Next
U.S. Equity Sectors Report
Thursday, September 15

The U.S. Election: More Tweak Than Change Is Likely

- A Clinton presidency is the most probable outcome of this year's election, which would largely represent a continuation of recent policy thrusts.
- Markets would likely prefer a Clinton win over Trump, who could usher in major shifts in policy and considerable uncertainty.
- Based on fiscal proposals, Treasurys and the dollar would be at greater risk if Trump is elected, reflecting a much larger budget deficit.
- Either candidate's ability to drive policy changes depends on the Congressional outcomes. Markets would likely prefer a split Congress to provide balance, despite the risk of gridlock.
- The make-up of the Fed depends on the election, with Clinton reappointing Yellen in 2018, while Trump would seek change.

For all the talk that the electorate wants "change", the most likely outcome of the 2016 U.S. election is a tweaking of existing policies rather than something more profound. This reflects the fact that the betting odds, statistical models, and state-by-state polling point to Hillary Clinton as the winner in the presidential race, although the race has been tightening in the past few weeks[1]. On balance, Clinton would largely represent a continuation of the main thrusts of the Obama Administration, especially on domestic issues. In contrast, a Donald Trump victory would potentially represent a marked shift in both domestic and foreign policy, albeit in an unpredictable manner.

While the presidential election garners popular attention, the political landscape over the next few months also hinges critically on the results in the House of Representatives (the House) and the Senate. This is not only because of the constitutional separation of powers, but also because of the long-term decline in bipartisanship, due in part to gerrymandering by both parties favoring primary candidates with entrenched positions and extreme political bases. Accordingly, any assessment of the implications of the political backdrop for future investment strategy must be scenario based given the possible outcomes in Congress as well as the presidency. As always, it must be remembered that campaigns and policymaking normally differ markedly given political realities and constraints.

> The odds point to Hillary Clinton as the winner in the presidential race

A Clinton victory would have more widespread ramifications if the Democrats control at least one Congressional body (most likely the Senate). A Trump win, combined with

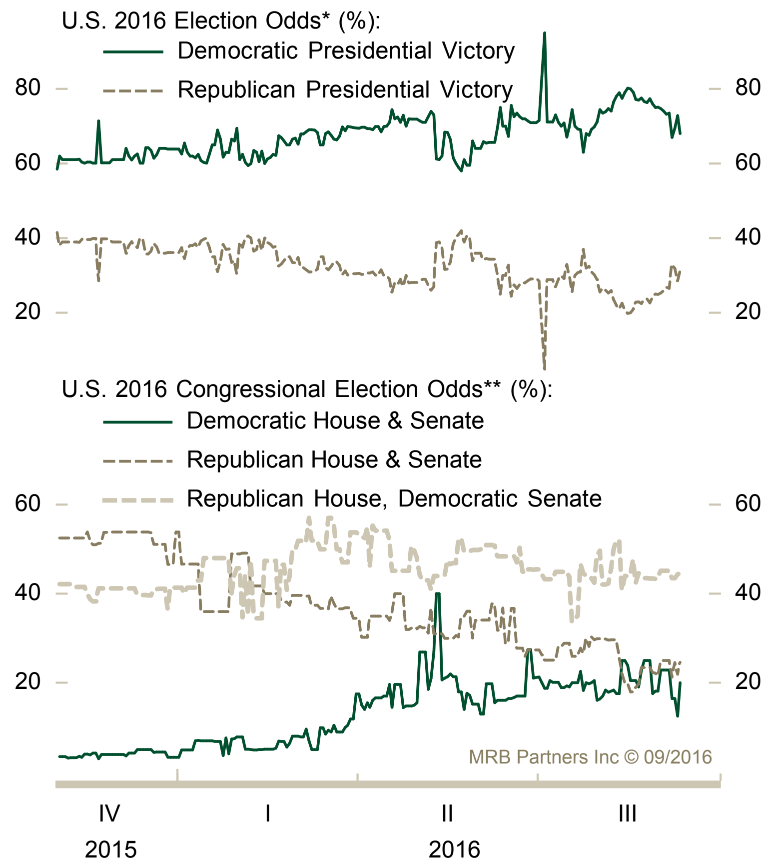
[1] **MRB *Asset Allocation Report***, "***U.S. Politics: The Heat Is On***", August 5, 2016

Republican retention of the House and Senate, could translate into sweeping changes in Washington, with an unwinding of key planks of President Obama.

In general, capital markets are discounting a Clinton victory and to a lesser extent a Democratic Senate (but not the House), so confirmation would likely have a limited impact (**chart 1**). Given capital market trends in recent years, "more of the same" would be viewed comparatively favorably. We would expect a sell-off in U.S. assets immediately following a Trump win or evidence it was a high probability. Thereafter, market reaction would depend on clarification of his policy objectives.

