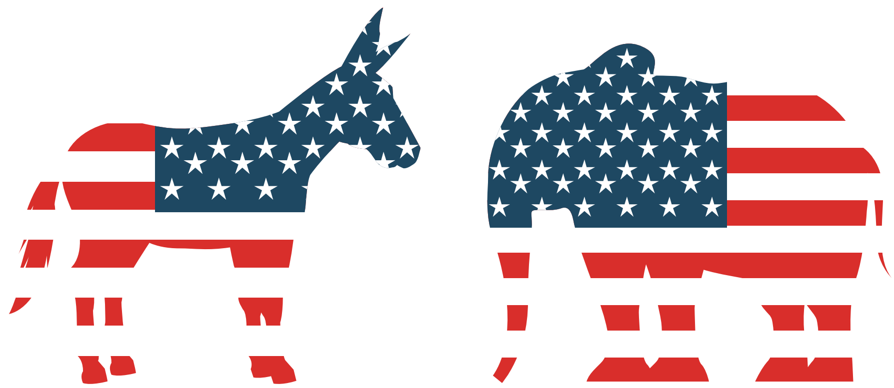
THE 2020 ELECTION

INVESTOR GUIDE



In this edition of *Strategy Insights*, we share our views and analysis on the potential market and investment implications of the 2020 election. We examine the two candidates' campaign platforms, consider the effects of a change in congressional control, take a look at historical election predictors to see how they stack up this time around, and consider the effects of not knowing the outcome on election night. As usual, there's no shortage of material to review and we hope this serves as a useful investor guide in the final stages of this election cycle.

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Our Forecast: Cloudy with a Chance of Curveballs

We are finally closing in on the US presidential election, but for months we've been inundated with myriad polls, ads, and predictions, made all the more complicated by the cloud of uncertainty stemming from the COVID-19 pandemic. Indeed the momentum of political rhetoric and discord is likely to only accelerate from here. As we expect the election to dominate the near-term news flow, we thought it would be helpful to revisit the historical effects of presidential election cycles on markets while also considering how investors' portfolios could be affected – for better or worse – in 2020 and beyond.

We first shared our thoughts and analysis on the election in our 2020 Strategy Outlook, published nine months ago. What follows is an update and expansion of those ideas to reflect the many changes – political, economic, or otherwise – that have occurred over the ensuing months. Several of our original predictions held true, such as the limited impact of impeachment proceedings on markets as well as the likelihood of Vice President Joseph Biden becoming the Democratic nominee. However, given our initial outlook was written pre-pandemic, the landscape has clearly changed dramatically, so we wanted to share our updated thoughts.

Undeniably, the biggest change since the beginning of the year has been the devastating impact that COVID-19 has had on the economy and the volatility it created in global markets. It's not a stretch to believe the pandemic will play an important role in the upcoming election as well, which could have important ramifications for the economy and markets over the long term. In addition, we believe the highly polarized nature of our political backdrop is likely to play a role in determining the outcome of the coming election.

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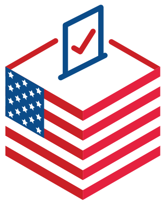


Do Presidential Election Cycles Move Markets?

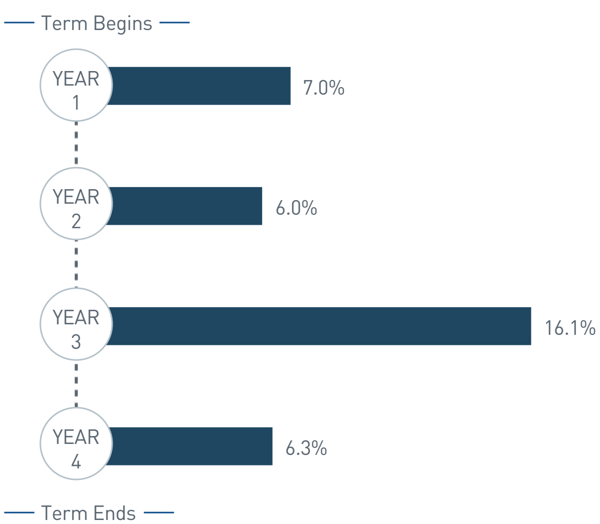
Over the long term, equity markets have tended to follow a pattern during presidential cycles (Chart 1). Since 1948, in the first and second years of an administration, the S&P 500®'s price returns have averaged more than 6%. During this period, one can imagine how the implementation of campaign policies is starting to find its way into economic growth and equity prices. Year three of the cycle has *by far* been the best year for returns, with an average of about 16%. Intuitively this makes sense, as proposals made by candidates in the forthcoming election entice investors with how their specific policies will produce greater economic growth and prosperity. Year four has seen the market return to mid-single-digit price appreciation, as investors are likely awaiting the next election's outcome.

In the short term, however, markets tend not to be fond of political surprises. In fact, the 2016 presidential election provides both a recent and relevant example. Based on polling data ahead of the election, the upset by President Donald Trump was one of the biggest surprises in US election history. A poll from RealClearPolitics.com just the day before the election predicted former Secretary of State Hillary Clinton would win both the popular vote and the Electoral College, albeit by a modest margin. Ultimately, as we know, this polling proved only partially correct. Clinton won the popular vote by about 2%, but President Trump won the Electoral College by a comfortable 304 votes to 227. In doing so, he became just the fifth president to win the Electoral College after losing the popular vote, joining the likes of John Quincy Adams (1824), Rutherford B. Hayes (1876), Benjamin Harrison (1888), and George W. Bush (2000).

Chart 1

Average S&P 500 Price Returns by Presidential Cycle Year

1948 - 2018



Source: Strategas Research Partners, PNC

Equity markets reacted quickly to this surprise by initially selling off as much as 4% in the after-hours markets on November 8, 2016, taking a decidedly bearish view of the potential policy implications of a Trump presidency and much more gridlock in Congress. Global equity and currency markets also fell precipitously. However, less than 24 hours later, the S&P 500 finished up a bit more than 1%, with some investors believing that many of the policies President Trump ran on might actually prove beneficial for investors. In addition, fears of more political gridlock faded with the Republican Party maintaining its majorities in the House and Senate.

