Confidence must be earned

Amundi ASSET MANAGEMENT

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Investment Talks:

US presidential election: how it will impact US economy and financial markets

INVESTMENT TALKS

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- ***US presidential election outcome:*** *Joe Biden has enjoyed a remarkably stable lead in the national polls this year. Currently, he is leading President Trump by 7.6%, according to our poll of polls. However, we believe the race is much closer, at around 50/50, with a small Biden edge.* ***The outcome remains uncertain for different reasons****. We expect the election to be determined by a handful of swing states.. In addition, turnout will be critical. We are anticipating record turnout, with the highest number on record voting by mail. Overall,* ***the public has a net negative approval rating for Trump of -9.6%,*** *according to our poll of polls. However, Trump enjoys a positive net approval rating of 4.0% on his handling of the economy, which could help him gain more popular support if the economy gains momentum.*

- ***Key themes for the candidates:*** *There are three main themes in Trump's campaign: law and order, China, and Biden's fitness for office. Biden is campaigning on economic policy ("Build Back Better"), healthcare, racial justice and morality. Biden is planning another fiscal stimulus package to address immediate economic issues tied to the pandemic. Also, he has plans for a major infrastructure investment and supports a modified version of the Green New Deal. Biden plans to boost Obamacare and prescription drug reform. Both candidates will have to deal with the long-term issue of rising inequality.*

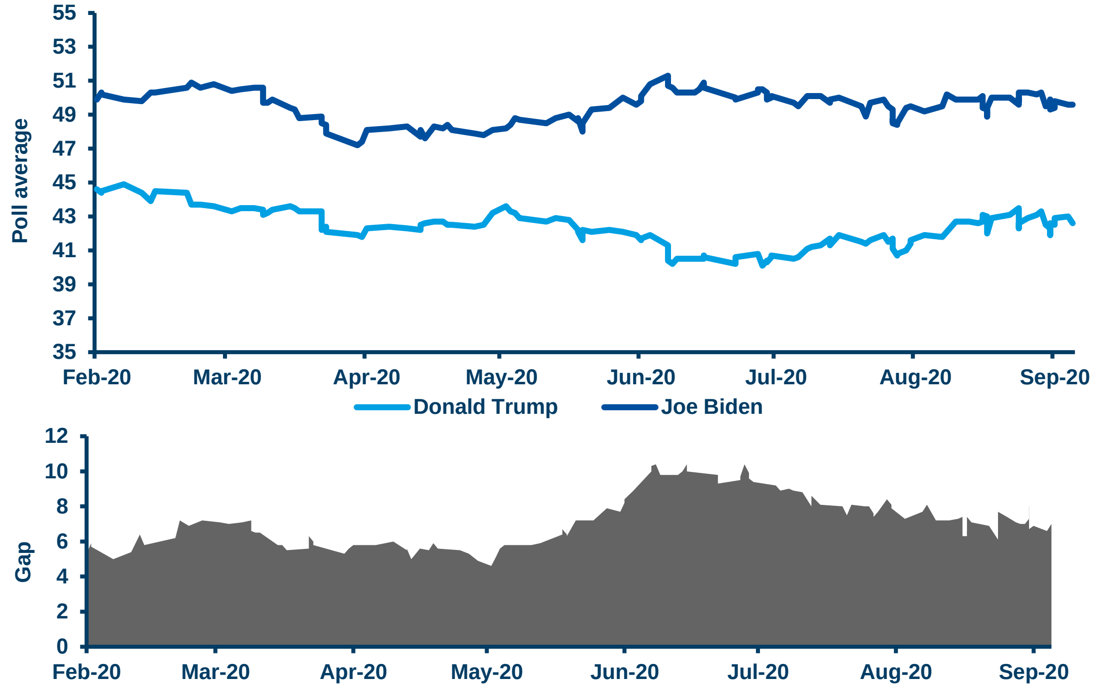
- ***Investment implications****:* ***The dollar should stay weak in the medium term****, due to the re-emergence of twin deficits and an escalating debt/GDP ratio, together with the Fed's long-term commitment to near-zero rates.* ***If the prospects of a Trump re-election increase, we could see the dollar appreciate temporarily*** *based on concerns regarding the prospects of heightened trade tensions and broader geopolitical uncertainty. In any case, we expect to see near-term market volatility around election time.* ***Depending on the winner, certain market sectors may respond differently.*** *Big tech, defense, financials and carbon energy sectors are likely to perform better under Trump while renewable energy and infrastructure-related sectors will be winners under Biden.* ***Under both scenarios****, we believe that* ***ESG investing will gain increasing traction*** *globally, with rising investor pressure for increased disclosure and enhanced ESG practices, supported by accelerating ESG equity flows, including in the United States and despite Trump's backtracking. Should Trump be re-elected, the theme will continue to gain traction, albeit not at the same level should there be a Democratic sweep.*

The US presidential election is expected to be one of the key market drivers in Q4: what are current market expectations and what is your view?