In this report, we outline the main policy elements of the two presidential candidates, and examine the implications for the economy, capital markets and investment strategy depending on the Congressional outcomes. Please note that we examined several major policy issues in an earlier report, as well as laid out the basic electoral process, which may be referenced for details[2]. A later report will focus on the implications for U.S. equity sector strategy, with particular emphasis on energy, financials and health care.

Chart 1 Odds Favor A Clinton Presidency And Split Congress



* Winner take all; source: Iowa Electronic Markets
** Source: Iowa Electronic Markets

The Policy Planks

A comprehensive assessment of the policy platforms of the two presidential candidates is beyond the scope of this report. Instead, we focus on the major components that will impinge upon the economy and investment strategy. Below we take fiscal, monetary, trade, regulatory and other policies in turn. **Table 1** provides a synopsis of major policy orientation and our assessment of the markets' preferred outcome/candidate based on current information.

Capital markets are discounting a Clinton victory

2 **MRB U.S. Research Highlight Report**, "***The U.S. Election: Does It Matter For Investment Strategy?***", April 14, 2016

Table 1 Key Policy Orientation

Policy Area	Clinton	Trump	Market Preference/Implications
Fiscal	Moderate increase in deficit and debt; higher revenue	Significant increase in deficit and debt; lower revenue	Favors Clinton
Monetary	Re-appointment of Yellen; no change in policy direction	New Fed Chair in 2018; attempt to curtail Fed policy flexibility	Favors Clinton
Regulatory	Stepped up regulation	Restrained/reduced regulation	Favors Trump
Trade	Still pro-trade, more restrictions	Trade skepticism; more restrictions; uncertain outcome	Favors Clinton
Other	Supreme Court = more liberal; foreign policy = more hawkish	Supreme Court = more conservative; foreign policy = less predictable, more isolationist	Unclear; slight Clinton bias
Overall economy in 2017	Continuation of current trend	Greater uncertainty	Favors Clinton

Fiscal Policy

Both Clinton and Trump have outlined key elements of their fiscal plans, but many are unclear or difficult to quantify. We have relied on two primary sources for tax and spending forecasts, including the Committee for a Responsible Federal Budget (CRFB) and the Tax Policy Center (TPC), both of which are ostensibly non-partisan, although that may be in the eye of the reader[3]. Their revenue and deficit projections are broadly similar, but their spending assumptions are less clear.

MRB's analysis and conclusions are based on the statements of the two candidates, the party platforms and traditions, and the estimates provided by these and other organizations, as well as our judgment. They are subject to change as candidates modify their views and will depend on their legislative power/capacity.

Trump's plan calls for across-the-board personal income tax cuts

Trump

- **Taxes:** Trump's plan calls for across-the-board personal income tax cuts, albeit skewed in dollar terms toward the higher-income brackets. Dividend and capital gains rates will be maintained at current levels, although there are some benefits compared with

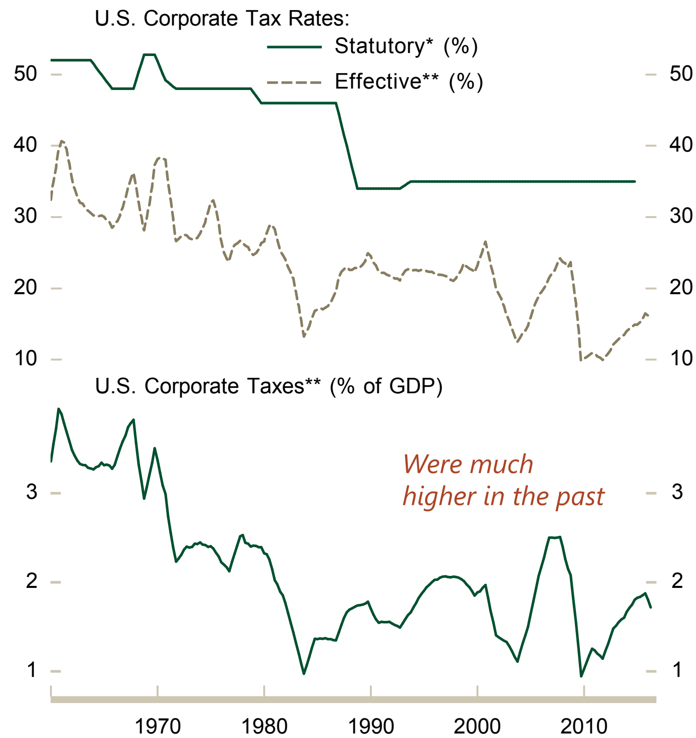
3 The TPC estimates are available ***here***; The CRFB estimates are available at ***here***

current guidelines. He plans to reduce the corporate tax rate to 15% from 35%, and tax the return of corporate cash held overseas at a one-time 10% rate.

- **Spending:** Trump has given few details on spending, other than to suggest up to US$1 trillion in infrastructure outlays over an indeterminate period. The CRFB estimates that spending under Trump would decline modestly over the coming decade.

