A Consequential Election
Impact of 2016 US election on investing
Introduction

The 2016 US election campaign has been unique in many ways, but the underlying dynamics are not. These are partly driven by widening income inequality across the world, in our view, a trend that has accelerated after the financial crisis and subsequent policy responses. Related is a growing perception that the benefits of trade and globalisation have only accrued to a few. Whoever moves into the White House will have to address these issues, and we could see fiscal expansion directed at improving infrastructure and measures aimed at redistributing prosperity. We expect similar themes and outcomes to play out in key European elections next year.

Our bottom line: this is an unusually consequential election that challenges the post-crisis status quo.

Summary

- Washington decision making is likely to become more fractious regardless of the Nov. 8 election result. Divisions between and within the Republican and Democratic Parties have been growing, and an outcome whereby neither party would have a significant majority in the House of Representatives is a possibility. This could make it harder to reach consensus on legislation, potentially heralding a return to dramatic showdowns over budget issues.

- Yet corporate tax reform and increased spending on infrastructure appear to have some bipartisan support – and would be a ripe area for negotiation in a divided Congress. Infrastructure spending should boost growth more than usual amid rock-bottom rates, in our view. We offer some of our own policy thoughts, including steps to address a looming retirement crisis and to entice private capital to finance infrastructure.

- A growing backlash against free trade and immigration threatens to make economies more insular – at a time when economic growth and productivity in many countries are barely above stall speed. Emerging markets have the most to lose, especially under a victory by Republican nominee Donald Trump. Mexico is a clear potential loser given its heavy reliance on exports to the US.

- The US election campaign suggests rising populist sentiment is likely here to stay. We also see potential changes to income taxes, with ripple effects on US municipal bonds. We focus on two sectors that could be most affected by the election: financials and health care. Mergers and acquisitions are set to face increased scrutiny if Democratic nominee Hillary Clinton prevails, as her party appears to view anti-trust enforcement as a tool to boost competition and address inequality.

Contents

3–5 Backdrop
6–8 Policy
9 Policy thoughts
10–11 Sector impacts

Authors (left to right)

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Erin Xie – Portfolio Manager, BlackRock’s Global Opportunities team
Policymakers’ response to the 2008 financial crisis has been credited for averting a repeat of the Great Depression, and years of extraordinary monetary easing have boosted asset prices. Yet economic growth remains sub-par, wage growth has been anaemic, and income inequality is on the rise. Many citizens see globalisation as one of the culprits and rue a perceived or real loss of sovereignty. The UK’s Brexit vote reflected these forces. We see the similar themes playing out in 2017 Dutch, French and German elections.

A large majority of US individual investors sees this vote as even more consequential than the 2008 election, which came at the height of the global financial crisis, an October BlackRock Investor Pulse survey shows. Nearly 70% of respondents said the current political environment made them less comfortable about investing.

The populist wave is unlikely to subside after the election. Sluggish economies, stagnant productivity growth, ageing populations and disruptive technological change pose challenges to policymakers around the world. Consider:

- Pre-tax incomes for 81% of the US population have been flat or falling over the past decade, a trend reflected in most of the developed world. See the chart on the bottom right. This trend could be turning. Real median US household incomes grew 5.3% in 2015, the fastest growth on record, according to the US Census Bureau.

- Almost half of Americans cannot cover a $400 bill for unanticipated costs such as a car repair or health emergency, a May 2015 Federal Reserve (Fed) report notes. The US labour force participation rate is near multi-decade lows. Working-age males especially appear to be having a tough time. One in nine are out of work, versus one in 50 in 1954, Bureau of Labor Statistics data show.

- UK inflation-adjusted earnings are still 5% below a 2009 peak – the longest period of flat or falling real wages since at least the 1850s, according to 2015 Bank of England data.

The candidates

This is also a most unusual election. Both candidates are unpopular, and Republican nominee Donald Trump is running with a populist agenda that departs from decades of Republican tradition.

He has promised to implement tax cuts, deport millions of illegal immigrants and withdraw from or renegotiate the North American Free Trade Agreement (NAFTA) and other trade deals. Tapping into a backlash against the Washington status quo, he has often appeared at war with his own party.