The effectiveness or other aspects of President Trump's various policies and proposals can be debated, but it is hard to argue, at least as it relates to large-cap US equity returns, that his initiatives have been anything other than beneficial. Since Election Day 2016, the S&P 500 has delivered a total return of 76.4%, equating to 16.1% on an annualized basis. The S&P 500 was up 19.4% on a price-only basis in 2017 (year one of President Trump's term), down 6.2% in 2018 (year two), and up 28.9% in 2019 (year three). These returns were widely outside of the long-term averages for presidential cycles. However, remarkably, and despite all the turmoil over the last five months from the impact of the pandemic, the S&P 500 is trending in line with – even slightly ahead of – year four's historical average, with a price return of more than 8% as of August 31.

BOTTOM LINE

Over the long term, election cycles correlate with a pattern of market returns, while over the short term, surprises can create pockets of volatility. However, when it comes to who's in office, sustainable market drivers generally arise from the legislative measures enacted and their impact on the economy.

Is There a Good Predictor/Indicator of Election Outcomes?

If we use the health of the economy as our lens, every president since the 1920s who has avoided a recession in the two years prior to reelection has gone on to win (Table 1). Based on this, President Trump's reelection chances looked solid to start the year. However, with the onset of the COVID-driven recession in February, those chances may have been upended.

Table 1
Recession Election Indicator

Election Year	Incumbent President	Recession 2 Years Prior to Reelection?	Reelected?
2012	Obama	✗	☑
2004	Bush, W	✗	☑
1996	Clinton	✗	☑
1992	Bush, HW	☑	✗
1984	Reagan	✗	☑
1980	Carter	☑	✗
1976	Ford	☑	✗
1972	Nixon	✗	☑
1964	Johnson	✗	☑
1956	Eisenhower	✗	☑
1948	Truman	✗	☑
1944	Roosevelt	✗	☑
1940	Roosevelt	✗	☑
1936	Roosevelt	✗	☑
1932	Hoover	☑	✗
1924	Coolidge	☑	☑
1916	Wilson	✗	☑
1912	Taft	☑	✗

Source: Strategas Research Partners, PNC

Our analysis also suggests a high correlation between election outcomes and real disposable income per capita. According to the Bureau of Economic Analysis, over the last 15 years, year-over-year growth in real disposable income per capita has averaged about 1.7%. More recently (since mid-2017), the average rate increased to more than 2%. However, with the onset of the COVID-19-driven recession, this measure has become more volatile. In the first quarter this year, it fell to just 0.9% before jumping to nearly 12% in the second quarter, largely due to fiscal stimulus measures enacted in response to the pandemic.

Two other variables that appear highly correlated with election outcomes are nonfarm payrolls — not the unemployment rate but the actual jobs number — and the trajectory of real GDP. While these measures have deteriorated significantly since the beginning of the year, payroll levels have recovered off of their lows. Nonfarm payrolls declined by more than 20 million jobs in April but have since added more than 2 million jobs as of August 31. However, continuing unemployment claims still sit near 14.5 million. For context, at the start of the year, continuing unemployment claims were at just 1.8 million. As for quarterly GDP growth, most estimates predict that it likely reached a low in the second quarter (-32%, the worst quarter on record), but a strong rebound is expected in the third quarter (+21%).

It's unclear whether voters will focus on these more traditional indicators, or if voters will place more weight on hints of recent economic improvement from data that are reported with higher frequency. Often cited economic indicators, including industrial production, monthly retail sales, and even GDP, face time lags in reporting, so they won't give voters a clear picture of how the economy is recovering in real time. As a result, we believe the indicators in Table 2 on page 4 are worth watching. Unfortunately with a consumer-driven recession, it's not like flipping a switch from a credit bubble after the smoke clears. The economic recovery isn't likely to be a straight line up and to the right, which could make forecasting the outcome of the presidential election that much more difficult than in prior cycles based on these indicators alone.

Intuitively, approval ratings might seem like a reliable prediction metric; however, contrary to popular belief, approval ratings actually have a poor track record of forecasting presidential election outcomes. In our view, it is economic conditions that tend to "trump" other variables (pun intended). President Trump's current approval ratings are flat relative to his averages over the last few years (presently about 44%, according to RealClearPolitics.com), but are well below the rough threshold of 50% that would portend reelection.

Table 2
Economic Indicators We're Watching

Weekly Mortgage Applications	Applications have improved from the sharp declines during the spring, but growth remains negative and volatile from week to week.
Johnson Redbook Same-Store-Sales	This indicator measures brick-and-mortar retail only. August's growth rate was 0.6% year over year, turning positive for the first time since April. However, it was most likely a function of last-minute back-to-school shopping. One data point does not make a trend, so it will be interesting to see if growth continues through the fall.
Public Transportation Usage from Moovit	Moovit is a public transportation app that releases usage data for major metropolitan areas. Cities such as New York, Chicago, and Philadelphia have all experienced 50%-plus declines in demand for public transportation versus pre-COVID levels.
OpenTable Restaurant Bookings	Bookings are still down 64% year over year, highlighting how the hospitality and leisure industry has been one of the hardest hit due to COVID-19. While consumers may be patronizing restaurants, the proportion of to-go/curbside pickup has likely increased to the detriment of dining in, which has a meaningful impact on the operations and labor requirements for restaurants.
Airline Passenger Bookings	Bookings data leveled off in August but sit at the highest levels since the pandemic began. However, current bookings are still down approximately 30% from pre-COVID levels.
Conference Board's Consumer Confidence Survey	This survey hit a six-year low in August. Although this figure usually tracks the stock market, the plunge is still notable. Wall Street may be hitting new highs, but Main Street isn't out of the woods yet.

Source: PNC

Even in a scenario where President Trump's approval rating is lower than historical averages, as long as economic metrics remain supportive, we believe it likely gives him a solid chance at reelection.

Voter turnout is often a good gauge of election outcomes; unfortunately it has been volatile historically. Voter turnout played a key role in 2018 midterm elections, which resulted in Democrats gaining control of the House of Representatives. These elections saw a surge in Democratic turnout — in fact, the highest level for a midterm election since the early 1900s. At the same time, the Republican constituents who came out in droves to vote for President Trump in 2016 did not show up to the same degree. It remains to be seen whether the president's base can recover the turnout from the 2016 election. We believe voter turnout in 2020 will be a key determinant of election results.

