SEVEN WAYS BIDEN COULD IMPACT YOUR PORTFOLIO

Op Ed by Dr Rory Knight

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President Biden will face a full inbox when he finally manages to make his way through the doors of the Oval Office on 21st January, the morning after his inauguration. The pandemic and its attendant economic fallout (especially the need to combat spiralling unemployment) and reversing key Trump policies will occupy most of his first one hundred days in office.

But he will find himself operating under considerable constraint, chiefly the overall state of the US economy. Figure 1 below summarises the reality the President will be grappling with. Interest rates are close to zero, and the Federal Reserve balance sheet has nearly doubled in the last twelve months. The President wants to spend more than can be raised in taxes and as a result Federal debt will exceed 100% of annual GDP - low by Greek standards but highly unusual for the holder of the world's reserve currency. Continuing application of Modern Monetary Theory (MMT) will eventually run out of runway, and winding down the Fed's balance sheet could prove highly disruptive for investors. The basic message for investors must therefore be caveat emptor.

It still remains unclear whether the Democrats will control the Senate - which will not be known until votes in Georgia are announced on January 5th. But irrespective of the Senate the Democrats will continue to control the House of Representatives. That, together with the passing of presidential decrees will be enough for Mr Biden to implement many of his policies. Seven key aspects of these policies could have a major impact on investment portfolios - not all of them positively - and they will need to be reflected in the actions investors take to mitigate risk.

1. Combating Covid

Biden's plans to tackle Covid, which will be far more interventionist than Trump's, have received a warm welcome from the medical fraternity. It seems likely that the new President will invoke defence emergency powers to commandeer private companies to produce PPE and the like. In addition, he will exact higher insurance benefits for the unemployed from corporations. If his approach, buoyed by the benefits of early vaccines, curtails the pandemic and allows the economy to open early in the year, it will look very bullish for the US economy. However, it will involve significant costs both direct and indirect. If it doesn't work, his Covid strategy could act as a fairly significant damper on growth. The bottom line is likely to be increased risk in investing in the US.

2. Social policy spending

Biden clearly intends to reinstate the Affordable Care Act ('Obamacare') and even extend it. In addition, his concordat with the Democrat radical wing could lead to further entitlement programmes such as 'Medicare for all' and free college access. If Biden is simply projecting a one-term presidency (see below) this is an area where he is likely to push hard. However, with the US budget deficit surpassing \$3 trillion as of 30th September, there may be some resistance to further fiscal profligacy.

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The budget deficit as a percentage of US GDP is now at an all-time high. The US federal debt, held by the public, is expected to reach close to 100% of annual GDP at over $20 trillion by the time Biden takes office. Pursuing admittedly laudable social policies will add further pressure to an already difficult financial position. This again suggests that growth will slow and further risks for those investing in the US economy.

3. Tax hikes

Biden's tax policies will have the largest impact on investment. He has stated his intention to increase corporate tax rates from 21% to 28%, to tax foreign income and to impose a 12.4% social security payroll tax on wages above $400,000. While it is estimated that this will generate tax revenues of around $3 trillion over the next decade, the potential cost is a nearly 2% reduction in GDP and the loss of half a million jobs. Biden's need to raise revenue is stark, but his dilemma is that the expected revenues will not be enough to cover the increased costs of his other policies. As a result the deficit and national debt will inexorably increase. Investors in the US should therefore plan for lower returns and a weaker dollar.

4. Tougher regulation

Trump made considerable progress in deregulating Wall Street, although not as much as he promised. Reversing these measures is likely to be high on Biden's agenda. His initial choice of hawkish advisors signals that banks are in for more stringent scrutiny. Biden is likely to seek to rebuild and extend the Dodd-Frank financial regulation act introduced by Obama, which was subsequently diluted but not eliminated by Trump. Regulating Wall Street is popular with many of his supporters. These interventions will reduce bank profitability just at the time when the banking sector is being challenged by international competition and the threat of technological obsolescence. The larger the bank the greater will be the impact, and this could be a sector meriting underweighting in future portfolios. Universal banks may remain popular.

5. Greening America

Climate change is another top priority for the incoming president. Trump halted progress in this policy area, most conspicuously by withdrawing from the Paris Climate Accord. Biden has indicated that he will immediately sign the US back in again. Although he is unlikely to embrace the more radical "New Green Deal" proposed by some Democrats which would see most carbon emissions eliminated within a decade, Biden's plans remain ambitious.

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He plans to eliminate all carbon use in electricity generation by 2035 and make the whole country carbon neutral by 2050. There will be winners and losers in this new regime as significant costs of regulation will be imposed on carbon-intensive industries. While electric vehicle manufacturers will receive a boost in developing public transport, fracking by contrast, will be reined-in.

Biden's policies are progressive and deserve a worldwide welcome, but the costs will be high. His budget alone for upgrading millions of buildings to be more energy efficient is $2 trillion. Government spending will need to be financed which will mean increases in tax and debt - a further potential weakener to the US economy.

6. Reining in Big Tech

Both contenders in the presidential election promised a break-up of the Big Tech companies. Whether this is sound policy is a moot question, but it will certainly reduce the value of some of the most valuable companies in the world. Europe is also taking aim at these companies, and if Biden makes good on his campaign promises, underweighting high tech stocks, which to date have provided formidable returns, may now be advisable. Interestingly, these same companies provided much support to the Biden campaign in the form of funding and editorial support. Perhaps in the light of this President Biden's response will be more nuanced. Either way many investors will be considering reducing their exposure to these stocks.