Joe Biden has enjoyed a remarkably stable lead in the national polls since the beginning of the year. According to our poll of polls, Biden leads President Donald Trump by 7.3% as of 15 September 2020, little changed from before the Democratic and Republican conventions which took place this summer, when Biden's lead was 7.5% on 5 August 2020. However, Biden's margin has shrunk from a peak of 10.4% reached on 23 June 2020.

"The trajectory of the race remains fluid and potentially volatile as we head into the final stretch of the campaign".

Biden has led Trump since beginning 2020, US general election poll average



Source: Amundi, based on polls of polls as of 22 September 2020.

The political betting sites also have Biden as the favourite. Predictit — one of the leading betting sites — recently forecast the odds of a Biden victory at 60% while Iowa Electronic Markets showed a smaller edge, at 52% as of 13 September 2020. However, despite the stability in the national polls and the betting site expectations, we **believe the race is much closer**, at around 50/50, with a small Biden edge. **The outcome remains uncertain**. **The trajectory of the race remains fluid and potentially volatile as we head into the final stretch of the campaign** for different reasons:

- While Biden's lead in the national polls is significant, his lead in the swing states is only 3.9%, and in many states, his lead is within the margin of error. **We expect the election to be determined by a handful of swing states and we are focusing on Arizona, Florida, Georgia, Michigan, North Carolina, Pennsylvania and Wisconsin.** Biden's lead in Florida and North Carolina is within the margin of error; his lead in the other states remains nominally above it.
- **Turnout will also be critical**. **We are anticipating an all-time record turnout**, with the highest number on record voting by mail. This could potentially account for one-third of all votes cast. We estimate that among Biden supporters, only 25% of voters expect to vote on election day compared with 67% of Trump voters. This begs the question of whether there are adequate resources in place around the country to handle the number of votes by mail. Regarding Trump, he is likely to bring more voters to the polls who do not normally vote in elections. This was his path to victory in 2016. Moreover, the **debates are likely to have a large impact and may sway the small number of undecided voters**. The

focus will be Biden's performance in the debates, as the pandemic has limited his exposure to voters on the campaign trail.

"There are three main themes in Trump's campaign: law and order, China and Biden's fitness for the office. Biden is campaigning on economic policy, healthcare, racial justice and morality".

What are the most important issues facing the United States in this election? What are the key distinguishing points of the Trump vs. the Biden campaign?

Americans believe the most important issues facing the United States are **the economy and jobs**, at 29%. Behind that, 15% cite **healthcare and COVID-19**, with morality picking up 9% and 8% choosing crime, according to an Ipsos poll taken over 3-8 September 2020. **Trump is facing tremendous pressure to shift the narrative in this election from a referendum on his first term** — which is typical for a president running for re-election — **to a binary choice between him and Biden**. Overall, **the public has a net negative approval rating for Trump of -9.6%,** according to our poll of polls, based on his handling of COVID-19 and race relations. However, Trump enjoys a positive net approval rating of 4.0% on his handling of the economy, which could help him gain more popular support if the economy gains momentum in the next six weeks.

There are three main themes in Trump's campaign: **law and order**, **China and Biden's fitness for the office.** In order to respond to negative poll numbers on the social/racial protests, Trump has accused Biden of supporting the defunding of police departments, a move that does not have popular support among Americans.
Biden has denied any move to defund the police. **On China**, **Trump's campaign has focused on a tough-on-China message**, and his success negotiating the phase-one trade agreement. Such a deal should help boost exports and create jobs in the United States. Finally, a recurring theme for Trump has been questioning Biden's mental and physical fitness for the office, though there is no evidence that Biden is not capable of governing. Trump hopes this tactic will help change the narrative from a referendum on his presidency to a binary choice. **We would expect that the Trump administration's approach regarding deregulation and taxes will persist**.