One indicator with a good track record at picking presidents is the return of the S&P 500 for the three months prior to election. In fact, it has been near-perfect at determining the outcome of the presidential contest going all the way back to 1928 (Table 3, page 6). If the S&P 500 posted a positive price return in the three months before the election, the incumbent party remained in the White House, according to analysis by Strategas Research Partners. If it was negative, the incumbent lost the election. There are only three times since 1928 that this model has not worked: 1956, 1968, and 1980. For all the discussion about the surprising results of the 2016 election, this market predictor got the outcome correct. While we won't know the full three-month performance of the S&P 500 until the end of October, the positive return for the index through August (7.0%) is a favorable head start for the president's reelection hopes.

Clearly there are a multitude of factors that one can look toward to try to predict the outcome of the election. Unfortunately, it's a double-edged sword: With so many different polls, metrics, and data points, a definitive conclusion from any one measure seems far from certain. And that's before factoring in the overhang of the COVID-19 pandemic! Given the unique circumstances surrounding the 2020 election, these factors may suggest more uncertainty than clarity for the outcome.

BOTTOM LINE

COVID-19 and the associated economic downturn, along with the impact of continued social distancing measures, will muddy the waters when it comes to previously used market and economic election indicators. In short, there's no one measure that we view as perfectly reliable when it comes to predicting this year's outcome.

Table 3

S&P 500 Price Return for the Three Months Prior to Election

Election Year	Price Return (%)	Incumbent Party Won/Lost
1928	14.91	Won
1932	-2.56	Lost
1936	7.92	Won
1940	8.56	Won
1944	2.29	Won
1948	5.36	Won
1952	-3.26	Lost
1956	-2.58	Won
1960	-0.74	Lost
1964	2.63	Won
1968	6.45	Lost
1972	6.91	Won
1976	-0.09	Lost
1980	6.73	Lost
1984	4.80	Won
1988	1.91	Won
1992	-1.22	Lost
1996	8.17	Won
2000	-3.21	Lost
2004	2.16	Won
2008	-19.48	Lost
2012	2.45	Won
2016	-1.90	Lost

Source: Strategas Research Partners, PNC

What Are the Areas of Focus of a Trump Second Term Likely to Be?

Coming into this year, we believed the president would build his case for reelection on his accomplishments to date, with a focus around the strong economy. With third- and fourth-quarter 2019 GDP at 2.6% and 2.4%, respectively, and an unemployment rate of 3.5% (a 50-year low), we felt the economy was in a solid position to support the president's reelection platform. Obviously, COVID-19 has significantly altered President Trump's ability to run on his economic record. The spread of the virus in the United States and the corresponding economic shutdown caused US GDP to fall nearly 5% on a sequential basis in the first quarter of 2020 and nearly 32% (revised) in the second quarter, the worst quarterly decline on record.

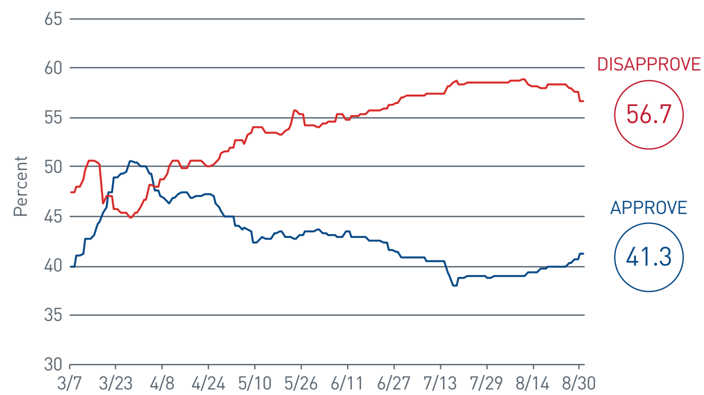
What remains to be seen is if voters will hold the president accountable for the dramatic fall-off in GDP due to the shutdown. One poll depicting the approval rating of his handling of the pandemic would suggest voters will hold him accountable, as the rate of those who disapprove is sitting near its highest level as of August 31 (Chart 2). However, his overall approval rating of 44.4%, according to RealClearPolitics.com, has improved in the last month, and is roughly in line with the average over the last three years. We believe it's likely the president will focus on pre-COVID economic performance and tout that his policies are best suited to return the economy to a growth footing. Third-quarter GDP will be released on October 29, just days before the November 3 election, and September employment numbers will be released on October 2, which could hinder or support the success of this message. Of course, the path of the virus, flattening of the case curve, and the pace of reopening the economy will also weigh heavily on this data and are likely to play key roles in the outcome of the election.

In addition to the economy, a key focus of the president's reelection message appears to be his plan to take a tougher stance on China. After signing the Phase 1 trade agreement in January, prospects for better long-term relations between the two countries seemed to be improving, offering a boost to his reelection prospects. However, in the ensuing months, the president has explicitly blamed China for the COVID-19 outbreak and has suggested the country is not complying with its trade agreement. As a result, tensions between the two countries have escalated, and the president has stated that if reelected he will take a tougher stance on China in his second term.

Chart 2

Approval of Trump's Handling of COVID-19

3/7/2020 – 8/31/2020



Source: RealClearPolitics.com, Strategas Research Partners, PNC

Taxes are another potential area of focus for a Trump second term. Although the president has continued to suggest he will introduce further tax cuts for the middle class, we remain skeptical that this legislation would pass through Congress. In fact, with improving prospects of a Democratic sweep of the White House, Senate, and House of Representatives, we believe the probability of tax *increases* now appear greater than tax cuts.

We continue to expect tougher regulation of internet and social media companies, along with companies in the Health Care sector. Recent congressional hearings with technology industry executives suggests that both Republicans and Democrats are eager to see greater regulation in this area. In addition, we have seen the president increase his rhetoric with regard to the federal government taking a more proactive role in negotiating prescription drug prices, which is likely to serve as an ongoing headwind for the Health Care sector.

