ELECTION 2020: WHO WON?

SPLIT GOVERNMENT LIKELY TO CONSTRAIN POLICY

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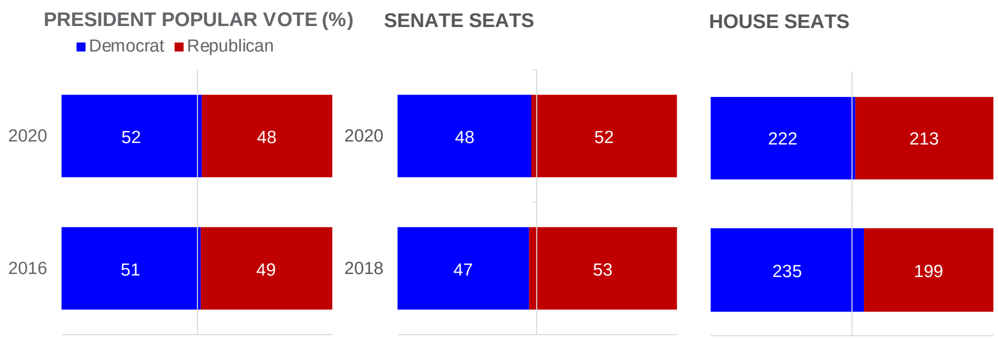
While the results are not yet final, all the media organizations have called the presidential election for former vice president Joe Biden and the financial markets are pricing in divided government. We thought this was the second most likely of our four main scenarios going in to the election, but graded it as the most beneficial to economic growth. We expect an agreement on some fiscal stimulus, while tax increases are off the table. Finally, the surprisingly positive news on the coronavirus vaccine early this week is another good sign for the risk-taking outlook over the next year.

It looks like divided government will be the rule in Washington, D.C. for the next two years. There are legal challenges and recounts still to be conducted, and control of the Senate will not be known until the Georgia run-off elections on January 5. But the most likely outcome is divided government that will significantly limit policy. For example, a sweep by either party would have allowed that party to effect tax and spending plans through the reconciliation process, thus avoiding the filibuster blockade in the Senate. As we show in Exhibit 1 below, the overall shift in votes was not dramatic. While the electoral college votes may swing significantly, the margins in key swing states remained tight and the shift in the popular vote was lower than pollsters forecast. The biggest change looks to be in the House of Representatives, where the Republicans' seat gains look to be in the double digits. With key referendums passed (or defeated) at the state level, this election may become known as one where Americans showed their desire for limiting government.

EXHIBIT 1: NO WAVE

Overall voting results – based on current projections – shifted less than polls expected.



Source: Northern Trust Asset Management. 2018 election results: NY Times; One House seat was undecided as results from North Carolina's 9th congressional district were voided and led to a 2019 special election. 2020 election results: as of 11/9/2020; president popular vote from The Associated Press; Senate and House results from RealClearPolitics using present leader for races not yet called, except for one House race (Iowa) which was tied and thus marked Democrat given tendency of mail-in ballots to lean Democrat. Georgia run-offs marked Republican given underlying trends.

We spent the weeks ahead of the election debating the realistic scenarios we could see unfolding — taking the poll numbers into consideration, but with a healthy degree of skepticism given their track record in recent years. We did think the most likely scenario was a Democratic president, with a Democratic Senate (but just a small majority, not a "blue wave") and a Democratic House. Our second most likely scenario was a Democratic president and House, with the Republicans holding the Senate. As it looks like this second scenario is unfolding, Exhibit 2 shows how we expect the election results to affect the key macro inputs to our investment outlook.

EXHIBIT 2: KEY MACRO IMPLICATIONS OF ELECTION RESULTS

Divided government represents our most positive scenario for growth over the next year.

VARIABLE	IMPACT	NOTES
Growth	Positive	We viewed the split government outcome as a "medium" positive to growth as we expect some stimulus without accompanying tax hikes.
Inflation	Low risk	Higher inflation was only a risk-case in any outcome, but divided government reduces this risk – as the "further left" agenda can no longer be passed.
Monetary Policy	None	Monetary policy is expected to remain highly accommodative and independent of the election.
Fiscal Policy	Stimulative	As discussed under growth, greater spending without offsetting tax hikes is the most stimulative outcome.
Regulatory Reform	On watch	There is potential for increased regulation of energy, consumer finance, housing and the environment; cabinet appointments and policy announcements will help gauge the scale of the potential impact.