- **Deficit/Debt Implications:** The CRFB estimates that the Trump plan would reduce federal receipts by US$11.5 trillion over the next decade, with three-quarters coming from individual taxes[4]. The revenue losses would increase over time. Upper-income recipients would be the biggest beneficiaries. The CRFB estimates the plan would increase the federal debt by approximately 41% of GDP over the next decade, which includes additional interest payments from the larger debt.

Chart 2 **Corporate Tax Payments Are Low**



* Source: U.S. Tax Policy Center
** Corporate tax payments as a share of GDP; sources: U.S. Bureau of Economic Analysis and Congressional Budget Office
MRB Partners Inc © 09/2016

- **MRB Assessment:** Trump's tax plan should provide a modest boost to consumer spending, but the skew toward tax cuts for the upper-income groups reduces its impact, as these groups have a higher saving rate. While the proposed corporate tax cut would also be positive for growth, note that the ***effective*** tax rate of approximately 16% is far below the statutory 35% given numerous loopholes (**chart 2**). Moreover, the main impediment to higher investment appears to be uncertainty about the outlook for final demand, as profitability is already strong and corporate taxes are already low as a share of GDP by historical standards[5]. Overall, the plan appears to offer limited growth bang for a significant buck. Trump's current plan does not address the major longer-term entitlement challenges of the federal government (although neither does Clinton's).

Plan would increase the federal debt by approximately 41% of GDP over the next decade

Trump's tax plan could be initially positive for the equity market, as it would boost corporate profits and increase the value of potential capital gains and dividends for high-income earners. However, the surge in the federal debt would be negative for bonds and the U.S. dollar, with eventual negative ramifications for equities.

4 The TPC estimates Trump's plan would reduce revenues by US$9.5 trillion over the next decade.

5 Corporate taxes have averaged 1.6% of GDP since 2010, compared with an average of 2.7% from 1950 to 2010.

Clinton

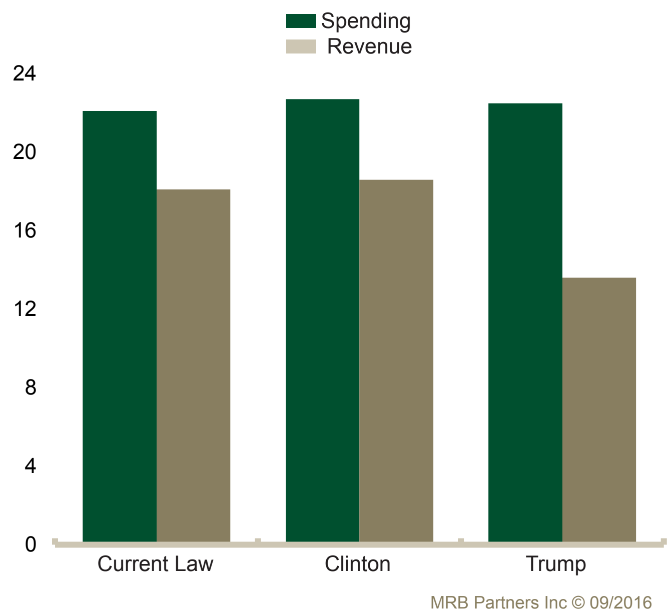
- **Taxes:** Individual tax increases on upper-income earners, with a minimum tax on incomes over US$1 million. Reduce various deductions and exclusions. Introduce a graduated capital gains tax structure, with lower rates on longer-held assets.

- **Spending:** Clinton proposes a 5-year US$275 billion infrastructure spending program. She proposes to make university tuition-free for middle- and lower-income families, increase access to childcare, and other programs. The CRFB estimates that spending under Clinton would increase by US$1.45 trillion over the next decade, or 0.6% of GDP per annum.

- **Deficit/Debt Implications:** The TCRFB estimates that Clinton's proposals would increase federal revenues by approximately US$0.25 trillion over the next decade. Based on these projections, the CRFB estimates that federal debt would be more or less flat as a share of GDP over the next decade. As a reference, the TPC estimates that federal debt would decline modestly under the Clinton plan.

- **MRB Assessment:** Clinton's plan would provide a modest boost to economic growth via a shift in taxation to lower- and middle-income households with a higher propensity to spend. As with Trump, the infrastructure program would boost investment, but would only represent 0.3% of GDP per annum. Overall, the fiscal package as currently specified would not have a major impact on the U.S. growth trajectory. At the same time, the current plan does not address the longer-term entitlement issues, either on the spending or revenue side.

Chart 3 U.S. Fiscal Impact Over 10 Years* (% of GDP)



* CFRB calculations based on CBO Projections

In isolation, Clinton's fiscal proposals would not have a major impact on capital markets or the value of the U.S. dollar, relative to the current trajectory.