Finally, should President Trump be reelected, he might have the opportunity to add more conservative justices to the Supreme Court. So far during his term, he already appointed two justices, Neil Gorsuch and Brett Kavanaugh. With those additions to the Court, the political balance shifted slightly to the right, with Chief Justice John Roberts playing more of the balanced role. Should more liberal justices leave the bench during a second President Trump term, having a majority of conservative justices may give the Court the ability to revisit prior rulings in areas such as healthcare and clean energy, which could have long-term implications for investors.

BOTTOM LINE

Despite the COVID-19-induced recession and market volatility, we expect the primary pillar of President Trump's reelection campaign will focus on the economy – both what he was able to accomplish pre-COVID as well as what he could do to reignite growth coming out of the pandemic. Issues to watch in a second term include technology and healthcare company regulation, as well as the potential for further change on the Supreme Court bench.

What Does Biden Want for America?

Consistent with his polling leads throughout 2019 and 2020, Vice President Joseph Biden prevailed against his many competitors to secure the Democratic nomination for president. We view Biden as sitting along the more moderate end of the political spectrum compared with some of his former competitors. As such, we see his nomination as a relative "safe choice" for Democrats. Biden did, however, make history with his selection of California Senator Kamala Harris as his running mate. Harris becomes the first woman of color in the history of the country to be nominated by one of the two major parties on its presidential ticket.

In analyzing several of Biden's policy proposals, including his "Build Back Better Program," we see tax increases as key to his platform. He plans to "reverse some of President Trump's tax cuts for corporations and impose common-sense tax reforms that finally make sure the wealthiest Americans pay their fair share" by raising individual rates back to pre-Tax Cuts and Jobs Act (TCJA) levels and corporate rates back to 28% from the current 21% (they were 35% pre-TCJA).

If these tax increases were enacted early in a Biden term, we estimate this would reduce 2021 earnings per share (EPS) for the S&P 500 by roughly 11-12%. In our view, about half of the EPS hit could be recovered if Biden were to eliminate the China-related tariffs imposed on US companies by President Trump's trade policies. The key question is would a Biden administration be willing to raise taxes so early in his term given the likely scenario of a slow- to no-growth economic environment as the country continues its recovery from COVID-19? Again, the shape of the virus curve, along with the success or failure of vaccines and therapeutic options would likely play a key role in policy implementation.

Regardless of the timing, we expect a Biden win would eventually lead to higher tax rates for corporations and some individuals. According to the Build Back Better Program, these tax increases would fund various investment proposals across multiple areas, including:

- solving the public health crisis from the pandemic;
- providing immediate further relief to working families, small businesses, and communities;
- returning supply chains to the United States;
- infrastructure projects for roads and bridges, energy grids, schools, and universal broadband;
- building a 21st century caregiving and education workforce to help ease the burden of care for working parents, especially women;
- advancing racial equity in America;
- raising the minimum wage to $15 per hour; and
- helping small businesses and entrepreneurs to come out the other side of this crisis strong.

A little known feature of Biden's tax plan includes a proposal to modify how traditional 401(k) retirement accounts are treated in the tax code. While details are still somewhat vague, this proposal would replace the current tax exemption on 401(k) contributions with a flat tax credit for each dollar saved. The amount of the tax credit has not been detailed by the Biden campaign. The goal of this proposal would be to equalize the tax benefit for contributions regardless of the income level of the employee, as the Biden campaign believes higher-income earners receive a greater tax benefit from their contributions due to the progressive nature of the tax code. This significant change aims to encourage more retirement savings for lower-income employees who do not take advantage of 401(k) savings at the same rate as higher-income employees. We believe this change has the potential to decrease the level of flows into equity markets due to a lower level of pre-tax retirement contributions. In addition, the change could also lead to more contributions into Roth IRAs versus traditional 401(k) plans.

Under a Biden administration, we continue to believe the area that is most likely to see the biggest spending increase is healthcare. Given Biden's experience with the Obama administration, we expect he will focus on expanding the Affordable Care Act, rather than push for the elimination of private insurance companies and the implementation of Medicare-for-all. The latter proposal was the favored policy position for some of the more progressive Democratic candidates in the primaries. Like President Trump, we expect that as president, Biden would also be in favor of the government limiting or negotiating prescription drug prices.

We also expect infrastructure spending would play a prominent role in a Biden administration; however, the size and scope of this spending would be highly dependent on the make-up of Congress. As a reminder, late last year we saw congressional Democrats propose a roughly $1 trillion infrastructure bill that went nowhere due to a divided Congress. With pent-up demand for infrastructure investments and bipartisan support for more spending, a Biden win could see both parties coalescing around infrastructure as a way to seek common ground, similar to what took place after President Barack Obama entered his first term. However, additional infrastructure spending only occurred late in President Obama's second term and was only designated toward highways.

Government oversight with regard to energy policy, carbon emissions, the labor market, technology companies, financial services, and general business regulation would likely increase under a Biden presidency, in our view. We believe Biden would look to reverse many of the regulatory reductions enacted by the Trump administration. Regulatory powers are perhaps one of the greatest levers a new president can pull to quickly enact an agenda. A divided Congress makes complex policy changes like healthcare or tax reform difficult, but broad executive regulatory powers can quickly affect various segments of the economy. An additional consideration under a divided government is the lower probability of further fiscal stimulus, should it be warranted later in the year. Under this outcome, we would expect monetary policy support from the Federal Reserve (Fed) to increase well beyond current levels.

BOTTOM LINE

While we believe it's likely we'll see proposals for increased taxes and regulation under a Biden White House, particularly if Democrats gain control of both houses of Congress, these efforts would be directed toward a number of initiatives, including infrastructure spending, further healthcare reform, supporting the middle class, and promoting greater racial equity.