Hillary Clinton, by contrast, looks to build on the legacy of President Barack Obama’s two terms. Yet she has leaned to the left after a bruising primary battle with Bernie Sanders for the Democratic nomination. She supports increasing the minimum wage and making college tuition free for lower-income students, and plans to pay for it by raising taxes on the wealthy. She also has pulled her support for the Trans-Pacific Partnership (TPP) trade deal.

Unequal gains

Share of households with flat or falling income, 2004-2014

Sources: BlackRock Investment Institute and McKinsey Global Institute, October 2016. Notes: Incomes are inflation-adjusted, include wages and income from capital and are before taxes and transfers. The average is a population-weighted average of 25 advanced economies selected by McKinsey.
Crumbling consensus

No matter who wins the US election, we see waning support for globalisation. The pace of growth in both actual global trade and new trade agreements shows signs of slowing from the heady clip of the 2000s. See the chart below.

To be sure, most of the heavy lifting on removing global trade barriers has already been done. The average import tariff of World Trade Organization (WTO) members had fallen to less than 3% by 2012, roughly one-tenth the level of the mid-1990s, World Bank data show.

World trade volumes have grown by just over 3% a year since 2012, less than half the rate of expansion during the previous three decades, according to the International Monetary Fund (IMF)’s most recent World Economic Outlook. Up to three-fourths of the slowdown can be attributed to subdued economic growth and investment, the IMF estimates. Capital spending cutbacks by resources exporters due to commodity price declines have worsened the trend. Any investment rebound could revive the virtuous circle of trade and growth.

Rising isolationist sentiment is a risk to this scenario, particularly in the case of a Trump victory. The Republican nominee has threatened to pull the US out of the WTO, slap tariffs on imports and brand China as a ‘currency manipulator.’ This could raise the risk of retaliatory tariffs and trade wars with other nations. Any such moves would likely initially result in ‘risk-off’ sentiment and a flight to perceived safety such as US Treasuries and the US dollar, we believe.

Slowing momentum

Global free trade agreements and their coverage, 1980-2016

Sources: BlackRock Investment Institute and IMF World Economic Outlook, September 2016.
Notes: the data are based on the WTO Regional Trade Agreements database. The chart shows the number of trading partners the average WTO member country has free trade agreements with, and the share of global GDP that these partners represent.

Productivity anchor

EM total factor productivity and annual export growth, 1990-2016

Sources: BlackRock Investment Institute, International Monetary Fund (IMF) and The Conference Board, October 2016.
Note: the chart shows three-year moving averages for both series.

EM threat

The benefits of free trade are one of the few things economists typically agree on. The classical view: trade encourages specialisation and competition, speeds up technology transfers and boosts productivity growth.

Yet today’s trade agreements go beyond tariffs and are more about agreeing on frameworks and rules. They focus on complex and controversial areas such as services, product standards and intellectual property. Many of these cut into a nation’s sovereignty and affect the everyday lives of voters. In addition, there is a growing focus on the costs of trade – in the form of displaced workers and communities. The result: a backlash against globalisation.

This could hurt industries and companies with global supply chains. EM countries, too, have a lot to lose. Declining export growth since the mid-2000s has been mirrored by a collapse in EM productivity growth. See the chart above and Productivity Slowdown Puzzle of January 2016 for details. Mexico could be a potential loser of any rise in US protectionism. The US accounted for 80% of its exports in 2015, according to the United Nations.

Anti-trade measures could temporarily trigger a slide in EM currencies against the US dollar, and hurt other EM assets. Yet we see EM assets supported for now by improving domestic fundamentals, easing monetary policies, a greater global focus on fiscal spending and inflows from investors upping their allocations.
US political dysfunction

Widening ideological gaps between and within the Republican and Democratic Parties have increased political polarisation, making it harder to pass any legislation. Legislators increasingly have voted mostly along party lines. The result: US Congress is more divided than at any time in the past century. See the chart below.