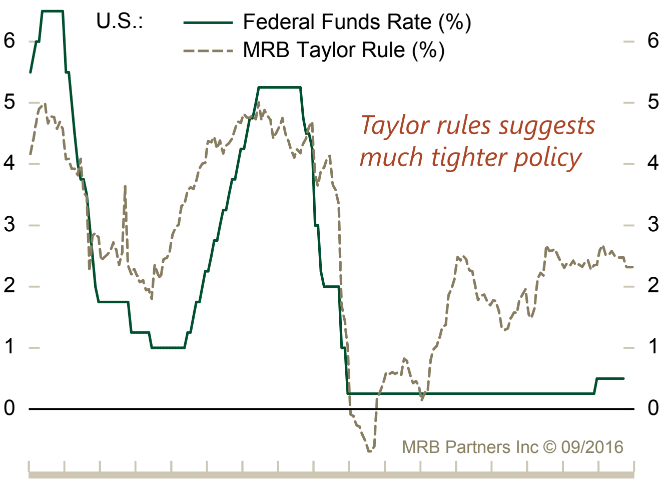
Clinton's fiscal policy will likely be judged as more favorable than Trump's

Overall, Clinton's fiscal policy will likely be judged as more favorable than Trump's for capital markets and the dollar (**chart 3**).

Monetary Policy

The Fed is an independent body, but it is overseen by the Congress and the president appoints the Fed Chair and other board members. While formally independent, board nominations and approvals are intensely political. The Federal Reserve Board (FRB) currently has two vacancies waiting to be filled, but needing Congressional approval. A small FRB is not optimal, but is not detrimental to operations.

Chart 4 **Could A Trump Presidency Usher In A Rule-Based Fed?**



The Fed has been widely criticized by Republicans, many of whom view it as a partisan body sacrificing monetary orthodoxy to support growth. Important factions of the Republican Party, including several presidential primary candidates, favor a gold standard or an explicit policy rule such as the Taylor Rule for the Fed to follow. A conventional Taylor Rule approach would imply significantly higher rates than currently prevail, as does MRB's monetary framework (**chart 4**)[6]. Presumably, Fed Chair Yellen would not be re-appointed under a Trump administration when her term expires in February 2018. It is not clear whom he might appoint, but a reasonably conventional monetarist/economist would be the most likely successor.

Candidate Clinton has not indicated any policy toward the Fed, and we assume she would support the leadership of Janet Yellen and her re-appointment for another term. She would seek to fill the two vacancies on the board, presumably with a Keynesian bias.

A Trump victory could initially cause some concern about the direction of monetary policy

Barring a sweeping Republican victory or a dramatic change in economic performance, the most likely outcome is that a conventional monetary regime will prevail in the next four years, although conventional now includes formerly unconventional tactics. Regardless of the electoral outcome, however, either candidate will likely press for a re-think of overall monetary policy following the extraordinary events of the past decade.

In the final analysis, a Clinton victory would likely have no impact on monetary policy expectations over the next 12-18 months. A Trump victory could initially cause some concern about the direction of monetary policy, albeit one ultimately assuaged by economic and political realities.

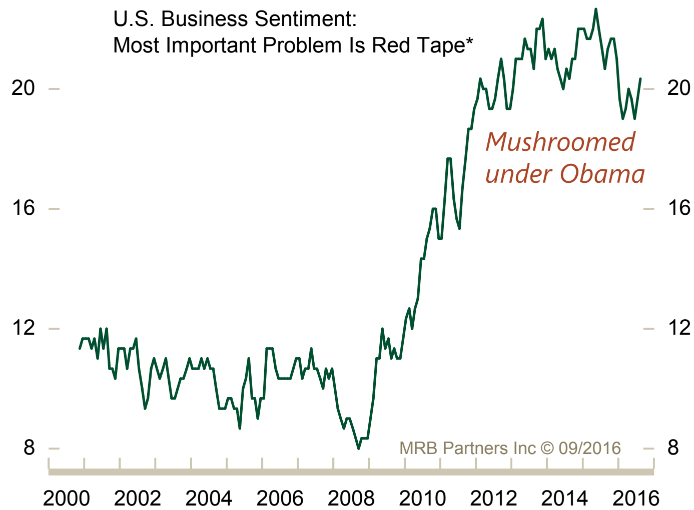
6 **MRB Policy Research Highlight Report**, "***Policy – Gauging Monetary Policy Pressures: Is Another Shot Of Reflation Warranted?***", July 14, 2016

Regulation

Regulation is a key area where the two candidates will likely differ in spirit and focus, with markets favoring a Trump approach over that of Clinton. In reality, regulation will almost certainly increase under either candidate, albeit less so under Trump.

