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POLITICAL PULSE

When Is Mr. Market Going to Start Worrying About President Biden?

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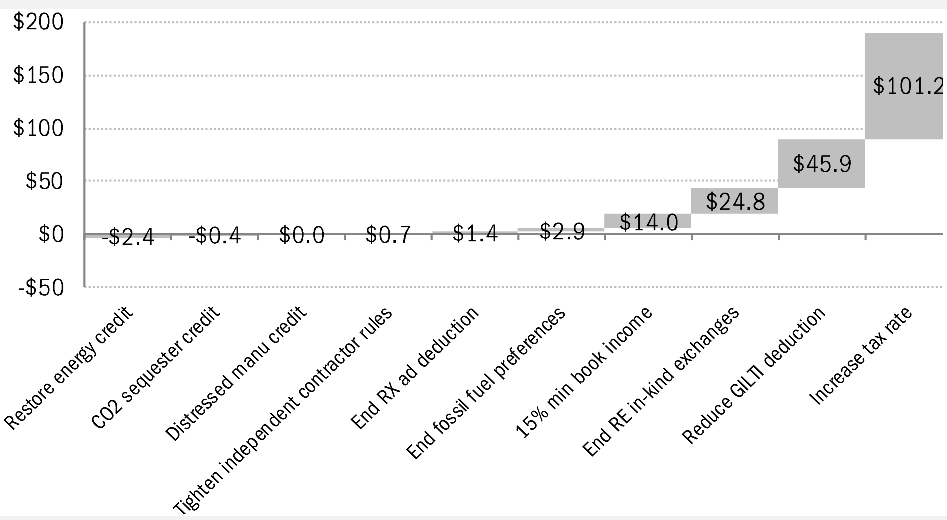
Bidenomics would knock 12% off S&P 500 earnings and give the Fed a new third mandate.

With under 100 days till the presidential election, we still believe strongly that *Mr. Market would prefer to see the continuation of President Donald J. Trump's business-friendly economic policy agenda* – setting aside whatever we may think of the candidates' other policies or personal character (see, most recently, "On the June Jobs Report, and Our 2020 Election Model" July 2, 2020). With most polls pointing instead toward a Joseph Biden win in November – indeed a Democratic tsunami – and the prospects of a higher-tax and heavier-regulation agenda, it seems inexplicable that stocks have managed to rally within striking distance of all-time highs, especially considering that, by the numbers, we have just barely passed the trough of what amounts to a depression.

Perhaps the Occam's Razor explanation is that Mr. Market can read the same polls as the rest of us, and has already written off Trumponomics as lost. What would that imply? That it doesn't matter? Or would equities be 20% higher otherwise? Maybe Mr. Market thinks the worst can be avoided if the GOP keeps Senate control – which is very possible even if Trump loses. Or – dare we think the unthinkable? – *maybe Mr. Market thinks Trump will win*.

That said, we can't escape the intuition that markets are whistling past the

Changes in corporate tax collections under Biden plan, 2022, USD billions



Source: Tax Policy Center, TrendMacro calculations

Update to strategic view

US MACRO, US ELECTION MODEL, US STOCKS, US BONDS, US FED, OIL: Markets are not acting like the US presidential election is less than 100 days away, with a potential "Democratic tsunami" ushering in a period of anti-growth economic policy. Perhaps markets are ignoring the risk, perhaps they don't think Bidenomics will be so bad, or perhaps they think Trump will be re-elected. We are braced for a new equilibrium if markets suddenly decide to be more worried. The most anti-growth element of Bidenomics is tax policy, under which after-tax income would fall for all Americans, and higher corporate taxes would cut S&P 500 earnings by about 12%. Biden now says he would not seek to ban fracking, and his trade and Covid-2019 policies are similar to Trump's. But de-carbonizing power generation would decimate the coal and natural gas industries. Biden would increase banking regulation, including a "third mandate" for the Fed to pursue racial equity. Significant infrastructure spending is proposed, mostly in "clean energy."