This is reflected in a steady decline in the number of laws passed per session of US Congress to roughly half the level of the early 1980s in recent years, data from GovTrack shows. Political dysfunction has become so bad even Washington lawmakers have noticed. A bipartisan group calling itself ‘no labels’ is trying to work together to actually make things happen. The group’s slogan: stop fighting, start fixing.

Popular wisdom holds that gridlock is good for markets: governments are forced to compromise. Yet a simple analysis of Dow Jones Industrial Average returns tells a different story. The Dow’s median annual return has been less than 5% in periods of a divided Congress, versus around 9% under single-party rule, our analysis of data since 1900 shows.

Political gridlock means important longer-term budget reforms – such as changes to make entitlement programmes more fiscally sustainable – are likely to stay in the too-heavy-to-lift basket. Uncertainty and lack of stable government policies provide more reasons for companies to hold off on investment at a time they are already reducing spending in the low-growth environment. See the chart to the right.

Deeper divide
Share of US legislators voting with their party majority, 1919-2013

Policy depends in large part on the make-up of Congress, which is currently controlled by the Republican Party. Polls and prediction markets in mid-October indicated a likely Clinton win. Expectations centred on the Democrats taking control of the Senate but not the House of Representatives. An alternative scenario looked to be a Clinton win with both houses of Congress narrowly remaining under Republican control. Referenda on UK’s European Union membership as well as on a Colombian peace accord have shown the limits of prediction markets and polls, however.

We see a growing chance of gridlock in Congress regardless of the election result. Increasing use of the so-called filibuster, a delaying tactic used to block votes on bills, has long meant a simple Senate majority is not enough to get things done. And neither party is likely to command a significant majority in the House. This could make it difficult to craft bipartisan tax and budget deals in the House, raising the spectre of a return to the days of dramatic showdowns over budgets and the US debt ceiling.

Corporate tax reform and infrastructure investment appear to have a measure of bipartisan support, however. This makes some of us believe collaboration is possible – if only because lawmakers appear eager to get something done to fight poor public perception of the way they do their jobs. Approval ratings of Congress have ticked up this year, but still stood at just 20% in September, according to Gallup.
Policy

The US fiscal deficit has steadily shrunk since the last election, yet threatens to widen in the longer term as health care and Social Security liabilities mount. We could see the US shifting toward fiscal expansion, including greater infrastructure spending.

The US economy is in much stronger shape than it was during the last presidential election campaign of 2012. See the table below of key economic and market indicators.

A fiscal makeover is reflected in the country’s sovereign risk profile. Our **BlackRock Sovereign Risk Index** — a framework for assessing sovereign risk across 50 countries — shows a steady recovery in the overall US score over the past four years. The US’s fiscal space – our measure of fiscal sustainability – has flipped to a sizable positive from a drag. See the chart to the right. This is a product of lower spending, an apparent slowdown in health care cost increases in recent years, low interest rates reducing debt servicing costs and steady if historically subdued economic growth.

Yet the fiscal turnaround may be fleeting. Slower economic growth as ageing baby boomers exit the workforce, and growing projected health care and Social Security outlays will likely lead to rising budget deficits and debt-to-GDP levels over the coming decade under current policies, 2016 Congressional Budget Office (CBO) projections suggest.

### Now versus then

**Selected economic and market measures, 2012 vs. 2016**

<table>
<thead>
<tr>
<th>Measure</th>
<th>2012</th>
<th>2016</th>
<th>Change</th>
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</thead>
<tbody>
<tr>
<td>Economic</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real GDP growth</td>
<td>2.2%</td>
<td>1.6%</td>
<td>-0.6%</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>7.7%</td>
<td>5.0%</td>
<td>-2.7%</td>
</tr>
<tr>
<td>Labour participation rate</td>
<td>63.7%</td>
<td>62.9%</td>
<td>-0.8%</td>
</tr>
<tr>
<td>Core inflation</td>
<td>1.9%</td>
<td>2.3%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Budget balance</td>
<td>-6.8%</td>
<td>-3.2%</td>
<td>3.6%</td>
</tr>
<tr>
<td>Debt-to-GDP ratio</td>
<td>103%</td>
<td>108%</td>
<td>+5%</td>
</tr>
<tr>
<td>Market</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>1,428</td>
<td>2,126</td>
<td>49%</td>
</tr>
<tr>
<td>US 10-year Treasury yield</td>
<td>1.7%</td>
<td>1.7%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Crude oil (WTI)</td>
<td>$88.6</td>
<td>$50.0</td>
<td>-44%</td>
</tr>
<tr>
<td>US dollar (DXY)</td>
<td>80.6</td>
<td>97.7</td>
<td>21%</td>
</tr>
</tbody>
</table>

