spending.

Eiswert agrees that US companies would experience an "earnings reset" if the Biden tax plan passed, though he also believes that the effects would be "manageable and likely offset, in part, by fiscal stimulus."

Tax policy would likely be little changed in a second Trump administration term, our investment professionals believe. If Republicans keep control of the Senate, lawmakers could even seek to cut corporate taxes below their post-2017 rates, says Eiswert. However, enacting another tax cut would be very difficult with Democrats in control of the House of Representatives. Trump might also continue to advocate for a payroll tax holiday, which he describes as a payroll tax cut. GOP legislators have shown limited interest in this measure due to the importance of the payroll tax in funding Social Security.

Deficit Spending Expected to Continue Regardless of Election Outcome

US deficit spending to fund pandemic relief this year is driving the deficit and the level of government debt outstanding rapidly higher. However, absent a Democratic electoral sweep of both houses of Congress as well as the presidency, Biden's tax increases would likely face significant obstacles. An inability to pass tax increases could result in even more deficit spending. T. Rowe Price Chief US Economist Alan Levenson argues that federal deficits will remain high no matter who is president.

The Congressional Budget Office recently projected that outstanding federal government debt will reach 98% of gross domestic product (GDP) in 2020 and exceed 100% next year. Nonetheless, Levenson's outlook for the US fiscal position is sanguine, noting that the Federal Reserve's massive purchases of US Treasury securities—currently USD 80 billion per month—are offsetting much of the new supply.

Debt service costs are also low, Levenson says. "Interest rates are so low that federal interest expense as a percentage of GDP has barely risen," he explains. While Biden's proposed USD 2 trillion in net spending over the next 10 years may appear high, the government spent more than that in the second quarter of 2020 alone on pandemic relief programs, Levenson notes.

Longer term, Vaselkiv says, "we may be arriving at a place where fiscal deficits don't matter." This, he adds, is because the US may be moving toward a situation like Japan's, where the government has taken on a huge debt load since the late 1980s in an effort to stimulate economic growth. Longer-term secular drivers of growth, such as demographics, do not bode well for the US economy as the population ages, Vaselkiv adds.

Municipalities in Need of Fiscal Assistance

In terms of more immediate fiscal needs, Vaselkiv asserts that the economy is weakest at the state and local levels, where governments need help to mitigate cuts in essential services amid quickly declining revenues. He believes that Biden would likely seek additional funding for states and municipalities.

> "Tensions with China seem to resonate across the political divide."
> **— Quentin Fitzsimmons International Fixed Income Portfolio Manager**

Trump so far has advocated against similar support. This partisan dynamic means that the election outcome could help determine the credit quality of municipal debt for years to come as the economy recovers from the pandemic, Vaselkiv says.

A Democratic "blue wave"—an electoral sweep of the presidency and both houses of Congress—would raise the prospects of enacting additional fiscal stimulus at all levels in 2021. If Biden is elected president but Republicans retain control of the Senate, Vaselkiv predicts that political gridlock likely would delay or diminish further stimulus.

Tensions With China Resonate Across Parties

Quentin Fitzsimmons, a London-based T. Rowe Price international fixed income portfolio manager, says he is not convinced that a Biden administration would try to materially improve relations with China.

"Tensions with China seem to resonate across Fitzsimmons says. He believes Biden would maintain pressure on China to address concerns about intellectual property rights in the technology sector. In a second Trump term, Fitzsimmons says that investors should expect to see more of the same policies toward China—including the use of tariffs to try to reduce the US trade deficit.

Levenson says he believes that Biden would focus less on the trade balance than Trump and would not place punitive tariffs on countries typically viewed as trade partners, like Canada. However, Levenson asserts, Biden will face the conundrum of advocating for free trade and moving more manufacturing onshore to the US, which the candidate has emphasized in his central policy proposals.

Eiswert also believes that Biden would likely take a relatively tough stance on China, although he says that he thinks the Democrat would pursue a "more multilateral approach," pushing for reforms but "with more of a focus on the long term."

