

U.S. Municipal Bond Market

Election 2020: Results Will Impact the Economy, Markets, and Municipal Bonds

Summary

- The outcome of the 2020 presidential election matters in many different ways. Policy outcomes could be very different considering various election results.
- A key reason this year's presidential election matters is if former Vice President Joe Biden takes the White House and creates enough momentum for the Democrats across the country, it is possible the Democrats could not only hold the House of Representatives but also claim control of the Senate.
- A Democrat "Blue Wave" result is likely to have a more impactful result on near-term policy than other outcomes. Favorable fiscal policy relief, infrastructure spending, and fiscal stimulus would in turn support spending, drive growth, and be supportive to municipal bond market credit quality. Higher taxes would also increase the value of the municipal bond tax-exemption.
- Potential impact from tonight's debate: Even though the data tells us voters' minds are made up, it seems the landscape could be ripe for a shift. Perhaps in tonight's debate we will witness another important historical debate performance like that in 1960 or in 1984. If so, then we could see a real possibility of a scenario where President Trump remains in the White House, the Republicans keep the Senate, and the Democrats keep control of the House.
- Economic policy uncertainty has reached new levels this year. As of this week, the prospect for even more volatility and uncertainty has risen, mostly because President Trump last week failed to commit to a peaceful transfer of power if he loses the November 2020 election.
- There are potential scenarios where President Trump could lose the election and still try to remain in the White House, which we will review some. If scenarios such as these play out volatility and policy uncertainty could rise and even last longer than we saw it last in the wake of the 2000 presidential election.

The Outcome of the 2020 Elections Matter

Traditionally it has been argued that the individual sitting behind the Resolute Desk in the West Wing of the White House has not had as strong of an impact on domestic policy than on foreign policy. Some have even argued that the [president's sphere of influence on foreign policy has increased in recent years](#). Others are using this analysis to support the idea that the outcome of the 2020 presidential election will not matter for investors, the markets, public finance, nor municipal bonds.

Let's be crystal clear: the outcome of the 2020 presidential election matters in many different ways. The individual in the White House come January 2021 will have an outsized impact on domestic policy going forward, especially considering the current environment. The impact would be even higher if one of the political parties is able to take the White House and both chambers of Congress. It appears there is the potential for this to occur.

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Potential Economic, Market, and Policy Impact from 2020 Elections

Policy Topic	Status Quo Renewed (Trump, Rep, Dem)	Dems in White House (Biden, Rep, Dem)	Blue "Democrat" Wave (Biden, Dem, Dem)
Another phase COVID-19 relief	Only slightly possible, but unlikely to be substantial, still strong potential for impasse	Only slightly possible, not as clear, unlikely to be substantial, still strong potential for impasse	Very likely to materialize, better chance close to \$3 trillion HEROES Act-like number
Infrastructure	Slightly possible, likelihood uncertain	Slightly possible, likelihood uncertain	Very likely to be substantial (details very early in 2021)
Potential for fiscal stimulus (different than relief)	Slightly possible, but likelihood uncertain	Slightly possible, but likelihood uncertain	Very likely, type & amount to be determined
Economic recovery (near term pace)	Slower	Slower	Relatively faster, not without impact to deficit
Economic growth (near term, assuming the above policies)	Weakening consumer sentiment, less disposable income, weaker consumption, lower GDP growth	Weakening consumer sentiment, less disposable income, weaker consumption, lower GDP growth	Stronger consumer sentiment, artificially supported disposable income, stronger consumption, faster GDP growth
Impact on U.S. Deficit	Unchanged to slightly negative	Unchanged to slightly negative	Negative to very negative
U.S. policy uncertainty	Continues to be well above average	Well above average to just above average	Average to just above average
Transfer of power questions, potential market turmoil	Unlikely	Likely	Less likely
Climate change, energy/environmental policy	Unlikely to change	Unlikely to change	Pressure to build into 2H21 proposal, could drag on economic performance
U.S. Trade	Trade tensions likely to continue	Tensions likely to decline	Tensions likely to decline
Regulation (bank, energy & environment)	Deregulation continues	Slight increase	Heavy increase, could also create a drag on economic performance
National health care	Potential threat to ACA, replaced with undetermined alternative	Slight to moderate changes	Increased national support
Tax policy (reform)	Unchanged	Unchanged	Moderate to significant tax increases
Municipal credit conditions	Weaker to slightly weaker	Weaker to slightly weaker	Expect relief, still slightly weaker
Municipal bond issuance	Refundings up, new money down slightly to moderately	Refundings up, new money down slightly to moderately	Refundings up, new money up potentially substantially if there is infrastructure and other relief/ stimulus

Source: HilltopSecurities.