There is a widespread sense that regulation has increased dramatically in recent years. U.S. small business concerns about "red tape" have risen markedly under the Obama Administration, although it is not clear whether this pertains to specific regulations or a general perception (**chart 5**). Other frequently cited measures of regulation, such as the number of pages in the Federal Register, are also growing, but at a slower pace than in past decades, refuting to some extent the burdensome regulation argument[7]. Any overarching assessment of regulation is complicated.

Chart 5 **Small Businesses Are Concerned About Regulation**



* Smoothed; source: National Federation of Independent Business

Trump proposes a temporary moratorium on new regulations and a review of existing regulations to determine what might be repealed or eased. Environmental regulations will be under the greatest scrutiny, with Trump advocating withdrawing from the Obama administration's climate change agreement, easing restrictions on the coal industry and offshore oil drilling, as well as on oil pipelines.

Regulation is a key area where the two candidates will likely differ in spirit and focus

Trump has also signaled his intention to repeal the Dodd-Frank financial sector regulation and overturn many elements of the Affordable Care Act (ACA or "Obamacare"). He has not stated what might replace the ACA, although Republican plans have generally concentrated on reducing restrictions on insurance requirements, ending the insurance mandate for citizens and converting Medicaid (health care for lower-income groups) into block grants administered by the states rather than under federal control.

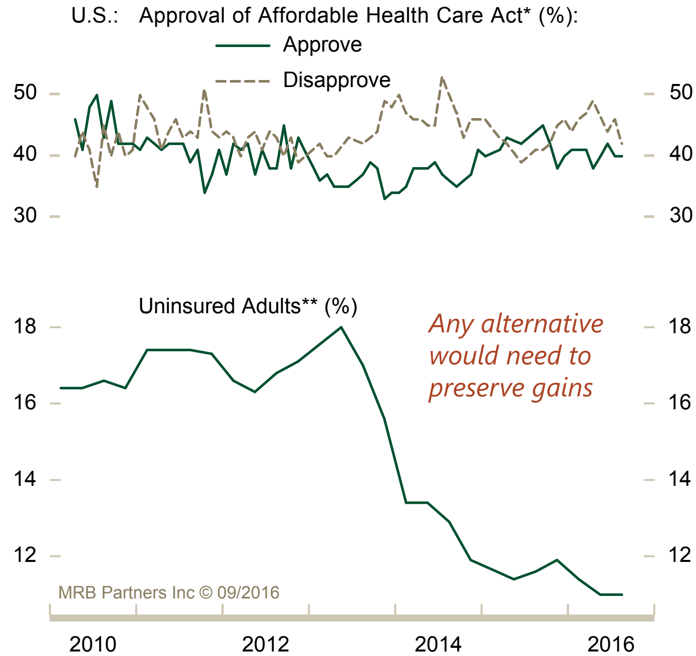
Overturning the ACA is unlikely unless Republicans maintain control of both houses of Congress (**chart 6**). Even then, the program is now fairly entrenched, and will more likely be modified rather than abandoned, although any Republican program will certainly re-brand it (and a Trump administration and Republican Congress will strive for a formal vote of repeal even if many of the basic provisions are maintained).

7 See ***https://regulatorystudies.columbian.gwu.edu/reg-stats#*** Total Pages in the Code of Federal Regulations (1936 - 2013)

Immigration reform will be a cornerstone of a Trump administration, but the details are increasingly murky given recent changes in rhetoric. On balance, investors should assume stricter border controls, with inflows corresponding more with the needs of the technology and agricultural sectors, which depend on foreign workers. Wholesale immigration reform is possible, but will be difficult to achieve in the next four years given the divergent views of key Republican factions and prospective demographic trends.

The Clinton regulatory program will likely follow the Obama trend. Democratic constituents are determined to expand oversight of the financial sector, health care, environmental protection, and workplace climate.

Chart 6 The ACA Remains Unpopular, But Is Now Entrenched



* Source: Kaiser Institute
** Source: Gallup

Among the key planks of a Clinton Administration will be to raise the minimum wage, at least for federal employees. It will be an uphill struggle to achieve it if the House remains in Republican hands, but the presidential bully pulpit, perceived widening income disparities, and public sentiment point to increasing pressure for a higher national minimum wage if Clinton is elected (directionally it will also be true under Trump, but will evolve without his support).

A Clinton administration will propose modifications to the ACA in order to expand the number of insurance suppliers in many states, and better harmonize the state insurance exchanges. Republicans can be expected to support modifications to the ACA, despite their fundamental opposition to it, in order to meet constituent demands for improvements. The program should become somewhat clearer and more robust in the coming years if Clinton is elected.

The regulatory advantage, from a markets perspective, goes to Trump

How these regulatory efforts will be balanced against the express Clinton objectives of improving employment opportunities remains to be seen, but Clinton will likely tilt at least slightly more in favor of the latter compared with Obama.