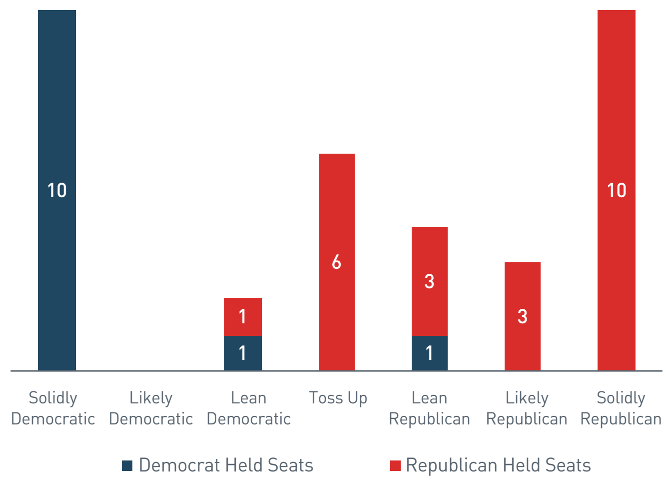
What is the Likelihood Democrats Control the House of Representatives and the Senate Postelection?

Currently, Democrats hold a majority of 232 seats in the House of Representatives versus Republicans' 198. One member is an Independent, and four seats are vacant. With all House seats on the ballot again in 2020, and in light of the solid pickup in Democratic seats in 2018, the likelihood of Republicans regaining control of the House appears quite difficult, in our view.

In the Senate, Republicans hold a 53-seat to 47-seat majority, with two Independent senators typically voting with the Democrats. Democrats would need a four-seat swing to take control of the Senate, or three seats if they were to retake the White House, with the vice president casting the tie-breaking vote for a majority. A total of 35 seats are being contested this cycle, with Republicans defending 23 of these seats. As we noted previously, control of the Senate will be key to determining if either President Trump or a President Biden would be able to move his legislative agenda through Congress. After the COVID-19 pandemic, the rising prospects that Democrats will re-take control of the Senate is the biggest change to our initial outlook on the election late last year.

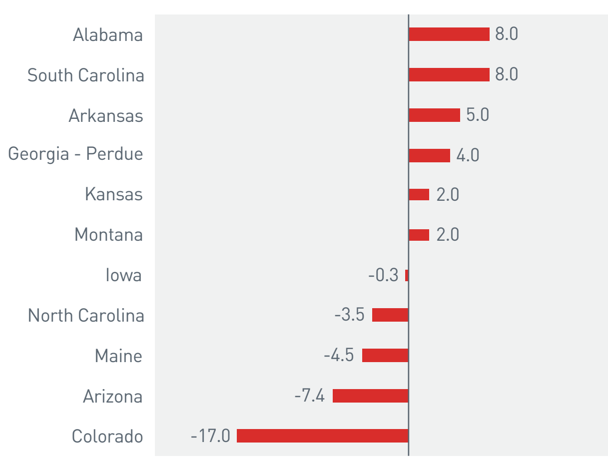
Since December, Republicans have seen their prospects of maintaining the Senate diminish, as the number of seats viewed as either “solidly” or “likely” Republican have declined from 19 to 13, according to the Cook Political Report (Chart 3). Democrats have seen their number for these combined categories hold steady at 10, with one seat continuing to “lean” Democrat. Republicans have seen 5 seats move into either the “toss up” or “lean” Republican category over the past nine months, with one moving to “lean Democrat.” Of the now 10 “toss up” or “lean” races, President Trump won seven of these states in 2016 – Alabama, Georgia (two seats up for election, with one moving to “lean Democrat”), Iowa, Kansas, Montana, North Carolina, and South Carolina – and lost two – Colorado and Maine. However, recent polling from these states, according to RealClearPolitics.com, shows the Republican candidate leading in only six of these contests (Chart 4). However, separate polling data from PredictIt shows the Democrats’ prospects of sweeping the White House and Congress actually peaked in late July (Chart 5). From an investment perspective, we believe a divided government is the most favorable outcome for the market, as this scenario has delivered the strongest equity returns since 1933 (Chart 6, page 11). As this chart shows, when the White House and Congress

Chart 3
2020 US Senate Race Outlook
As of 8/17/2020



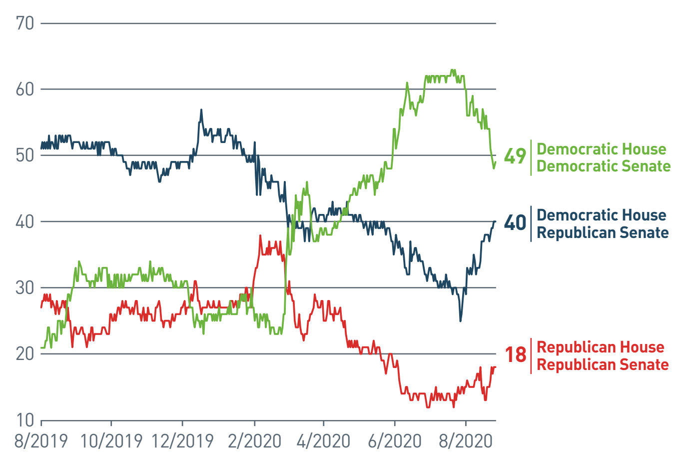
Source: Cook Political Report, Strategas Research Partners, PNC

Chart 4
Republican Candidates’ Lead in Key 2020 Senate Races (%)
As of 8/18/2020



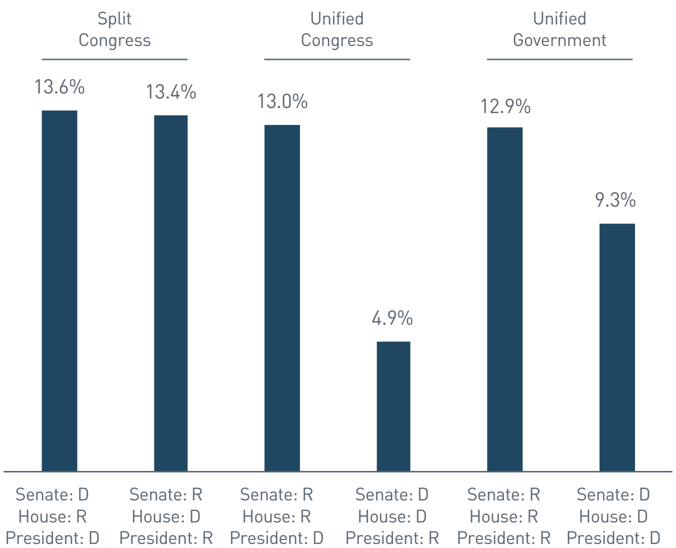
Source: RealClearPolitics.com, Strategas Research Partners, PNC

Chart 5
Post-2020 Congressional Balance of Power
As of 8/31/2020



Source: PredictIt, Strategas Research Partners, PNC

Chart 6
Partisan Control, Average Annual S&P 500 Performance
*1933 – 2019**



**Excludes 2001-2002*
Source: Strategas Research Partners, PNC

are controlled by different parties, returns for the market have averaged 13% or more. However, the averages become less favorable under scenarios where control is concentrated in one of the two parties. This is understandable, as a divided government provides a balance of power, making major policy changes by either party more difficult. In short, divided government limits the potential for negative political surprises, paving the way for stronger equity returns.