A key reason this year's presidential election matters is if former Vice President Joe Biden takes the White House and creates enough momentum for the Democrats across the country, it is possible the Democrats could not only hold the House of Representatives but also claim control of the Senate. This type of Democrat "Blue Wave," as you can see in the accompanying table of analysis, would have a larger-than-average impact on almost every variable included.

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We, like many, remain skeptical about political polling data, especially because most polls showed that former Secretary of State Hillary Clinton was likely to defeat Donald Trump in 2016. This year, it appears the Democratic Party challenger to incumbent President Donald Trump is [leading in the national poll \(51% vs 43%, via CNN\)](#) and Biden is also leading in some key battleground states as well, [according to this Fox News account](#). This is considerable evidence, but still questionable considering 2016.

A Democratic win in both branches is likely to have a more impactful result on near-term policy. Favorable fiscal policy relief, infrastructure spending, and fiscal stimulus would in turn support spending, drive growth, and be supportive to municipal bond market credit quality.

The Biden lead is not just appearing in polling data, however. [The Economist prepared a statistical model](#) that currently shows there is an 86% probability that former Vice President Joe Biden is likely to win the 2020 presidential election. A similar model also forecasts there is a 67% chance that the Democrats will flip control of the Senate in their party's favor. This makes a strong argument for the Blue "Democrat" Wave scenario in our above analysis. This result is likely to have a more impactful result on near-term policy. Favorable fiscal policy relief, infrastructure spending, and fiscal stimulus would in turn support spending, drive growth, and be supportive to municipal bond market credit quality. Demand for municipal bonds is likely to grow as well because tax rates are likely to rise to help offset spending increases.

Presidential Debates Can Factor Into Decision-Making

The stakes are always high during a presidential debate. Sometimes the results are unexpected. The first televised debate between U.S. presidential candidates was a memorable event in both election and television history. It occurred before the 1960 contest when Senator John F. Kennedy took on Vice President Richard Nixon. Before the first debate, Nixon was recovering from an illness and had lost weight. Afterwards, Kennedy was perceived as more calm and confident during this first debate performance. The story has always been that those who watched the initial debate thought Kennedy performed best, while those who listened on radio thought the winner was Nixon. Many believe that [it was Kennedy's performance in that first debate that allowed him to win the 1960 election](#), despite the fact that Nixon recovered in later debates.

The first televised debate between U.S. presidential candidates (1960) was a memorable event in both election and television history, as Senator John F. Kennedy took on Vice President Richard Nixon.

Twenty-four years later, the Republican incumbent, President Ronald Reagan found himself under attack because of his age compared to challenger, former Vice President Walter Mondale. Reagan was the oldest to serve as president to that point. Concern was mounting about President Reagan's debate ability, which was a serious concern considering Reagan, a former actor, was known for his ability to connect with the public.

[In the second debate of the 1984 run to the Presidential election, moderator Henry Trehwitt of the Baltimore Sun asked President Reagan](#), "You already are the oldest president in history. And some of your staff say you were tired after your most recent [debating] encounter with Mr. Mondale. I recall yet that President [John F.] Kennedy had to go for days on end with very little sleep during the Cuban missile crisis. Is there any doubt in your mind that you would be able to function in such circumstances?"

President Reagan famously responded, "Not at all, Mr. Trehwitt, and I want you to know that also I will not make age an issue of this campaign. I am not going to exploit, for political purposes, my opponent's youth, and inexperience. If I still have time, I might add, Mr. Trehwitt, I might add that it was Seneca, or it was Cicero, I don't know which, that said, 'If it was not for the elders correcting the mistakes of the young, there would be no state.'"