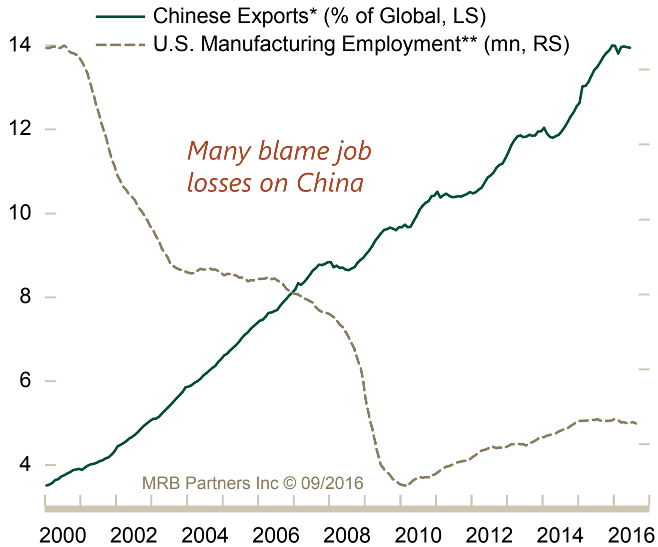
Overall, the advantage, from a markets perspective, goes to Trump.

Trade Policy

Trade policy has risen to be high on the list of public interest, with both Trump and Clinton arguing that workers have suffered as a result of globalization and free-trade deals. Most of the talk is likely bluster, but any significant weakening of the U.S. commitment to free-trade and globalization would be negative for equities, corporate profits, Treasurys and the U.S. dollar.

Trump is on record as intending to repeal NAFTA and scuppering the TPP and TTIP deals now being negotiated. The challenge for a Trump administration would be that much of the Republican establishment that he would inevitably need to lean on to govern, favors these trade deals and wants help in liberalizing global trade regulations. He will negotiate and take into account business interests, despite his rhetoric.

Chart 7 China's Export Success Under Attack In Washington



* U.S. dollars; smoothed; source: IMF
** Source: U.S. Bureau of Labor Statistics

Trump's attacks on China have a better chance of translating into policy changes, given widespread public perception that trade is stacked in China's favor, while manufacturing jobs have declined (**chart 7**). His proposal to dramatically increase the tariff on Chinese goods will not become law, although investors should expect more aggressive actions in specific sectors. Pressure to brand China a currency manipulator is growing in Washington, although geopolitical considerations will continue to weigh heavily on any decision, as will the interests of U.S. businesses operating in China. It will likely be lost on politicians that the Chinese authorities have struggled for much of the past year to prevent the yuan from declining more sharply!

The pace of globalization seems poised to slow but dramatic changes are improbable over the next four years

Clinton has also criticized past trade deals, and will be pressured by the left-wing of her party to revoke or modify the TPP and TTIP. However, her future legislative posture is difficult to gauge given her past strong support for trade-expanding treaties. On balance, our judgement is that Clinton believes trade is a net job producer for the U.S., implying a broadly supportive trade policy bias.

Overall, even under a Trump presidency, the odds of NAFTA being repealed are very slim, while the TPP and TTIP would likely be modified and delayed under either Trump or Clinton. The pace of globalization seems poised to slow under either a Trump or Clinton presidency, but dramatic and abrupt changes are improbable over the next four years. From a market perspective, Clinton will be viewed more favorably on trade policy, particularly outside the U.S.

Other Issues

There are any number of other issues and policies that will be affected by the election outcome. Two in particular are especially important:

Table 2 **Expected Election Outcomes**

Clinton Presidency	
RH/RS	Few legislative policy initiatives; chronic gridlock; reliance on executive orders; "more of the same" but worsening political climate
RH/DS	Same policy action; more political compromise; less reliance on executive orders; slightly better political climate
DH/DS	Active Democratic legislative agenda; fractured opposition; more decisive action, but little political healing
Trump Presidency	
RH/RS	Unpredictable, but active policy; likely sharp turn to political right; test of wills between Republican establishment and rogue Trump faction; Democratic Party obstinancy
RH/DS	Unpredictable policy; likely sharp turn to political right; test of wills between Republican establishment and rogue Trump faction; reliance on executive orders; national political divisions widen
DH/DS	Isolated president; executive orders; little legislative progress; extreme political animosity

RH: Republican control of House of Representatives

RS: Republican control of Senate

DH: Democrat control of House Representatives

DS: Democrat control of Senate

MRB Partners Inc © 09/2016

❍ **Supreme Court:** The two candidates' policy stances are effectively diametrically opposed, based on the criteria the two parties normally use for selecting nominees (although both say they do not employ strict litmus tests). The outcome could be crucial on many fronts, but especially on the ability of corporations to contribute to elections, the legality of the ACA, and on various environmental actions of the EPA. The next president will likely have the opportunity to appoint multiple justices, thereby tilting the voting balance decisively. Markets would likely be more comfortable with Trump appointees, which would likely extend the pro-business bias of the current bench.