Now versus then

**Selected economic and market measures, 2012 vs. 2016**

- **Sources**: BlackRock Investment Institute and Thomson Reuters, Oct. 17, 2016. For 2016 GDP and debt-to-GDP ratios are based on IMF estimates; budget balances are based on data from the Congressional Budget Office. The changes for economic data and US Treasury yields are displayed in basis points.

### Elusive grand bargain

A ‘grand bargain’ that includes reforming the tax code and curbing costs of entitlement programs such as Social Security and Medicare is a long-held dream of fiscal reformers. Yet most of us see major obstacles to such a deal:

- A failed attempt at such a deal during Obama’s first term led to greater distrust between the two parties.
- Any cuts to long-standing government programmes would be unpopular with the electorate. This could make politicians shy away from tough decisions.
- Many Democrats want to prioritise infrastructure and education spending over entitlement reform. And some want to expand — not cut — the social safety net. Worries about the nation’s mounting debt level have eased for now amid ‘low-for-longer’ rate expectations. Low interest rates have pushed down the cost of servicing the debt to a near 50-year lows as a share of GDP, US Office of Management and Budget data show.
**Trump: high uncertainty**

Trump’s policy agenda at face value comes with many economic and market uncertainties. If fully implemented, it could lead to a slowdown in cross-border trade and capital flows, a large deterioration in the budget and sharply slower growth, according to ratings agency Moody’s. We believe this analysis is directionally right, and use it here simply to illustrate the wide range of possible economic outcomes. See the purple shaded area in the charts below.

A lot hinges on Trump’s ability to carry out planned income tax cuts. These could initially boost consumer spending, but might soon lead to a large deterioration in the budget and rising rates, Moody’s estimates. Similarly, a plan to deport more than 10 million undocumented immigrants could lead to labour shortages and rising wages. The likely result: rising inflation and US Treasury yields. If the Fed responded by sharply raising rates, as Moody’s assumes, it might tip the economy into recession.

Yet inflation levels and the Fed’s actions are hard to predict in reality. And the Fed’s board could change significantly over during the next president’s term, including the chair and vice chair. Trump’s ability to carry out his stated agenda also would be restricted by traditional Republicans, we believe.

We do see a tail risk: any move to raise tariffs on Chinese goods – as Trump has threatened – could lead to retaliation, including a possible yuan devaluation. Ensuing trade and currency wars would hurt commodities and EMs, in our view.

**Clinton: details matter**

Moody’s sees growth improving under a Clinton scenario, with the budget deficit rising slightly as a share of GDP. See the green shaded area in the charts below. Clinton plans to finance infrastructure spending and other priorities partly by raising taxes on the wealthy. Some of us see her facing pressure from within the Democratic Party to spend more, which could result in very different budget outcomes. Clinton’s agenda includes detailed policy proposals on everything from early childhood education to clean energy. Washington gridlock may constrain Clinton’s ability to implement her agenda, however, we believe.

Clinton favours immigration reforms that include a pathway to legalisation for undocumented immigrants. Other policy plans such as paid family leave and more spending on education could help boost productivity, but the effects are slow-burning and hard to estimate, in our view.

Corporate tax reform may have bipartisan support. A one-off ‘repatriation tax’ on profits parked overseas could generate revenues to pay for infrastructure spending.

Yet the details matter. Republicans want to slash the 35% corporate tax rate, while Democrats are focussed on closing tax loopholes.

A Clinton administration may look to executive actions and other creative ways to advance its agenda. Democrats see antitrust actions as a way to raise competitiveness and address inequality concerns, for example. Corporate acquisitions may face greater scrutiny.