It was a magnificently memorable moment in presidential debate history. Reagan's Oct. 21, 1984 debate performance reaffirmed why he was referred to as, [The Great Communicator](#). The performance catapulted his polling numbers and he swept the 1984 election.

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First 2020 Presidential Debate in Cleveland, Ohio

Tonight is the first televised debate between President Donald Trump and Democratic Party challenger Joe Biden. The political landscape is tense. Recent polling shows that Biden is [leading not only nationally \(51% vs 43%, via CNN\)](#) but also in many important battleground states, [according to this Fox News account](#).

Only 29% of voters said that the 2020 debates are "extremely important" or "quite important." This was down from 34% before the 2016 debates and 38% before the 2012 debates.

Even though most polling favors a Biden win in November, there are still over 30 days left before the election. That is plenty of time for unforeseen circumstances to unravel Biden's lead. The televised debates are the perfect opportunity for President Trump to shore up undecided voter support, or for Biden to potentially lose ground. That being said, [a NBCNews/WSJ poll](#) recorded the lowest ever number in reaction to the question of how important the presidential debates are currently to voters. Only 29% of voters said that the 2020 debates are "extremely important" or "quite important." This was down from 34% before the 2016 debates and 38% before the 2012 debates. So, going into the 2020 debates it seems as though voters might have already made up their minds. We will see if there is anything that occurs that could potentially change voters' minds.

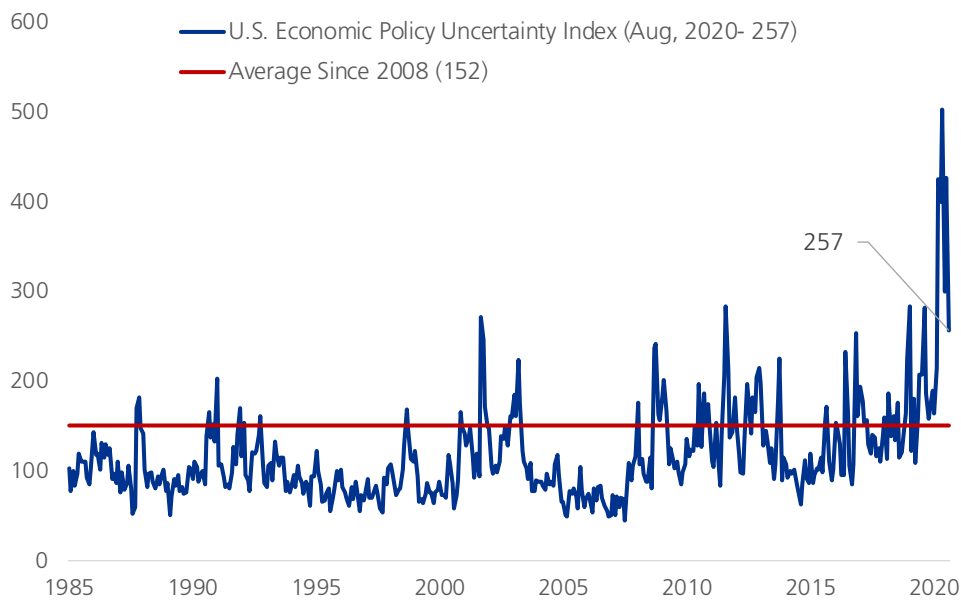
Even though the data is telling us that minds are made up, it seems the landscape could be ripe for a shift because of that fact. Perhaps in tonight's debate we will witness another important historical debate performance like those witnessed in 1960 or even in 1984. If so, then we could see a real possibility of a scenario where President Trump remains in the White House, the Republicans keep the Senate, and the Democrats keep control of the House.

U.S. Economic Policy Uncertainty

There has been a rise in U.S. economic policy uncertainty over the last 10 years. This indicator rose after the 2008 financial crisis. The uncertainty continued as many business leaders complained they were unable to plan because of a lack of clear guidance from Congress, and the White House as the economy was recovering from the worst of the mortgage squeeze and credit crisis. Policy uncertainty rose to a new height during the summer of 2011's debt ceiling showdown. It then rose to an amazing height, according to the 'Measuring Economic Policy Uncertainty' index calculated by Scott Baker, Nicholas Bloom, and Steven J. Davis in March 2020 because of the COVID-19 shutdowns.