The Supreme Court is a crucial policy factor

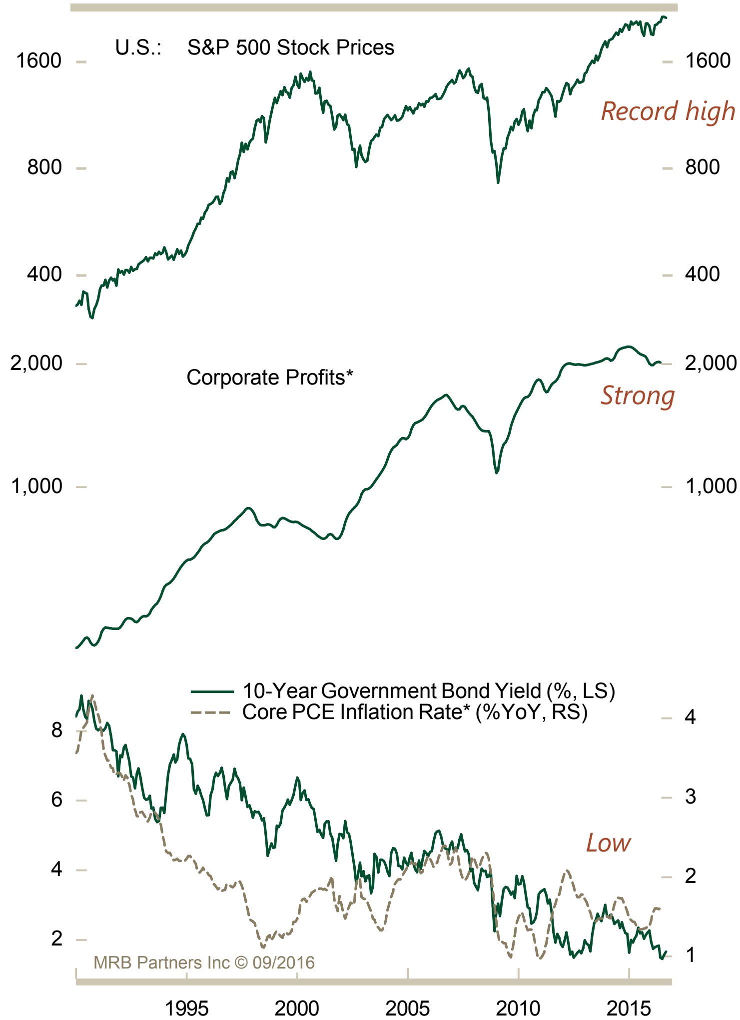
❍ **Foreign Policy:** The president holds important sway on foreign policy (along with the Senate). Trump is particularly weak on foreign policy, but advocates aggressive policies that markets would view negatively. Markets typically prefer an active foreign policy to protect the U.S.'s global economic interests and power. Clinton is on the hawkish end of the Democratic spectrum, which combined with her experience as Secretary of State, should be viewed favorably by market participants. At least verbally, both candidates would be positive for the defense budget and industry. However, on balance, markets appear likely to prefer Clinton given her greater international experience and knowledge.

Outcomes And Investment Implications

Table 2 provides our assessment of the likely political backdrop under Clinton and Trump, depending on the Congressional makeup. The main conclusions are as follows:

- In simple terms, a Clinton presidency, combined with a divided Congress will likely produce a similar, or arguably slightly more benign, political backdrop to that which has prevailed in recent years, albeit one still marked by considerable rancor and gridlock/dithering. The potential for a less rancorous atmosphere would depend on whether the Republican Party elects to move toward the political center in the wake of a Trump defeat and the loss of full Congressional control (i.e. the Senate). This is the most likely outcome based on current national and state polling, and political markets shifted to this scenario early in the year, after assuming Republican control of Congress until recently. On balance, this would likely be slightly better for risk assets than in the past few years, underpinned by ongoing moderate economic growth, with investors exhibiting relief that the election had passed (**chart 8**). Bonds would likely produce modest losses as yields trended higher. The dollar would be firmer, but not unduly strong. We would expect to maintain an overweight stance on equities versus bonds in this scenario, all else being equal.

