ELECTION 2020

Biden Win Might Bring Mixed Outlook for Investors

Additional fiscal stimulus likely, tax hikes uncertain.

November 2020

KEY INSIGHTS

- T. Rowe Price investment professionals expect President-elect Joe Biden to push for another fiscal stimulus package, including funding for municipalities.
- While Biden supports corporate tax increases, it is far from certain they would be enacted in the next Congress.
- Biden has suggested taking a tough stance toward China on market practices, though he may seek multilateral partnerships to address these issues.

Democrat Joe Biden's policy proposals as the next U.S. president (pending the outcome of potential legal challenges) could have mixed implications for investors if implemented, according to T. Rowe Price investment professionals. On the positive side, many see Biden as likely to prioritize additional major fiscal stimulus to help the economy continue to recover from the steep downturn caused by the coronavirus pandemic. However, Biden also supports corporate tax increases that would be used to fund some of the additional spending. It is far from certain that they would be enacted given Republican opposition.

Spending and Taxes

Mark Vaselkiv, T. Rowe Price's chief investment officer (CIO) for Fixed Income, believes that Biden is likely to seek additional funding for states and municipalities. "The economy is weakest at the state and local level, where governments need help to mitigate cuts in essential services amid quickly declining revenues," Vaselkiv asserts. This push for funds for localities could help stabilize and support the credit quality of municipal debt for years to come as the economy recovers from the pandemic, he says.

Biden has proposed raising corporate taxes to halve the tax cut enacted by the Tax Cuts and Jobs Act (TCJA) of 2017. Biden's plan involves increasing the corporate income tax rate—currently a flat 21%—to 28%. That would still leave the rate meaningfully lower than the pre-TCJA rate of 35%. President-elect Biden would also likely try to boost taxes on the foreign income of U.S. companies and institute a form of alternative minimum tax for corporations. However, Republican opposition could limit or prevent some of these measures to increase taxes.

Short-Term Effect on Corporate Earnings

Biden's outlined tax hikes, if implemented, could reduce after-tax corporate earnings.

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> *International Fixed Income Portfolio Manager*

David Giroux, T. Rowe Price CIO of Equity and Multi-Asset and head of Investment Strategy, says that the tax rate increases proposed by Biden could collectively reduce after-tax profits for companies in the S&P 500 Index. However, some industries could benefit from increased spending. Global Focused Growth Equity Strategy Portfolio Manager David Eiswert agrees that U.S. companies would experience an "earnings reset" if the Biden tax plan passes, although he also believes that the effects would be "manageable and likely offset, in part, by fiscal stimulus."

Looking at corporate bonds, Vaselkiv asserts that "Biden's tax increases would impact equities more directly than corporate credit, probably hitting the wildly profitable giant tech stocks the hardest." A tax hike would not necessarily hold back growth, Vaselkiv adds, noting that U.S. corporate earnings and the broader U.S. economy both continued to grow after tax hikes during the Clinton and Obama administrations.

According to T. Rowe Price Chief U.S. Economist Alan Levenson, the first order of fiscal business for Biden will likely be a debt-financed coronavirus response and economic rescue package. Biden will probably wait until later in 2021 to try to implement his broader vision for economic renewal, with roughly half of the 10-year cost expected to be offset by tax and other revenue increases. "The implied addition to debt is manageable because borrowing rates are low relative to the economy's potential growth," he explains.

Pressure on China to Continue

All signs suggest that, as president, Biden will take a tough stance toward China on market practices and human rights issues, though he will likely seek multilateral partnerships and engage levers beyond trade in any renegotiation of the U.S.-China relationship.

"Tensions with China seem to resonate across the political divide," says Quentin Fitzsimmons, a London-based T. Rowe Price International Fixed Income portfolio manager. He believes Biden will maintain pressure on China to address concerns about intellectual property rights in the technology sector. "It's tough to say how U.S.-China relations will evolve in a Biden presidency," Science & Technology Equity Strategy Portfolio Manager Ken Allen states, "but if volatility were to lessen, that could be a positive for technology companies that are perceived as having some exposure to trade tensions between the two countries."

However, according to Levenson, Biden may face tensions between reengaging more constructively with allies on trade while seeking to re-shore critical supply lines and manufacturing jobs in general.

Industrials Could Benefit From Push Toward Energy Efficiency

Biden has indicated that he will seek higher levels of federal procurement spending and tax incentives to create jobs and drive economic development by rebuilding critical infrastructure. This push would focus on reducing carbon emissions and investing in clean-energy technologies, although it could face opposition from Republicans in Congress.

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

Conversely, U.S. defense spending "faces the prospect of several years of a modest downward trajectory after a seven-year upcycle, which would have been likely

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regardless of who was elected as the next president," Adams asserts.

Health Care Policies May Expand Market for Medicare-Focused Firms

Expanding access to health insurance also appears to be a priority for Biden, who has proposed lowering the age requirement for Medicare eligibility to 60 years from 65 and creating a new Medicare-administered public option that would automatically enroll low-income Americans who aren't eligible for Medicaid. Health Services Analyst Rouven Wool-Lewis believes that, if implemented, these policies could expand the market for Medicare-focused managed care organizations while potentially siphoning away some customers from private health insurance providers.

President-elect Biden and President Trump advocated different solutions to curb drug costs. Pharmaceuticals Analyst Jeff Holford says such proposals are more likely to be enacted in the Biden administration, which could negatively impact pharmaceutical stocks. Holford also notes, however, that the politics of health care legislation are complicated given the strong relationships that politicians across the political divide have with the pharmaceutical industry.

Potential for Heightened Bank Regulation

The Biden administration might seek to impose stricter rules and enforcement policies for banks. These potential measures could include additional limits on bank dividends and share buybacks as the U.S. recovers from the pandemic and its fallout. However, Gabriel Solomon, portfolio manager of the Financial Services Equity Strategy, believes that the regulatory environment may prove "less adversarial" than during the Obama administration, after lax bank regulation was widely viewed as contributing to the global financial crisis of 2008–2009.

Regulatory Moves Likely to Have Little Impact on Oil Market

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

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

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ID0003725 (11/2020)
202010-1382946