7. China trade wars

The single biggest foreign policy issue confronting President Elect Biden is of course the US's relationship with China. Under Trump, relations with China touched an all-time low, with mutual tariff impositions, the sanctioning of Chinese companies and sabre rattling in the South China Sea. Trump imposed tariffs on everything from solar panels to washing machines and all things Chinese. Tariffs send out an effective signal both to trade partners and to voting constituents who enjoy greater short-term protection. They are all the more credible because of the known associated costs. But whilst tariffs may create short-term protectionist benefits the economics literature offers plenty of evidence that over the longer-term tariffs are costly for all concerned.

As with reining in Big Tech, both contenders for the White House promised tough policies on China. But once in office, President Biden's actions may not be so aggressive. He will be in a position to reverse these tariff policies and to send a positive message to the world that the US is open for business - which in turn would boost the US economy. The dilemma the president faces is that there is bipartisan support for curbing China's path to economic dominance. Reversing tariffs too quickly might be perceived as weakness. The president will obviously need to resolve these issues before acting over China.

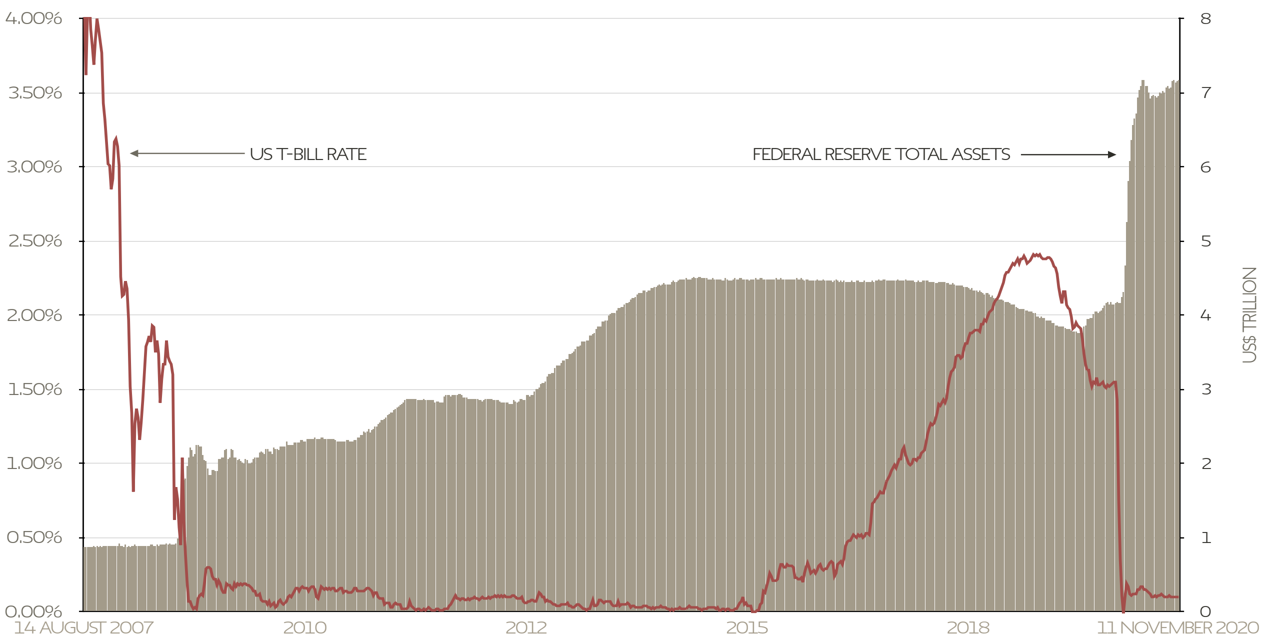
Polarisation in the world economy brings both opportunities and threats for investors. Investors should be seriously considering their weightings in China and the US.

On balance the international investor should probably view the Biden ascendency as potentially improving the US relationship with regard to world trade.

But in reality, what Biden does is less important that how China views the relationship. Public pronouncements from Beijing would seem to indicate that they are not optimistic about changes in US policy. The 14th five-year plan unveiled at the most recent Chinese Communist Party conference did not mention annual growth targets but put the emphasis rather on technological self-sufficiency and so-called Dual Circulation (growth driven by internal consumption). But China may be playing a watching game. US foreign policy is no longer the constant it once was, and China may be contemplating a one-term Biden presidency only. Are we facing a one-term presidency? Joe Biden will be 78 years old on inauguration day and the oldest person ever to take up the office of president. In 2024 he will be 82! Even if he does not retire early it is unlikely that he will run for a second term. The prospect of a one-term presidency has great significance for how Biden tackles his agenda. Will he be Slow Joe or Old Man in a Hurry? If the latter, he is likely to focus more on legacy issues and risk unpopular policies which will not come back to haunt him. Whatever path he picks there is likely to be a sharp change of course in an attempt to reverse Trump's policies. The resultant discontinuity is likely to add further uncertainty and possibly weaken the dollar.

However that said, since the end of the first Cold War the world no longer banks on consistency from one presidency to another. Whatever Biden reverses in the course of his term is just as likely to be reversed by an incoming Republican president in 2024. Witness the Paris accord: Obama in, Trump out, Biden in and then who knows ...

FIGURE 1: Weekly interest rates & Fed assets
SOURCE: US Federal Reserve



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