Chart 8 **More Of The Same Would Be OK For Markets**



* Smoothed; source: U.S. Buerau of Economic Analysis

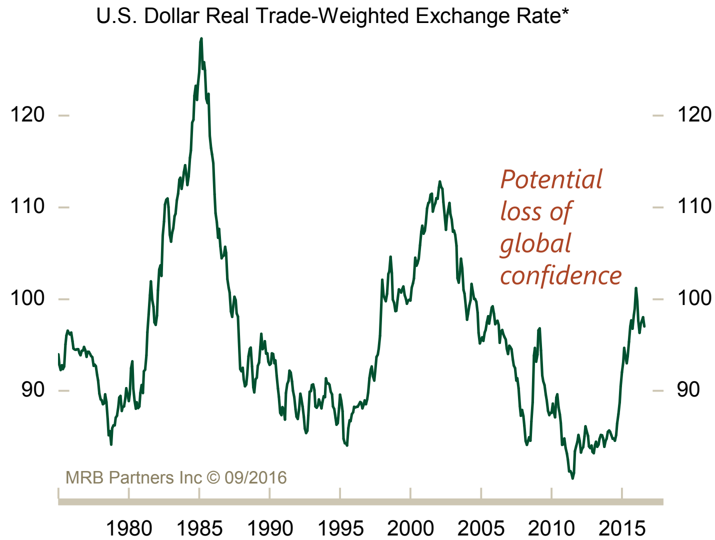
- The political climate would likely deteriorate if Clinton wins the presidency but the Republicans retain control of both houses of Congress. This would further entrench the extreme partisanship currently prevailing, with neither party willing to compromise to produce legislation. The danger would be that while the economy might initially remain on cruise control, ultimately confidence in the political system (and institutions more broadly) would erode. Eventually, such an outcome would correspond with weaker stocks, lower bond yields and a soggy dollar.

A Clinton presidency will likely produce a similar political backdrop to that which has prevailed in recent years

- Markets would likely look upon a Democratic sweep (including both houses of Congress) negatively, as raising the risk of a marked shift left in the policy platform, with potentially adverse implications for the federal deficit (despite Clinton's proposals) via higher spending, and more active regulatory pressures on the financial, energy and health care sectors in particular.

❍ A Trump victory would likely increase uncertainty for the markets under any Congressional outcome. If the Republicans were to retain full control of Congress, policy would likely be unpredictable but highly active. There would inevitably be conflict between establishment Republicans and a Trump camp anxious to shake things up. That said, in the end, this scenario would effectively validate Trump's approach, with uncertain ramifications. It would take a while for markets to gain a clear understanding of the policy path ahead. Initially, this outcome would be negative for stocks, bonds and the dollar. We would downgrade equities, bonds and the dollar if this scenario became increasingly probable, while upgrading cash and commodities.

Chart 9 **The Dollar Would Be A Potential Casualty Of Trump**



* Source: Federal Reserve

❍ A Trump victory with a split Congress would also create policy uncertainty, but markets would assume the Congress would provide some leash on the Trump agenda. Trump would likely rely heavily on executive orders to pursue policy. National political divisions would likely widen. Markets would need time to assess policy direction, and would likely be skittish initially, but would prefer this outcome to others if Trump wins.

A Trump victory would likely increase uncertainty for the markets

❍ Market turmoil would be likely in the almost implausible event that Trump wins but the Democrats win control of both houses of Congress. Trump would be isolated in Washington and operate via executive orders. Extreme animosity would develop as the gap between the two parties widened, with potential for a full-blown political crisis. Equities, bonds and the dollar would all be at substantial risk in such a scenario (**chart 9**).

❍ As always, it is important to note that things change over the course of a presidential term, with leaders often changing policies and priorities according to circumstances.

Peter Perkins

MRB – The Macro Research Board is a privately-owned independent research firm providing integrated, global, multi-asset investment strategy as well as actionable, absolute-return ideas. Our views incorporate a long-term outlook based on in-depth theme research, together with rigorous forecasting models and indicators that drive 6-12 month asset market performance. MRB's team of analysts and strategists leverage the firm's robust research engine and their extensive experience to ensure that investment strategy is developed and articulated in an integrated, coherent and client-friendly manner.

For more information, please contact:
Client Relations
clientrelations@mrbpartners.com

London
Token House
12 Tokenhouse Yard
London, EC2R 7AS
United Kingdom
Tel+44 (0) 20 7073 2792

Montreal
2001, boul. Robert-Bourassa
Suite 810
Montreal, Quebec
Canada H3A 2A6
Tel+1 514 558 1515

New York
122 East 42nd Street
Suite 2310,
New York, NY 10168
USA
Tel+1 212 390 1148

www.mrbpartners.com

Recent *Research Reports*

- U.S. Consumer Durable & Apparel Stocks: Mixed Prospects
- Asia Ex-Japan Equities Report
- Global Fixed Income Report
- South Africa Report
- Betting On U.K. Fallout: An Update
- U.S. Real Estate Stocks: Don't Buy The Hype
- Assessing Credit Quality For EM Government Bonds
- The Hunt For Secure Dividend Yields
- Are Any Russian Assets Uncontaminated By Oil?
- Emerging Markets Foreign Exchange Report
- The U.S. Housing Recovery Grinds On
- China Economy: Prepare For A Rough Landing
- Trading Monetary Policy Trends
- U.S. Equity Sectors Report
- Oil Prices: Will The Sideways Churn End?
- Global Fixed Income Report

For copies of all our previous research, please click here (www.mrbpartners.com/my_mrb) or contact client relations.