BOTTOM LINE

The prospects of Democrats regaining control of both houses of Congress is increasing. Should Democrats have control of the Senate – either outright or with the help of a supportive vice president in the event of a 50/50 tie – the long-standing filibuster procedure could be in jeopardy for the minority party. Its elimination only requires a simple majority vote, and while acknowledging the change itself could be filibustered, it has a high probability of being debated and voted on, in our view. From an investment perspective, this scenario may not be the most favorable outcome.

Are There any Bipartisan Issues That Could Influence Markets Regardless of the Election Outcome?

Political gridlock typically increases with a divided government, as we have now; however, Republicans' and Democrats' generally opposing principals did move toward a middle ground as a result of the negative economic impact of COVID-19, albeit temporarily. Despite heightened rhetoric between the two parties over the last several years, it was encouraging to see both parties unite to pass several major fiscal support packages, headlined by the $2.2 trillion Coronavirus Aid, Relief, and Economic Security Act signed into law in late March, right when the citizens of this country needed them the most. However, this unity has been short-lived, as we have seen renewed discord over the need for additional fiscal support.

As of July 31, 2020, all of the fiscal stimulus programs for individuals expired, and as of August 8, the Paycheck Protection Program ended. Although the programs were relatively successful in bridging the gap for individuals and businesses during the peak of the COVID-related economic disruption, the path of the virus continues to evolve and as such the economy has yet to return to steady footing. We believe the longer renewed fiscal stimulus remains an open question, the more likely underlying stresses in the economic backdrop (e.g., the health of brick-and-mortar retail and commercial real estate and the true unemployment rate, among others) will be exacerbated, which could filter into market performance of certain sectors, industries, and companies.

In addition to fiscal policy developments, we believe trade relations between the United States and China will continue to be a focal point for markets, regardless of who wins in 2020. We expect the major difference between the candidates' foreign policies is likely to be in the tactics and approaches used. Democratic candidates appear to favor a more cooperative approach by tackling this issue with the help of our traditional global allies as well as a return to more formal communication methods (i.e., less tweeting). In our view it's also possible a Democratic White House could seek to find additional areas of common ground with China (e.g., climate change) to help build a more collaborative working relationship and ease existing trade tensions. While there is bipartisan support for better relations with China, it's less clear what investors might define as "success" in this arena. In our view, if the countries are simply able to adhere to a more predictable path forward it would be a welcome development for markets, as they tend not to react favorably to being caught off guard by surprising news.

BOTTOM LINE

We believe two key legislative issues could influence markets regardless of the election outcome: fiscal policy, particularly as it relates to COVID-19-related stimulus, and US-China trade relations.

What Are the Sector and Industry Implications of the Election Outcome?

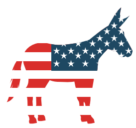
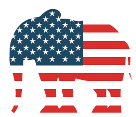
We expect the outcome of the election to have different sector and industry implications depending on who wins the White House as well as the composition of Congress. Table 4 on page 13 illustrates a comprehensive overview of our current views. This may be used as a road map for investors to examine and weigh their portfolio sector exposures. For some sectors and industries, we expect a win by one side or the other to have diverging implications, while in other cases we expect more of an election-agnostic outlook in terms of high-level impact, although the strategy or tactics employed by either party could vary widely.

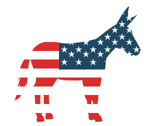
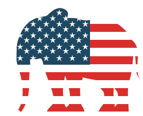
For example, Big Tech companies such as Alphabet Inc., Facebook, Inc., and Amazon.com, Inc. are likely to remain under heightened regulatory scrutiny regardless of the election outcome, as the desire for increased regulation of technology companies seems to be an area of mutual agreement. As these companies have been key drivers of the market's appreciation over the last decade, the impact of new regulation certainly bears watching, but we're also mindful that the rhetoric from Washington could turn out to be more "noise than news."

Healthcare is also likely to remain under scrutiny regardless of the election outcome. With rising healthcare costs always near the top of voter concerns, this is an area both sides will look to address. However, what is at stake next year is whether changes in the sector will be subtle, such as drug price reform and expansion of uninsured coverage, or if they will be more significant, such as the elimination of private health insurance and an adoption of Medicare-for-all. We continue to see the election outcome as an ongoing risk for the sector.

In contrast, we believe the outlook for the Energy sector is highly dependent on the election's outcome. Energy regulations and restrictions have been significantly reduced under the Trump administration and would likely remain a tailwind with another Trump win. Paradoxically, the Energy sector has been the worst performer within the S&P 500 since the November 2016 election, despite the administration's pro-energy policies. Therefore, while politics matter, supply-demand economics matter more. In contrast, under a Biden administration, we believe the probability of proposals to restrict energy exploration and operations, such as ending leases to drill on federal lands and, even more aggressively, banning fracking, could increase. This would be an additional headwind the Energy sector does not need.