Source: Northern Trust Asset Management.

SENATE RACES

We expect the Senate to shift by just one seat — with the Republican majority going from 53-47 to 52-48. This helped to remove post-election market volatility as investors fairly quickly realized that the Senate would serve as a check on any market-unfriendly Biden policy initiatives. It most likely will force Biden to choose more centrist cabinet members as they will need to be confirmed by a Republican-controlled Senate. Should Democrats win the two Georgia run-off seats, Biden will still be somewhat constrained in his cabinet appointments as he may not be able to bring in progressive senators from states with Republican governors, who will most likely give that seat to a fellow Republican — returning the majority to the Republicans along with it.

With two races still waiting to be called, the Republicans are holding a 50-48 majority. Exhibit 3 on the following page shows the Senate seats that were flipped and other close (and closely watched) cases. Thus far, Democrats have netted one seat by flipping an Arizona seat and a Colorado seat, but returning Republicans' recently lost Alabama seat. Republicans managed to fend off Democratic challengers in Iowa, Maine and North Carolina — and almost took a Michigan seat before late-counted votes put the Democratic incumbent back ahead with a final 1.5% margin.

EXHIBIT 3: THREE FLIPS AND TWO RUN-OFFS

The Georgia run-offs will determine eventual control of the Senate.

SENATE FLIPS				
State	Republican	Democrat	Outcome	Presidential race went…
Alabama	Tuberville	Jones	Republican	Republican
Arizona	McSally	Kelly	Democrat	Not Yet Called
Colorado	Gardner	Hickenlooper	Democrat	Democrat
OTHER CLOSE RACES				
State	Republican	Democrat	Outcome	Presidential race went…
Georgia 1	Perdue	Ossoff	TBD - runoff Jan. 5	Not Yet Called
Georgia 2	Loeffler	Warnock	TBD - runoff Jan. 5	Not Yet Called
Iowa	Ernst	Greenfield	Republican	Republican
Maine	Collins	Gideon	Republican	Democrat
Michigan	James	Peters	Democrat	Democrat
North Carolina	Tillis	Cunningham	Republican	Not Yet Called

Source: Northern Trust Asset Management, RealClearPolitics.

Now, all eyes are on Georgia, which — because no candidate in either of the two Senate races scored 50% of the vote — is conducting two run-off votes to restock its U.S. Senate seats. In the first Georgia race, the incumbent Republican beat the Democratic challenger but failed to reach the 50% threshold because of a third party (Libertarian) candidate taking 2.3% of the vote. The second Georgia race is a special election to replace a vacated Senate seat that was temporarily filled by a state-appointed Republican. That replacement took 26% of the vote in an effective three-person race — with another Republican taking 20% of the vote and a Democrat gaining a 33% share.

Republicans are favored in both run-offs. Ballots for the losing candidates in the first vote are more likely to migrate Republican. Meanwhile, U.S. voters more broadly seem to retain their bias toward split government as judged by the net gains by Republicans in the House. Republicans will cement their Senate majority if they win one of these two run-offs. If Democrats are able to take both Georgia seats, they will have effective majority by virtue of Vice President-Elect Kamala Harris representing the tie-breaking vote. Though, even in that situation, there's still not enough political "cushion" in the Senate for Democrats to pass overly progressive bills. It is this Senate-induced political gridlock that investors cheered post-election — and, all else equal, should support equity markets over a tactical (one-year) investment horizon.

STATEWIDE BALLOT MEASURES

On Election Day, voters across 32 states opined on over 120 ballot measures (also known as referendums or propositions). The number of ballot measures this election was below the recent historical average for an election year, largely chalked up to virus-induced difficulties in getting sufficient signatures to get the propositions on the ballots. In some respects, the votes were a big surprise as California voters, who overwhelmingly voted for Biden in the presidential race with two-thirds of the vote, rejected rent control and tax increases on commercial properties (generally viewed as Democratic initiatives). In Florida, where President Donald Trump won by over 370,000 votes (a virtual landslide in Florida!), 61% of voters supported moving to a $15 per hour minimum wage by 2026 (also viewed as a Democratic initiative). Several of the outcomes signal a somewhat general opposition to bigger government. On the tax front, Illinois voted against significant tax increases for wealthy individuals and Washington repealed certain business taxes. The cannabis industry was a huge beneficiary of clear voter support for cannabis reform as all six states opining on the matter voted in favor of more liberal regulation policies. In a similarly big win for gig economy companies (e.g. Uber and Lyft), California voted in favor of Proposition 22, a measure that allows ride-hailing and app-based delivery companies to continue to classify their drivers as contractors, avoiding harmful business regulation. The gambling industry was another clear winner from limited government sentiment as four out of four states voted in favor of expanding legal gambling. Exhibit 4 outlines the most closely-watched measures and their outcomes.