[Strategy dashboard]

graveyard of Trumponomics, myopically focused on the shape of recovery from the Covid-2019 recession. If that's true we should brace ourselves for the sudden onset of a new equilibrium when markets suddenly turn their attention to post-election policy risks.

The hypothesis that markets are already discounting a Biden presidency rests on the idea that, compared to Bernie Sanders or some of the other Democratic primary contenders, *Biden has the image of being a "moderate" who wouldn't do much policy damage. As we will see in a moment, some of his positions are very similar to Trump's. But some are not, and we have long cautioned against complacency. Important parts of Bidenomics are only "moderate" compared to Sandersnomics or Warrenomics, and unlike Sanders or Elizabeth Warren, Biden is electable, so he is the greater risk* (see "Biden: Be Careful What You Wish For" For March 5, 2020).

So far, Biden is catering to that complacency by running a low-profile campaign in which he is not sharply defining himself in any policy dimension, other than by being not Donald Trump. So it is difficult to say exactly what his economic agenda actually is. Unlike Warren, who posted exhaustively detailed plans, what Biden calls his "fact sheets" are quite vague and – if we can be forgiven for not pulling our punches – mostly just mash-ups of topical tropes. For example, the very first sentence of his fact sheet on energy and the environment is: "The current COVID-19 pandemic reminds us how profoundly the energy and environmental policy decisions of the past have failed communities of color…" Trust us that we're not being unfair to him – out of self-interest, we have scoured his fact sheets to determine his substantive positions. While his written statements are quite lengthy, and quite clear in their political positioning, they contain little by way of actual policy proposals.

- *But let us be as clear as we can, even if Biden is not. While short on specifics, the aspirational direction of his fact sheets and the lengthy Biden-Sanders Unity Task Force Recommendations make it certain that Biden's overall agenda would be to use federal power to interfere substantively in the economy in order to promote environmental, "social justice" and union objectives. We're not here to argue about whether those objectives are worthy – only that pursuing them inevitably will take a toll on economic liberty and efficiency, and on productivity and growth, and very likely on the performance of investment assets.*
- *We could go so far as to say that a Biden presidency would signal that the US electorate will have abandoned what we hailed with the rise of Trump in 2016 as a rebirth of the "animal spirits" of the economy, indeed a grass-roots generational "turning" toward risk-taking after a decade of "secular stagnation"* (see, among our earliest, "Trump May Be First Since Reagan To Unleash America's Animal Spirits" March 19, 2016).
- Our purpose today is not to take on those larger issues, nor to forecast who will win the election (see "On the June Jobs Report, and Our 2020 Election Model" July 2, 2020). This will be a far-from-exhaustive look at some key policy specifics. As you will see,

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in some cases there are sharp contrasts between Bidenomics and Trumponomics, and in other cases there are not. And it's worth bearing in mind that some elements would require a Democratic Senate to pass legislation, while others could be done by executive order or regulatory fiat.

TAX POLICY *For markets, we put tax policy first and foremost. Biden has not published a fact sheet on it per se*. In March he provided the non-partisan but slightly left-leaning Tax Policy Center with the details required for its analysts to do a detailed revenue and distributional scoring.

