Political stalemate – a profitable outcome?

In one of the most bizarre elections in living memory, with record turnout despite a pandemic, the USA appears to have chosen a divided government. Despite rejecting Donald Trump's erratic leadership, Americans have failed to fully endorse a Democratic mandate, with Republicans gaining seats in the House of Representatives and the Senate still undecided.

The "Blue Wave" predicted by the polls has failed to materialise. As a result, many of Joe Biden's signature campaign pledges will have to be scaled back, specifically those which require legislation and will materially impact the budget. Instead, Biden will have to rely on executive orders and regulatory bodies to implement a slimmed down agenda. Therefore, at least two more years of stalemate in the senate can be expected. And yet, it appeared that the markets were cheering on the result, with the S&P 500 advancing over 2% on the day after the election.

Both of Georgia's two Senate seats are headed for run-off races as no candidate managed to win sufficient votes. With the Democrats currently sitting on 48 seats and the Republicans on 50, the results could hand either party control (as the Vice-president has a tie-breaking vote). However, the Democrats have a tough hill to climb with both Republican candidates leading the votes cast on November 3rd. Should the Democrats fail to win both seats, Biden will be the first president in over 30 years to take office with the opposing party controlling the chamber. However, even if it ends in a tie, it needs to be borne in mind that the "progressive" initiatives on climate change and healthcare are in fact controversial within Democratic party ranks itself. For example, Senator Joe Manchin is against both these initiatives: he is from West Virginia, a state with a large coal mining and working-class population, and the senator's own daughter was the CEO of a large pharmaceutical company until a month ago.

In addition, Biden will likely have made many of his cabinet decisions before the run-offs take place. With cabinet nominations needing to be confirmed by the Senate, the likelihood of a Republican controlled Senate rejecting more left-wing nominations will clearly be a consideration. A more moderate cabinet surrounding the president seems increasingly likely.

The Republicans have held a majority in the Senate from 2015, led by Mitch McConnell. Prior to that, in the years as minority leader under President Obama, McConnell developed a reputation as an obstructionist. One example included blocking the government's distribution of the Troubled Asset Relief Program (TARP) funds, just three months after voting to authorise them under President Bush. His relationship with Obama was notoriously bad, surpassed only perhaps by the rancour existing between Nancy Pelosi and President Trump. And, as we head into a Biden presidency, he has shown little sign of a change in attitude, describing a Republican-controlled Senate as "the firewall against Nancy Pelosi's agenda".

However, one of Biden's key selling points as a Democratic candidate was his ability to work across the partisan divide. Indeed, when President Obama needed someone to work with McConnell to agree deals, he sent the vice-president, and Biden did have several successes. We do also believe that there are a few points on which the two of them may in fact agree.

McConnell has stated that his top priority is passing a new economic stimulus bill, something that the Democrats have also made a priority. He has even said that state and local aid could be included, one of the key Democrat demands. In addition, one could see a potential route through for some sort of increased infrastructure spending bill. However, more radical policies pushed by Sanders and Warren, such as tougher regulation of Big Tech, Banks, Healthcare and Energy companies, look to have a difficult road ahead. The prospect of an agreement on a stimulus bill without the more worrisome parts of the Democratic agenda certainly looks positive.

Perhaps the best outcome investors and the wider public could hope for, is for Biden to take his lead from the Clinton administration. After raising taxes and attempting to nationalise the healthcare system in the first two years, the US public elected both a Republican Senate and House of Representatives. Although this may have seemed like a recipe for stalemate, Clinton worked with the Republicans on many issues to balance the budget, cut taxes, limit the regulatory burden on companies and reform welfare. The period was characterised by strong economic growth and a budget surplus, i.e. not such a bad outcome. Perhaps, as one, commentator on an FT article said, the inherent checks and balances Americans have chosen to enact with this administration, may provide Biden with the excuse to ignore the more left-wing parts of his party and allow for more compromise.

As with all political events, this election presented both risks and opportunities. We approached this as we approach all such episodes, without predicting what the result would be. We analysed where we believed the markets were over-reacting to the risk of either outcome. An example of this is HCA Healthcare, which we wrote about in September this year (and a counter which has performed particularly strongly since the election). As we move forward, we believe that the US will likely continue to be an attractive market to invest in. Although the President may change, many of the long-term drivers of the companies we invest in will not.

Important notice