Table 4
Sector and Select Industry Outlook Summary by Presidential Party
As of 8/31/2020

Sector		
Communications Services	Negative	Negative
Consumer Discretionary	Negative	Positive
Consumer Staples	Positive	Neutral
Energy	Negative	Neutral
Financials	Negative	Positive
Health Care	Negative	Negative
Industrials	Positive	Positive
Information Technology	Neutral	Neutral
Materials	Neutral	Neutral
Real Estate	Negative	Neutral
Utilities	Neutral	Neutral

Select Industries		
Aerospace/Defense	Negative	Positive
Alternative Energy	Positive	Negative
Cannabis	Positive	Negative
ESG	Positive	Negative
For-profit Education	Negative	Positive
Housing	Negative	Neutral
Infrastructure	Positive	Positive
Insurance	Negative	Neutral
Master Limited Partnerships	Negative	Neutral
Municipal Bonds	Positive	Neutral
Natural Resources	Negative	Positive
Student Loan Debt	Positive	Neutral

Positive · Negative · Neutral

Source: Cornerstone Macro, Strategas Research Partners, PNC

BOTTOM LINE

We believe there are potential "winners" and "losers" under each outcome. In some cases, we expect an overall positive or negative outcome regardless of the election; however, the specific policies related to that sector or industry could vary widely by political party, which translates into a range of outcomes for investors.

Are There Any Positive Implications of a "Left Tail" Scenario?

The biggest concern for the markets and investors at this point in the election cycle appears to be the rising possibility of a Democratic sweep of the White House and both houses of Congress. We have not experienced that scenario since the first two years of President Obama's first term in office. In our view, there are some clearly negative investment outcomes associated with this scenario, including higher taxes and increased regulations, among others, but we believe there are some positive aspects of this potential outcome that investors may be underappreciating.

The first bright spot is on the trade policy front. Throughout 2019, investors faced significant periods of uncertainty and market volatility surrounding surprise announcements on trade. Every time a change in trade policy was announced, the market sold off due to anticipated negative effects on earnings and growth, as well as the fear of retaliation from our global trading partners. In our view, a Democratic sweep could lead to a more unified global trading arrangement and ease some of the existing strain by rolling back current tariffs and/or improving cooperation with companies that have significant international operations in China. We would also expect improved partnership with our two largest trading partners, Canada and Mexico, as well as with European auto manufacturers. Democrats could take steps to ease trade tensions with China, but we believe this relationship will be a work-in-progress long after the current election cycle as there is no easy or quick fix. Given the laundry list of non-trade-related risks the markets and economy are still grappling with, a reprieve on the trade front would be welcomed.

Another bright spot is the potential for an infrastructure stimulus bill in early 2021. President Trump and congressional Republicans have also expressed support for infrastructure spending, but a comprehensive bill has yet to be put forth. Therefore, as noted by Dan Clifton at Strategas Research Partners, "the Congressional make-up matters the most for infrastructure and a Democratic sweep significantly raises the odds of a large-scale infrastructure package. We would expect this program to boost highway, transit, rail, water, green energy, and broadband [5G] spending." We generally agree with this view, but it's important to keep in mind that infrastructure bills are surprisingly more difficult to pass than one might expect, even when you have party alignment. The long-term investment horizon of most infrastructure projects means that while costs are incurred up front, the returns on those investments aren't apparent for some time (likely well beyond one or more election cycles). The need for large-scale infrastructure spending is certainly real, as the American Society of Civil Engineers has given US infrastructure a D+ report card, but projects such as updating the electrical grid and water utilities and remediating coastal erosion don't offer immediate stimulative effects during periods of significant economic stress compared to simpler projects like patching and repaving a road.

A win for environmental, social, and governance (ESG) investors specifically would be in the area of climate change – a top priority for congressional Democrats. Biden has announced he supports the Green New Deal, which includes initiatives such as ending oil and gas drilling on federal lands and a recommitment to the Paris Agreement on climate change. A Democratic sweep would more than likely help renew subsidies to lower the cost of renewable energy such as wind, solar, and biofuels, and could further discussions about the potential for a carbon tax.

There are several other potentially positive aspects of a Democratic sweep. In the near term, Democrats appear focused on lowering prescription drug costs and creating a public insurance option (i.e., Medicare-for-all). If successful, it could result in significant savings for consumers. Marijuana decriminalization is another area of focus that might gain some traction, as the potential tax revenue and benefits from using it as a substitute for opioids in certain medical therapies raises the probability of a policy change.

Longer term, there are much bigger issues for policymakers to address. The acute stress created by the COVID-19 pandemic has exposed certain weaknesses in how our healthcare system is structured, medicines and equipment are sourced, and patient care is delivered. As a result, we believe there are several key issues within healthcare that will draw increased attention in the years to come: inventory and capacity practices, onshoring of medical manufacturing, telemedicine, and electronic health records. Although the societal value of these issues is difficult to dispute, from an investor perspective, markets have not baked in potential changes that may be coming down the pike, particularly as it relates to any impact on profitability.

BOTTOM LINE

It's easy to focus on the negative aspects of a Democratic sweep from an investment perspective. However, we believe some bright spots of this scenario include the potential for better and/or more consistent trade policy, a comprehensive infrastructure bill, progress on certain ESG issues, and further healthcare reform.

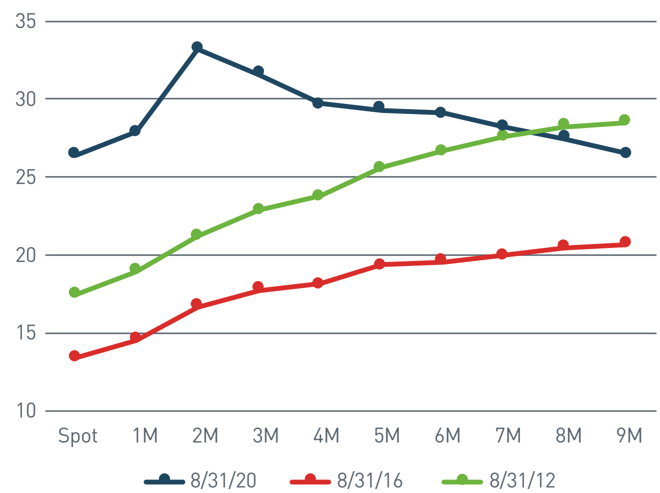
Will We Know the Outcome on Election Night?

The potential for a dramatic shift in party control is already weighing on investor expectations, but unique to this election is the likelihood of increased reliance on absentee and mail-in ballots versus in-person voting, as voters seek to protect their health amid the ongoing COVID-19 crisis. There has always been the ability to use a mail-in ballot; however, the system isn't designed to handle the anticipated high volume of ballots, particularly on a condensed timeline. For example, there are 16 states where a voter can postmark their ballot on Election Day, including states with significant Electoral College votes such as California and New York. Given the unique situation the country faces this year in just getting voters to the polls – in person or by mail – we believe it is highly unlikely we will definitively know the election results on Election Day.