- *Biden would hike corporate taxes by $188 billion in 2022, and $5.26 trillion cumulatively through 2040. We estimate this would reduce S&P 500 EPS by 12%. The immediate first-order effect would be to reduce market capitalization by the same percentage. Second-order effects include slowing capital investment because after-tax hurdle rates will be more prohibitive. Third-order effects include a secular slow-down in earnings growth thanks to this slowing capital investment. All this would run in reverse the positive effects of the corporate tax cut enacted in December 2017's Tax Cuts and Jobs Act (TCJA).*
- Raising the headline top tax rate from 21% to 28% accounts for a little more than half the first-order earnings damage (please see the chart on the first page). Other large impacts come from halving the deduction for global intangible low-tax income (GILTI), ending the like-kind exchange shelter for real estate, and imposing a minimum tax of 15% on book income.
- On individual income taxes, *Biden would let all sunsetting provisions of TCJA roll off as scheduled. However, for taxpayers earning more than $400,000, he would immediately revert tax rates back up to pre-TCJA levels, cap deductions, uncap Social Security wages, and tax capital gains and dividends at ordinary rates. He would not re-instate the deductibility of state and local taxes. He would tax unrealized capital gains at death, restore various credits for green expenditures, create credits for care-giver expenses connected with cognitive difficulties* (no snarky jokes, please) *and make student loan forgiveness tax-free.*
- Both the Tax Policy Center and the non-partisan but right-leaning Tax Foundation conclude that, overall, *this suite of policy changes would reduce after-tax income for taxpayers in all brackets, rich and poor. The immediate first order effect would be to leave less income for individual consumption and investment. Second order effects include disincentives to work for earned income as oppose to transfer payment and, because of the steepening of the progressivity of the tax code, to contribute marginal labor to earn marginal earned income. This, too, would run TCJA in reverse, making it less likely that we will re-attain the near-historic low levels of unemployment across demographic classes, and the rising incomes among the lowest-earners, that we saw develop over 2018 and early 2019*.

COVID-2019 POLICY Here Mr. Market should take comfort that Trump's policies will be continued even if he loses the election. Please trust us that we are being fair and objective when we say that *in every stated policy particular* *Biden promises to do exactly what Trump has already done* – while criticizing Trump for not having done it. For example, the very first policy promise is:

> *"Minutes after he is declared the winner of the election, Biden will make one of his first calls to Dr. Tony Fauci and ask him to extend his unprecedented record of service to six Presidents by serving one more."*

- We fail to see how Biden would differentiate himself from Trump by reappointing the same expert that Trump has relied upon (to a fault in our view) – indeed the same expert that six presidents have relied upon, as Biden himself points out.
- Still, it is a relief that Biden is not overtly promoting draconian lockdowns as an inevitable approach to dealing with the virus.

ENERGY POLICY Biden's energy policy fact sheet calls for "a carbon pollution-free power sector by 2035." Even holding power demand steady, that's a tall order, and a risky and disruptive one – considering that well more than half of today's power generation comes from natural gas (38.4%) and coal (23.5%). Demand for power would grow, under Biden's plan to subsidize electric vehicles – autos as well as "e-scooters and other micro-mobility vehicles" – making interference with cost-effective supply all the more risky.

But as a first-order effect, the 2035 ambition effectively destroys what's left of the US coal industry, for which power generation consumes 92% of production, and it does no favors for the already glutted natural gas industry, for which power generation consumes 36% of production.

- *From what we can see, there is no fact sheet or official position paper on fracking*. We suspect that's because Biden sees this as a no-win political issue for him, best avoided.
- He has been attacked by Republicans for his statement last year that "We would make sure it's eliminated," and another that "I guarantee you we are going to end fossil fuel." As recently as March he said in a debate with Sanders, "no new fracking" (we don't believe he said "read my lips").
- That has changed, now that Biden is running in the general election against Trump, not the primaries against Sanders. Probably with an eye on voters in fracking states such as Pennsylvania, Biden said recently:

  "Fracking is not going to be on the chopping block... We're losing a lot of jobs overseas, losing jobs to COVID-19, and if fracking is on the chopping block, how are you going to help these displaced workers?"

- Be that as it may, we think it's not a bad bet that, if Biden were president, he and his regulatory appointments would tend to bring back the fracking-unfriendly tendencies of the Obama years, rather than trying to clear the way for the industry, as Trump has done.

TRADE POLICY Until Trump, the Republicans have been the party of globalization, and the Democrats – with their union labor base – the party of protectionism. So it shouldn't be a surprise to read Biden's position on "Made in America." It's just that, unlike when Trump says the same thing, Biden overtly means "made in *unionized* America."