On the other hand, Biden is campaigning on economic policy ("Build Back Better"), **healthcare, racial justice and morality**. Biden has been focusing on promoting his economic plan, which begins by attacking the economy's largest hurdle, namely the effects of the COVID-19 pandemic. Such a plan would see the implementation of broader testing, an increase in the availability of medical supplies, and would ensure the safe opening of schools, even though the latter could be shut down depending on scientific advice. **Biden is planning another fiscal stimulus package to address immediate economic issues tied to the pandemic. Also, he has plans for major infrastructure spending and supports a modified version of the Green New Deal. Biden's healthcare plan is to boost Obamacare and prescription drug reform**. Finally, Biden frequently talks about "restoring decency" to the office. **Biden is hoping to woo voters that have cited morality as an important issue facing the United States. Funding for proposed initiatives is likely to come from higher corporate and individual taxes.**

"Biden is planning another fiscal stimulus package to address immediate economic issues tied to the pandemic. Also, he has plans for major infrastructure spending and supports a modified version of the Green New Deal".

Milestones on the way to the November election

29 September: first presidential debate

7 October: first and only vice president debate

15 October: second presidential debate

22 October: third presidential debate

3 November: election day

?? : election results

Source: Amundi as of 23 September 2020.

The first presidential debate has the potential to change the trajectory of the race or to reinforce the current polls. If Trump is still lagging in the polls, it may be his last opportunity to change the momentum in the race. For Biden, his goal will be to instil confidence that his message is more in tune with the American mood than that of Trump.

INVESTMENT IMPLICATIONS

Do you see any impact on the US dollar from the election?

The dollar has been experiencing a cyclical weakening. Over the last two years, the dollar bull market had been supported by large interest rate differential and above-trend growth relative to the rest of the world. Since the pandemic-induced recession, we have seen the removal of the twin pillars that used to support the dollar — interest rate differentials and US growth exceptionalism — replaced by the re-emergence of the twin deficits, especially the fiscal deficit. In addition, the Fed's long-term commitment to near-zero rates and an escalating debt/GDP ratio will put pressure on the currency, both now and in the medium term. **If the prospects of a Trump re-election increase, we could see the dollar temporarily appreciate on concerns about the prospects of heightened trade tensions and broader geopolitical uncertainty.**

The Fed has recently announced a change in its policy framework. What are the main risks and opportunities of such change? Do you see the possibility of a reassessment of inflation expectations, which would potentially affect real rates and risk asset valuations?

"There is a broad consensus that it is the equilibrium rate that has fallen, together with an increase in the equilibrium valuation of risky assets. All other things being equal, this factor should encourage savers to switch to equities from bonds".

As a result of its strategic review, the Fed amended its 'reaction function'. Now, it will seek to stabilise inflation around 2% on average over an entire economic cycle, most likely over a four- to eight-year period. In practice, this will allow the Fed to avoid rate hikes at the first signs of an acceleration in inflation. This will require that the recovery is firmly anchored and that inflation remains above 2%. These two conditions will not be met before 2024, according to most FOMC members (only four out of 17 members anticipate a first rate hike in 2023, despite having recently upgraded both growth and inflation forecasts). In doing so, the Fed will anchor the short end of the yield curve. Such an approach supports expectations of an economic recovery. In a very uncertain environment, it is essential to reassure investors that monetary conditions will remain very accommodative during the recovery phase. Also, this strategy will allow to contain interest charges to be contained and the postponement of the debate on rising federal debt.

However, **the recent fall in real interest rates is not only related to monetary policy developments. There is a broad consensus that it is the equilibrium rate that has fallen. As a result, the equilibrium valuation of risky assets has increased**. All other things being equal, **this factor should encourage savers to switch to equities from bonds.** That said, rising costs related to value-chain disruptions, de-globalisation (re-onshoring), and the aspirations of a growing share of the population for wage rises are likely to push up inflation expectations at some point. Moreover, real interest rates have fallen into negative territory and are now below their equilibrium rate. In the short term, if inflation expectations rise, real rates may fall even more sharply, temporarily supporting growth stocks. However, it should be remembered that the Fed is not committed to maintaining long-term yields at their current level. In particular, **if growth and inflation pick up more sharply than expected, the Fed may want to let market forces play their role, leading to a rise in long-term Treasury yields and to a steepening of the yield curve**. This is a potential source of volatility and correction in the stock market that will need to be monitored closely.