EXHIBIT 4: STATEWIDE REFERENDUMS FROM TAXES TO GAMBLING

Voters showed some tendency to favor smaller government and free markets.

TOPIC	APPROVED/REJECTED	BALLOT MEASURE
Controlled substances	AZ, MT, NJ, SD	Legalize marijuana for recreational purposes.
	MS, SD	Legalize marijuana for medical purposes.
	OR	Legalize use of hallucinogenic mushrooms in a licensed facility and set max fine of $100 for possession of any controlled substance.
Elections	CO	Join multistate agreement to select president by popular vote.
	FL	Open primary system, top two vote-getters advance to general election.
	MA	Ranked-choice voting in primary and general elections for state and federal offices starting in 2022.
Gig jobs	CA	Allow app-based transportation and delivery drivers to be classified as independent contractors.
Taxes	AR	Continue to levy a 0.5% sales tax to pay for roads.
	AZ	3.5% surtax on incomes over $250,000.
	CA	Partially repeal Prop 13 to remove limit on assessment increases for commercial property.
	CO	Reduce income tax rate from 4.63% to 4.55%; repeal the Gallagher Amendment that limits property taxes to 45% of state tax base.
	IL	Change income tax system from flat tax to a graduated tax.
	WA	Maintain or repeal increased business tax.
Tech privacy	CA	Consumers have right to restrict sale of their digital personal information and establish the California Privacy Protection Agency.
Gambling	CO	Expand gambling in Central City, Black Hawk, Cripple Creek.
	MD	Allow sports betting.
	NE	Authorize state laws legalizing gambling; allow gambling at racetracks; and impose 20% tax on racetrack gambling revenue.
	SD	Allow sports betting in Deadwood City.
Tobacco	CO	Increase cigarette tax from 84 cents/pack to $2.64 by 2027 and tax on other tobacco products from 40% to 62% by 2027; new tax on e-cigs at 30% of the manufacturer's price and then rising to 62%.
	OR	Increase cigarette tax by $2/pack, increase cap on cigar taxes from 50 cents to $1; a new 65% wholesale tax on e-cigs.
Housing	CA	Allow local governments to impose limits on rent increases.
Energy	*AK	Increase oil and gas production taxes on the North Slope.
	NV	Require utilities to provide 50% of electricity from renewable sources.
Labor	FL	Increase min wage from $8.56 to $15/hr by 2026.
Spending	LA	Change expenditure formula to limit spending to no more than 5% annually.
Guns	*MT	Local government cannot regulate gun ownership.
Muni debt	NE	Cities can repay debt over 20 years, increased from 15 years.
Payday lending	NE	Limit interest to 36% annually.

Source: Northern Trust Asset Management, Initiative and Referendum Institute, Cornerstone Macro, The Associated Press. *Not yet decided as of 11/11/2020.

SECTOR IMPLICATIONS

With any change in administration, and especially when the party platforms differ by so much, some sectors become more attractive while others suffer. On the following page, we look across the spectrum, from most helped to most hurt. We then dive into the industries on the ends of that full spectrum or where there are mixed impacts such as healthcare. The expected divided government changes the implications for sectors relative to full Democratic control, as the more controversial and impactful platform objectives for areas like healthcare and utilities are not viable with a Republican Senate. In addition, the expected reduction in near-term fiscal stimulus given a Republican Senate has been greeted poorly by cyclical sectors, including industrials and financials. Energy is expected to still be in a difficult position, as much can still be done via executive order. Tech seems to fall in a bit of a sweet spot, as the sector was more specifically targeted by aspects of Biden's tax plan that now seems unlikely, while a possibly less adversarial relationship with China would be favorable to intermediate-term fundamentals.

EXHIBIT 5: SECTOR WINNERS AND LOSERS

As is usually the case, new administrations impact industries differently.