- *Biden's China policy is not obviously any different than Trump's* (we have said all year that China-bashing will be a bipartisan staple of this election year – see, most recently, "China Strikes Back" June 1, 2020).
- Biden says nothing about rolling back Trump's tariffs on China, though he calls "Trump's go-it-alone trade war and empty 'phase one' deal with China…an unmitigated disaster." He says, as indeed he must, that he will

  "[t]ake aggressive trade enforcement actions against China or any other country seeking to undercut American manufacturing through unfair practices, including currency manipulation, anti-competitive dumping, state-owned company abuses, or unfair subsidies."

- His only policies that differ from Trump's are, first, to pursue what we think is merely a pipe-dream to "work with our closest allies," and second, to invest $300 billion in subsidies to make the US technology sector more competitive with China's subsidized technology sector by, yes, having the US government guess which technologies will be the most productive to subsidize.

BANK AND FEDERAL RESERVE POLICY It feels like the word "banks" appears more than any other in Biden's position statements. Our overall impression is that, for him they serve as whipping-boys for everything that's wrong with the US economy, and as *infinitely deep sources of lending for whatever Biden thinks would make things better – especially the funding of low-cost housing. This very thing was surely a key causal factor in the run-up to the mortgage crisis of 2008-2009*.

- We find it especially worrisome that the Biden-Sanders Unity Task force would advocate that President Biden sign an executive order requiring that

  "[t]he Federal Reserve should significantly elevate racial equity as part of its mandate by targeting not just the overall unemployment rate but disparate unemployment rate based on race. To do so, language in the Federal Reserve Act should be amended to require the Fed chair, in his or her semiannual report, to report not just on macroeconomic conditions, but on the extent of racial employment

and wage gaps, and what the central bank is doing to reduce them."

- *There's a very bullish element to this.* Minority unemployment was the lowest in the history of the data earlier this year, thanks to an unusually long business cycle expansion, which despite Fed Chair Jerome Powell's ill-advised attempts to the contrary, the Fed didn't manage to kill with too-high interest rates (see "The Fed Pretends to Listen" January 29, 2020). *So if what amounts to a new third mandate for the Fed encourages it to "run the economy hot" – at least when inflation isn't a palpable threat, as it never was in the previous long expansion – then so much the better.*
- *The less bullish dimension would be if some future Federal Reserve Board interprets this new mandate as requiring establishing minority-targeted lending programs funded by the Fed's printing press. Don't think it can't happen – such targeted lending programs are going on right now, such as the Fed's Main Street Lending Program.*
- With this possibility in mind, we note that one of the authors of this section of the Unity Task Force Recommendations is Stephanie Kelton, author of *The Deficit Myth*, and the most prominent academic economist who advocates Modern Monetary Theory.
- While Biden's policy statement seems directed to monetary policy, in the name of this new mandate the Fed, in its capacity as the top US bank regulator, could be used as a cudgel to force banks to into unwise loans or incentive-distorting wage and hiring policies.

INFRASTRUCTURE Many clients tell us they would expect *Biden to unleash a wave of government spending that would have the effect of fiscal stimulus*. It's true that across Biden's various policy proposals there is more than $2 trillion in proposed spending programs, most but not all in the "clean energy" field.

- We can debate whether such spending is truly stimulative. It can goose jobs and profits in the short-run, but long-term there is a cost in economic efficiency. And like any other capital investment, it has to be judged on the merits: will it, or will it not, produce a productive asset that will pay for itself? And more – is the asset it produces better than the one that would be been produced if capital and the resources it would have employed hadn't been crowded out of the market?

Bottom line

Markets are not acting like the US presidential election is less than 100 days away, with a potential "Democratic tsunami" ushering in a period of anti-growth economic policy. Perhaps markets are ignoring the risk, perhaps they don't think Bidenomics will be so bad, or perhaps they think Trump will be re-elected. We are braced for a new equilibrium if markets suddenly decide to be more worried. The most anti-growth element of Bidenomics is tax policy, under which after-tax earnings would fall for all

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