T. Rowe Price investment professionals also have specific views about how the election outcome potentially could affect some key sectors. These include:

Information Technology and Communication Services

Ken Allen, portfolio manager of the Science & Technology Equity Strategy, believes that sector fundamentals are likely to be driven more by the ongoing digitalization of the economy than by the outcome of the election. Regardless of who wins the presidential election, the mega-cap US technology companies are likely to remain in the regulatory spotlight both at home and in Europe.

The real, though difficult to quantify, risk of government regulation should not be new to technology investors, Allen observes. Antitrust issues and data privacy concerns, he notes, have driven pronounced swings in these stocks in recent years but have not prevented them from posting strong gains.

Technology trade tensions between the US and China are not likely to recede under either administration, Allen says, as both presidential candidates appear likely to seek to protect US intellectual property rights and address technology-related cybersecurity threats posed by China.

The two candidates' approaches to these issues could differ. "It's tough to say how US-China relations would evolve in a Biden presidency," Allen says, "but if volatility were to lessen, that could be a positive for technology companies that are perceived as having some exposure to trade tensions between the two countries."

Health Care

Ziad Bakri, portfolio manager of the Health Sciences Equity Strategy, maintains that the risk of a dramatic overhaul of the US health insurance market diminished significantly when Biden became the Democratic presidential nominee.

Candidate Policy Menu

Sector-level proposals of Biden and Trump*

	Joe Biden	Donald Trump	
Info. Tech. and Comm. Svcs.	■ Regulatory scrutiny of mega-cap tech ■ Choices to head Department of Justice and Federal Trade Commission will provide insight into policy ■ Protecting US intellectual property in China and addressing tech-related national security risks	■ Regulatory scrutiny of mega-cap tech ■ Protecting US intellectual property in China and addressing tech-related national security risks	■ Secular growth stories related to the digitalization of the economy remain intact, including software as a service, e-commerce, online payments, big data, and artificial intelligence
Health Care	■ Efforts to control drug costs ■ Expand access to health insurance and Medicare	■ Efforts to control drug costs	■ Uncertainty for pharmaceuticals, though Biden's most aggressive drug pricing reforms are unlikely to pass ■ Biden's efforts to expand access to Medicare could benefit some managed care companies ■ Health care fundamentals remain strong
Financials	■ Stricter rules and enforcement ■ Additional limits on banks returning capital to shareholders during pandemic	■ Deregulation	■ Potential for regulatory relations under Biden to be less adversarial than under Obama ■ Bank valuations appear undemanding, and we see potential for improving capital returns
Industrials	■ Campaign has called for massive spending and tax incentives to create jobs and drive the greening of US industry ■ Potential for modest downtrend in defense spending after seven-year upcycle	■ Focus on tariffs to try to improve trade balance ■ Environmental deregulation ■ Potential for modest downtrend in defense spending after seven-year upcycle	■ Cautious on defense stocks ■ Biden's ambitious spending plan could accelerate secular trends toward energy efficiency and reduced emissions in sector ■ In a second Trump term, the potential for further de-globalization and trade tensions could create uncertainty for industrials
Energy	■ Stricter regulation, including limits on greenhouse gas emissions, halting the issuance of new drilling permits on federal lands, and tougher permitting for oil and gas projects	■ Environmental deregulation	■ Policy decisions by Trump or Biden areunlikely to significantly alter the negative trajectory of oil market fundamentals

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However, the potential for drug pricing reform could be a source of volatility and headline risk for pharmaceutical stocks. Trump and Biden both appear to support a proposed indexing mechanism that would aim to bring the prices of drugs covered by Medicare more in line with the lower prices available in international markets.

If Biden wins the election and Democrats secure a majority in the Senate, pharmaceuticals analyst Jeff Holford says he believes the market's focus could shift to the risk that Congress might pass more aggressive proposals related to drug pricing. Pharmaceutical stocks could suffer in this scenario, Holford warns. He also notes that the Democrats would need a meaningful majority in the Senate for any significant reforms to have a chance of passing, given that several Democratic senators have good relationships with the pharmaceutical industry.

Expanding access to health insurance also appears to be a priority for Biden, who has proposed lowering the age requirement for Medicare eligibility to 60 years from 65 and creating a new Medicare-administered public option that would automatically enroll low-income Americans who aren't eligible for Medicaid.