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Rise in U.S. Economic Policy Uncertainty



Source: 'Measuring Economic Policy Uncertainty' by Scott Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com and HilltopSecurities.

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Going back to data collected beginning in 1985, we do not see that there is a causal relationship between significant peaks in this U.S. Economic Policy Uncertainty and Presidential elections. However, this year could be different.

We have been writing over the last two weeks that public finance issuers have been racing to complete their financings before the November election. We suspected this was because state and local governments and other municipal entities did not want to be caught post-November 3 in a circumstance that combined the wait-and-see dynamic of the 2000 election with the market volatility we saw after the 2016 election when the 10 year municipal benchmark rose by about 90 basis points in about a month.

As of this week, the prospect for even more volatility and uncertainty has risen, mostly because last week President Trump failed to commit to a peaceful transfer of power if he loses the election. ["Well, we're going to have to see what happens," President Trump said when asked if he would commit.](#)

Transfer of Power

Why has the question about the transfer of power from one U.S. President to another been made into such a big deal? That is because it is a tremendous deal, especially because the precedent goes back to 1801, and it is not codified legally. It has been more a tradition each former President has respected. Former President John Adams made many contributions to United States colonies and government in their formative years. One of those was that [he helped to establish the peaceful transfer of power to an opponent.](#) This transfer of power has been established more in ceremony and tradition but not officially assembled. The method as a result can be described as very fluid and potentially moveable.

Before sunrise on March 4, 1801, John Adams, the U.S.'s second president, left Washington, D.C. before his political opponent, Thomas Jefferson, was sworn in as the third president of the United States. This set an important precedent that would continue for over two centuries. This peaceful transfer of power is described well by Theodore White in his 1961 account of the 1960 presidential election, [The Making of the President 1960.](#)

The Making of the President

First, White identifies what President John Adams, and every U.S. President likely realized about the status of the office they held, meaning there is an immense amount of influence held in the West Wing of the White House. White wrote:

"The most awesome transfer of power in the world—the power to marshal and mobilize, the power to send soldiers to kill or be killed, the power to tax and destroy, the power to create and the responsibility to do so, the power to guide and the responsibility to heal—all committed into the hands of one person."¹

White also wrote in awe of how the U.S. presidency has been handed down to each successor since 1801.

"Heroes and philosophers, brave individuals and vile, have since Rome and Athens tried to make this particular manner of transfer of power work effectively; no people has succeeded at it better, or over a longer period of time, than the Americans. Yet, as the transfer of power takes place, there is nothing to be seen except an occasional line outside a church or school, or a file of people fidgeting in the rain, waiting to enter the booths."²

The transfer of power tradition may be under threat this year.

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How Will the U.S. Decide Who is President in 2020?

Uncertainty is anticipated as it relates to the potential 2020 election. Just how much uncertainty we are likely to witness is still, uncertain. At the beginning of September, Fareed Zakaria published an opinion piece that detailed an analysis that expects [President Trump may be ahead on election night but then days later Biden could be declared the winner](#). Zakaria even said that [the media should prepare voters for the idea that we may not have an election night, but an election month](#).

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[Zakaria reviewed a scenario that would allow President Trump to potentially remain in office if the duty of electing the President falls to state legislatures, instead of electors](#). This would undoubtedly be met with legal ramifications, but the results could mean Trump is able to stay in office even if he does not win the election. In addition, over the weekend Speaker Nancy Pelosi [sent a letter to Democrats trying to drum up support for state support](#), indicating to us that those in Washington, D.C. see this as a potential possibility. If scenarios such as these play out, volatility and policy uncertainty could rise and even last longer than we saw it last in the wake of the 2000 presidential election.

¹ White, Theodore H; *The Making of the President 1960*; Black Dog & Leventhal; 2004 reprint of 1961 book; page 4.

² *Ibid*.

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