When viewed through the market's lens, we believe investors may be already anticipating this scenario, as expectations for future market volatility have increased, despite a significant decline in current volatility since the height of COVID-related market stress earlier this year. The MOVE Index, a proxy for fixed income market volatility, reached an all-time low in July, and as of mid-August, the CBOE Volatility Index (VIX) – often referred to as the equity market "fear gauge" – was back to levels last seen in late February. However, the VIX futures market, particularly the shape of the VIX futures curve, offers a differing view.

A typical VIX futures curve is upward sloping; the further a point in the future is from "time zero," the more it should correspond with a higher degree of uncertainty, and thus a higher price level for those futures. However, the VIX futures curve as of August 31 is actually "hump" shaped, as prices in the middle of the curve (the October-November timeframe) are higher than both early and later-dated futures. The most likely explanation for this unusual pattern, in our view, is that volatility traders are hedging for potentially higher market volatility around the election. This phenomenon is not entirely unique to 2020, as both the 2016 and 2012 pre-election VIX futures curves saw a material spike higher in that same October futures price. However, this year's curve peaks sharply higher (Chart 7).

Chart 7
VIX Futures Price Curves
As of 8/31/2020



Source: Bloomberg L.P., PNC

While any major election can introduce uncertainty, there are unique issues this year that could be causing heightened market uncertainty, including the rising probability of a Democratic sweep of the White House and Congress and the unprecedented need to rely on absentee and mail-in ballots due to the pandemic, which could delay the tabulation of final results. Therefore it seems logical to not only see the VIX futures that correspond with the election reach the highest point on the curve, but also to see longer-dated futures are well above prior election year levels as well.

Should the election outcome take days or even weeks to resolve, it would not be surprising to see market volatility move higher on that basis alone. The 2000 presidential election is the most recent example when the outcome was not called that night, and the VIX jumped a significant 16% in the following week. Since it was also the first presidential election without an outcome the night of the election in more than one hundred years, the S&P 500 declined 1.6% the following day, and continued to fall 5% through December 13, 2000, the day of Vice President Al Gore's concession speech. Obviously markets are too complex to blame a single macro event, particularly as there was still ongoing fallout of the dot-com crash; however, we highlight the risk as it is another variable investors have to consider as markets continue to reach new all-time highs at fairly rich valuations.

BOTTOM LINE

Given the unique issues facing this year's election, it is unlikely we'll know the definitive outcome on election night. The market appears to agree based on the VIX futures curve pricing.

COVID-19: The Two Paths Forward

As markets sit at all-time highs, investors are naturally becoming concerned that we are long overdue for another significant sell-off, with some wondering if the election is going to be the catalyst. While the possibility of a market correction is forefront in our ongoing analysis, the wild card, in our view, is instead the path of COVID-19, which will be governed by new case curves in various geographies, any vaccine-related breakthroughs, and the success or failure of restarting the global economy. We believe the overall

Table 5
Select Strategy Views by Near-Term COVID-19 Path
As of 8/31/2020

	COVID-19 Curve Flattened	COVID-19 Lingers
GDP Growth	GDP growth returns sooner than consensus anticipates, with a strong economic resurgence in the second half of 2020.	The outcome underappreciated by markets; GDP growth doesn't fully recover for years.
Equities	Earnings recover to pre-COVID levels in 2021, helping justify current lofty valuations.	Earnings don't recover for years. The market may face a possible correction, as it is currently priced to reflect a faster return to normal.
Sector Trends	"Go Outside" trade rallies (value, Energy, Financials, Industrials, and smaller caps), at least initially. Need to see above-trend GDP growth to continue.	"Stay at Home" trade retains its leadership (large-cap growth, Technology, Communication Services, Consumer Staples, Health Care).
The Fed/Interest Rates	The Fed is in a difficult position of tapering programs and quantitative easing while avoiding a "taper tantrum" like in 2013.	Rates stay low for much longer, as the Fed maintains quantitative easing and other monetary stimulus programs.
Fixed Income	Corporate bond valuations are extremely stretched; performance could be challenged if rates rise.	Asset classes with positive nominal yields become very attractive: corporate credit, leveraged loans, and EM debt.
Emerging Markets (EM)	EM performs well, as a recovery in the United States acts as a tailwind for global growth.	EM equities perform well, as those countries have done a better job overall managing through COVID-19.

Source: PNC

direction of the market is likely to remain rather binary as the pandemic also has two basic outcomes: either we flatten the COVID-19 curve or we don't. Table 5 on page 16 outlines our high-level thoughts about what could happen under each scenario.

Although the potential for the political pendulum to swing in the opposite direction this year is indeed rising, we don't think the election outcome itself is likely to create a meaningful market correction of the size and scope we experienced back in March. With a $7 trillion backstop from the Fed, as the effective "buyer of last resort" remains very active in all facets of the capital markets, as well as several trillion dollars of fiscal relief in the system, we do not foresee a return to March lows.

However, even a 10% pullback – a "garden variety" type of correction – would be healthy and rational market behavior, especially given how far and how fast this market rally has gone. If we were to experience a second-wave effect from COVID-19 that is as bad as or worse than the first wave, that, in our view, could be what drives markets in the near term – not who is ultimately seated in the White House.

BOTTOM LINE

We believe the path of the pandemic and the associated effects on the economy will have a greater impact on markets than who is ultimately elected as president.

Last Word: For Markets, COVID-19 "Trumps" Election

The 2020 presidential election is in the home stretch, and yet investors know all too well there is no foolproof way to forecast what happens in November. Polling data, combined with the economic impact from COVID-19, suggest the probability of a Democrat victory for the White House is likely, while the stock market "poll" is pointing to a President Trump reelection at this point. The least favorable outcome from a market perspective, in our view, would be a Democratic sweep of the White House and Congress, but investors will have to stay tuned until November 3 – and probably even later – to know the final results. We expect the market's path to be volatile in the coming months, but believe it will likely be less influenced by who ends up residing in the White House over the next four years and more so by the path of COVID-19.