Health services analyst Rouven Wool-Lewis believes that, if implemented, these policies could expand the market for Medicare-focused managed care organizations while potentially siphoning away some customers from private health insurance providers.

Bakri says he maintains a positive long-term outlook for health care stocks, despite the political risks. "Fundamentals in this diverse sector continue to improve," he asserts, "on the back of accelerating innovation, new technology platforms, and a favorable funding environment."

Financials

A Biden administration might seek to impose stricter rules and enforcement for banks, while a second Trump term could lead to further financial deregulation. Under Biden, potential measures could include additional limits on bank dividends and share buybacks when the US recovers from the pandemic and its fallout.

Even if Biden wins and Democrats secure a Senate majority, Gabriel Solomon, portfolio manager of the Financial Services Equity Strategy, believes that the regulatory environment may prove "less adversarial" than during the Obama administration.

Solomon argues that the 2008–2009 financial crisis made the financials sector "an easy target, given how poorly banks managed their risks and how ugly the default/foreclosure process was." Thus far during the pandemic, by contrast, most banks appear to have managed their credit risks reasonably well—aided in part by federal assistance for households and businesses—and have tried to work proactively with borrowers to defer payments or restructure loans.

Solomon believes that banks could be viewed as a "part of the solution" in the recovery from the economic damage of the pandemic, which could bode well for their capital returns when the economy starts to normalize, the industry steps up lending, and restrictions on dividends and share buybacks are eased.

Solomon says he views banks' undemanding valuations and the possibility of improving capital returns as factors that have the potential to create attractive investment opportunities. Banks' prospects could be enhanced further by an eventual increase in interest rates, which tend to bolster banks' net interest margins, or the difference between the rates at which financial institutions borrow and lend.

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> **— Shawn Driscoll Global Natural Resources Equity Strategy Portfolio Manager**

Industrials

Regardless of which presidential candidate wins, Jason Adams, portfolio manager of the Global Industrials Equity Strategy, believes some type of infrastructure spending bill is likely, which could boost machinery and construction companies. Conversely, US defense spending "faces the prospect of several years of a modest downward trajectory after a seven-year upcycle," he adds.

In a second Trump term, the potential for further de-globalization and trade tensions could create uncertainty for industrials, Adams warns. He thinks factory automation companies would be "relative beneficiaries" in this scenario, as global supply chains become more localized and automated.

Biden has indicated that he would seek higher levels of federal procurement spending and tax incentives to create jobs and drive economic development by rebuilding critical infrastructure. This push would focus on reducing carbon emissions and investing in clean energy technologies.

Adams believes that, if implemented, Biden's ambitious plans could accelerate energy efficiency and emissions reductions. "Many industrial companies are part of the solution in this regard," he says. Potential beneficiaries, he adds, could include companies specializing in air compressors, rail transport, commercial aircraft, electric vehicles, and industrial gases.

Energy

Biden's platform, as well as his comments on the campaign trail, suggest that he would tighten regulation of the fossil fuels industry, which would likely result in higher compliance costs for the oil and gas industry. Biden has also voiced support for a moratorium on new oil and gas lease sales on federal lands and potentially halting the issuance of new drilling permits in these areas.

Shawn Driscoll, portfolio manager of the Global Natural Resources Equity Strategy, contends that conditions in the global oil market, not US political outcomes or their regulatory implications, are likely to have more influence on energy company earnings. "We don't think there's anything either candidate would do if elected that would change our view that, outside of the occasional countercyclical rally, oil will remain in a long-term bear market because of rising productivity and falling output costs."

Preelection Risks Raise Uncertainty

Along with the uncertainty about the US presidential election, several additional risks potentially could disrupt global markets before and after the November elections, Vaselkiv notes. These potential downside surprises include unexpected weakness in US employment data or another major wave of COVID-19 infections (the disease caused by the coronavirus).

On the positive side, a breakthrough in a COVID-19 vaccine or treatments for the disease could trigger selling pressure on safe-haven Treasuries and a rally in stocks and corporate bonds, Vaselkiv says. Of course, any of these events, positive or negative, could also affect either presidential candidate's election chances and policy agenda.

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