What about other possible market implications of the 2020 presidential race?

While history has shown that party leadership in the Oval Office has had little long-term impact on market returns, **we expect to see near-term volatility around election time**. Excluding the economic boom of the 1990s under the Clinton administration, and the subsequent dotcom bubble burst under George W Bush, market returns have been similar across party leadership.

"The greatest risk to short-term market dynamics is an undecided race".

The greatest risk to short-term market dynamics is an undecided race. There is already expectation that results in Georgia will not be certified until well into December, as half of the state's voters do so by mail, and a recent ruling allows for a delay in the absentee deadline. Eighteen other states accept absentee ballots after Election Day**. Given the recent decline in equity market volatility, there is a risk of a sharp sell-off from current levels, especially if the election outcome is still unknown days after 3 November.** Depending on the winner, certain market sectors may respond differently. **Big tech, defense, financials and carbon energy sectors are likely to perform better under Trump** while renewable energy and infrastructure-related sectors will be winners under Biden.

US 2020 presidential elections: market implications

Scenarios	Trump victory (Democrats House, Republicans Senate)	Democrats sweep	Biden victory (Democrats House, Republicans Senate)
Summary	Positive equities, stable rates, strong dollar.	Negative equities, higher rates, weak dollar.	Positive equities, stable rates, weak dollar.
Equities	Equities rise from prospects of further tax reform, may include capital gains; Infrastructure, defense, energy, financials and telecom sectors win.	Potential for initial sharp sell-off as markets price in higher taxes and regulation; Possibly buy on an overreaction; Construction, transportation and resource sectors could outperform.	The prospect of a divided government will push equities higher; Infrastructure, construction, defense may outperform, while tech and energy may underperform.
Rates	Large supply and Fed QE will help keep rates stable. However, potential for tighter fiscal policy later could push rates higher.	Large supply and fiscal impulse could offset Fed's QE, leading to higher rates.	Large supply and Fed QE will help keep rates stable. However, potential for tighter fiscal policy later could push rates higher.
Dollar	Uncertainty over trade policy, large portfolio inflows into equities and home bias by US investors could lead to stronger dollar.	Fiscal impulse will boost growth prospects in US/globally; without tighter monetary policy, dollar will depreciate further.	Low interest rate support, dollar overvalued and relative growth underperformance vs G10, leading to weaker dollar.

Source: Amundi as of 23 September 2020.

What might be the impact of the two candidates with regard to ESG themes? Which investment opportunities could arise in this respect?

"We believe that ESG investing will gain increasing traction globally going forward, with rising investor pressure for increased disclosure and enhanced ESG practices, supported by accelerating ESG equity flows, including in the US and despite Trump's backtracking".

Under President Trump, there has been a backtracking of ESG-friendly policies, with a rollback of regulations and loosening of environmental oversight. The Trump administration has discouraged the implementation of ESG criteria in the nation's retirement plans. According to a *New York Times* analysis of the Trump administration's environmental deregulation, **Trump eliminated 68 rules that were been completed, and another 32 rules are on track to be rolled back.** Trump's completed rollbacks include a loosening of air pollution and emissions standards, allowing more drilling and extraction, and rollbacks of other regulations related to infrastructure, animals, water pollution, toxic substances and safety. Some examples the administration's environmental deregulation include:

- Weakening the Endangered Species Act;
- Restricting California's ability to enforce stricter auto emissions;
- Loosening and cancelling requirement of energy companies to report methane emissions; and
- Weakening the National Environmental Policy Act for quicker approval of infrastructure projects.

A Biden win would alter the course for ESG in the United States. We would expect to see the following actions implemented:

- United States would re-join the 2015 Paris climate accord;
- Reversal all of Trump's anti-ESG policies via executive order; and
- Passage of parts of the Green New Deal. This could occur quickly if both houses of Congress are controlled by Democrats, but would take longer if Republicans maintain control of the Senate.

We believe that ESG investing will gain increasing traction globally going forward, with rising investor pressure for increased disclosure and enhanced ESG practices, supported by accelerating ESG equity flows, including in the United States and despite Trump's backtracking. Should Trump be re-elected, the theme will remain under way, albeit not at the same level should there be a Democratic sweep.

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