	Sector:	Comments:
Positive	Information Technology	Increased R&D funding for emerging technologies like 5G, quantum computing and artificial intelligence. Less adversarial/different approach to China. Positive stance on immigration and visa policies.
	Utilities	While tax rate increase relative benefits may not play out, some push toward clean energy will create capital expenditure opportunities, increasing long-term earnings growth/visibility.
	Healthcare: Services	Neutral to slightly positive impact. Removes the risk of a public option, but also reduces potential benefit from coverage expansion and increases the industry's exposure to the Supreme Court ACA case.
	Healthcare: Pharma & Biotech	Slight positive as it decreases the likelihood of passing significant drug pricing reform.
	Materials	Mixed impact with a slightly positive tilt. Avoiding a significant tax hike and expectations for higher renewable energy spending are positives. However, oilfield activity is still trending lower and a major infrastructure spending program is likely off the table.
	Consumer Discretionary	Neutral impact. Tax policy may spur increased consumer spending. However, minimum wage hike/unionization pushes increase retail/restaurant costs and clean air/green mandates raise apparel/textile manufacturer costs.
	Consumer Staples	Neutral to slightly negative. Tax policy effects benefit discretionary more than staples. Some benefits from less trade tensions such as lower commodity prices.
	Communication Services	Neutral to negative. Media and connectivity companies may be subject to higher regulatory scrutiny. The media weighting is lower with new sector configuration.
	Industrials	Mixed impact but modestly negative in aggregate. Less defense spending a notable risk. HVAC helped by calls for improved building air quality and sustainable home construction. Support for farmers to use precision agriculture equipment.
	Financials: Consumer Finance	A new Consumer Financial Protection Bureau Chair could increase supervision and enforcement actions against debt collectors, installment lenders, student lenders/servicers and card companies.
	Financials: Large Banks	Banks likely to face somewhat more regulatory scrutiny, somewhat higher capital requirements and increased consumer protections.
	Energy: Oilfield Services & Major Oil	U.S. operations hurt by headwinds from a significant reduction in oilfield activity on federal lands and rising environmental regulations.
Negative	Energy: Exploration & Production	U.S.-centric E&P companies hurt by a reduction in activity on federal lands and rising regulatory requirements – not only in drilling and completion activity on state and private lands, but also in critical infrastructure.

Source: Northern Trust Asset Management.

Information Technology – Modestly Positive Impact

We see positives and negatives for both technology and internet stocks. On the technology side, Biden has a plan to increase research and development funding for emerging technologies like 5G, quantum computing and artificial intelligence — and proposes that the federal government take a piece of the action in the form of royalties on successful products. Biden does propose aggressive enforcement actions against China for cyber espionage and intellectual property theft; however, he is also likely to take a more conciliatory approach to trade tensions. This could reduce the potential for retaliation against U.S. companies by the Chinese government. Biden takes a positive stance on immigration and the visa program used by many technology companies to augment the U.S. workforce. He is willing to offer tax incentives to bring supply chains and the manufacturing of critical technologies back to the U.S., which could mitigate the negative impacts from higher labor and environmental costs. Although not specifically a Biden proposal, Democrats have proposed new taxes on share repurchases, and the technology sector has bought back the largest percentage of its market cap over the past five years. In addition to the expectation for broadly higher corporate tax rates, minimum income taxes on book income discussed in the Biden platform appear to directly target some large-cap technology companies with low tax rates.

Healthcare – Modestly Positive Impact
Under a divided government, we believe the Biden administration will be unable to make significant changes to the healthcare system through legislation. Without a large Democratic majority in the Senate, the risk of passing a public option is virtually eliminated. However, this outcome also reduces the likelihood of legislatives fixes to the Affordable Care Act (ACA) or significant coverage expansion, which could have been positive for the sector. We believe Biden will work to expand coverage and build on the ACA through regulation, but see the scope of what can be accomplished as limited. Overall, we view the removal of several overhangs and a status quo operating environment as a positive for the sector.

The election outcome reduces the likelihood of passing some of the more extreme drug pricing proposals on Biden's platform including direct Medicare negotiation. Biden could bypass Congress through the regulatory process, although we expect this would be limited to more minor drug price reforms. Drug pricing has increasingly become a bipartisan issue and we do see some risk that Republicans and Democrats may work together on modest reforms. However, we believe the pharmaceutical industry's reputation has improved as result of its efforts to fight the pandemic which may mitigate some of this risk in the short term.

Utilities – Modestly Positive Impact
Utilities were deemed to be a unique beneficiary of a corporate tax rate increase expected under a Democratic sweep scenario as corporate taxes are a pass-through cost for the regulated utilities. Earnings will not be impacted as utilities are allowed to earn a fixed regulated return. With this unlikely to take hold with a Republican Senate, the focus shifts to clean energy issues. This too will be more difficult without a Democratic sweep, though Biden’s desire to make utilities emissions net zero by 2035 will likely still lead to increased capex opportunities for the utilities in clean energy infrastructure, accelerating and improving visibility for their long-term earnings growth.

Financials – Negative Impact
We believe the Fed will be moderately tougher on financial services firms — and we expect higher capital and leverage requirements for banks over time once Fed Chair Powell’s term ends (February 2022). We believe that stress tests could be tougher for banks and larger-scale mergers and acquisitions could take longer to approve. We note that, under the Trump administration, banks have been kept on a relatively tight leash with regards to capital return during the COVID-19 pandemic. In the near term, we expect changes on the consumer side to occur more quickly. Biden can appoint a new head of the Consumer Financial Protection Bureau (CFPB) on day one. We expect a Biden-appointed CFPB chair would have a new focus on supervision and enforcement actions against debt collectors, installment lenders, student lenders/servicers and credit card issuers. Under a Biden administration, the Treasury could go back to designating non-banks as systemically important. However, this re-designation could take a long time given the current makeup of the Fed voting members. We do not expect much impact on the property and casualty (P&C) insurance industry given that it is regulated at the state level. We believe the P&C insurance

industry is the least negatively exposed. Lastly, Biden and Harris have publicly supported a financial transaction tax (FTT). Details have been light, however we believe the idea of FTT has picked up traction in Democratic circles as the party has moved to the left. We believe the odds of passing a FTT under a divided government remain low. If a FTT were to pass, it would be a net negative for exchanges and asset managers. Lastly, we would note that there had been some discussion of higher rates under a Democratic sweep scenario as inflation expectations may have changed – higher rates would have been a benefit to financials.

Energy – Negative Impact

The energy industry represents perhaps the sharpest contrast between the two campaigns. The Trump administration's actions over the past four years have encouraged the development of domestic energy sources via the reduction in regulations on the oil and gas industry (OGI), the expansion of OGI infrastructure and the opening of new areas to development. The Biden energy plan is almost diametrically opposed to what the current administration has been doing. While details are somewhat lacking, it appears (from available information) that a Biden administration would quickly launch an aggressive broadside attack on the OGI industry (actually all hydrocarbons including coal) with proposals that would directly hurt the OGI by: 1) incentivizing the use of competing fuels (specifically renewable fuels) with subsidies; 2) potentially removing many OGI subsidies; and 3) placing significant burdens on the OGI.

Even without a sweep, the Biden administration still has a number of tools at its disposal to hinder and/or make more costly activities and investments in the domestic onshore and offshore areas. Despite rumors of a possible fracking ban across the U.S., the possibility of such an outcome is highly unlikely even on federal lands. However, a Biden administration could use executive powers to make some changes such as: 1) halting future leasing and well drilling permits on federal lands/offshore areas; 2) requiring more stringent environmental impact studies before permitting and drilling activity; and 3) appointing new members to federal agencies who could significantly tighten/extend regulations in the areas of clean air and clean water.

CONCLUSION: AN IMPROVED GROWTH OUTLOOK

There are two remaining uncertainties about the election results and implications: 1) the viability and effect of Trump administration legal challenges; 2) the January 5 Georgia Senate run-offs. The second uncertainty has a higher probability of disrupting our base case – as there is still the potential for a Democratic sweep. Maybe as important as the election outcome is the positive news this week on the Pfizer coronavirus vaccine, which showed efficacy of at least 90%. We think that analysts were expecting efficacy ranging from 60-70%, so this is well above expectations. This could encourage more people to take the vaccine when available, and Pfizer's success also augers well for the vaccine under development by Moderna, which uses similar technology. The northern hemisphere faces some difficult months as cases are increasing — alongside hospitalizations. But having a vaccine this close to approval, with the potential to start dosing high-risk people as early as January, will allow investors to look through current difficulties toward an eventual solution. We didn't know of the Pfizer vaccine news when we increased the recommended tactical risk in our Global Policy Model, but this development only improves the risk-taking outlook over the next year.

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