**Diverging scenarios**

Moody’s US GDP and budget deficit projections, 2016-2019

Sources: BlackRock Investment Institute, IMF, Congressional Budget Office (CBO) and Moody’s, June 2016. Notes: pre-2016 data are based on IMF data for GDP and CBO data for the budget deficit. The charts show the range of Moody’s projections from 2016 onwards based on three scenarios for each candidate. Moody’s considers three scenarios for each candidate: 1 election campaign policy proposals are implemented at face value; 2 campaign promises are largely implemented but on a smaller scale; 3 policies are scaled back due to political resistance. For further details see The Macroeconomic Consequences of Secretary Clinton’s Economic Policies of July 2016 and The Macroeconomic Consequences of Mr. Trump’s Policies of June 2016.
Rebuilding infrastructure

The tone on fiscal policy is changing: as monetary easing reaches its limits, some major economies are considering fiscal expansion. There has arguably never been a better time for governments to promote infrastructure investments, including teaming up with private capital (see page 9). We expect targeted fiscal expansion to generate higher growth than usual amid rock-bottom interest rates, as detailed in our Global Macro Outlook of September 2016. Infrastructure in many developed economies is ageing, with the average quality falling over the past decade. See the chart below.

Clinton has pledged $275 billion in infrastructure spending, mostly targeting transportation such as roads, bridges and rail. Trump’s spending goal is twice as large, but his plan is lacking in details.

The global economy will require big investments in the coming decades in sustainable infrastructure – especially in energy systems and cities. See Adapting portfolios to climate change of September 2016 for details. Clean energy may gain more support under Clinton, whereas we expect a Trump administration would be friendlier to the fossil fuel industry. Easier permitting for drilling and pipelines could spur activity in the oil and gas sector. Investors should also pay attention to factors beyond federal regulations and subsidies, we believe. A move in electricity generation away from coal, for example, is also driven by state-level regulations and market forces such as increased competitiveness of renewables.

Crumbling infrastructure

G7 overall infrastructure quality, 2006 vs. 2016

Widening gap

Yield spread between municipal and corporate bonds, 2012-2016

Sources: BlackRock Investment Institute and Bloomberg, October 2016.
Notes: the chart shows the spread between the tax-equivalent yield (assuming a top effective marginal tax rate of 43.4%) of the Barclays US Municipal Bond Index and the yield of the Barclays US Aggregate Corporate Index in percentage points.

Taxing matters

The rise in populism has intensified the focus on closing tax loopholes and limiting deductions that disproportionately benefit the wealthy. These could range from changing the tax treatment of carried interest to capping deductions for charitable giving and mortgage interest.

Our focus is on any moves to limit the amount of interest from US municipal bonds individuals can claim as tax exempt. Either candidate could introduce a cap, in our view, which would make munis less attractive and lead to a rise in yields in the $3.8 trillion market.

We see Clinton’s planned tax increases on the wealthy supporting munis, as they would raise the value of any tax-exempt interest income for individuals facing higher taxes. Conversely, Trump’s plan to slash personal tax rates could deal a blow to the asset class. Issuance has risen ahead of the election, and the yield premium of tax-adjusted munis over corporate debt has ticked up. See the chart above.

“We expect the tax-exempt status of munis to stay, but we could see a cap on the interest exemption introduced. Markets have yet to fully price in such a scenario. This is a reason for caution.”

Peter Hayes – Head of BlackRock’s Municipal Bonds Group
Policy thoughts

BlackRock co-founder Barbara Novick shares her perspective on policy challenges the next US president should tackle. On top of her list: solving the looming retirement crisis and enticing private capital to invest in infrastructure. We also touch on how to promote long-termism, modernise outdated financial market structures and reform housing finance.

What are the top issues in finance any new president should help solve?
We have a looming retirement crisis. We need to improve access to retirement plans and improve asset allocation in these plans, address underfunded defined benefit programs, and reform entitlement programmes. Now is not the time to kick the can down the road.

The low-hanging fruit is providing employees of small businesses with access to 401(k) pension programs. Another attractive idea is to encourage companies to re-enroll employees using multi-asset class default options with high contribution rates that rise gradually over time. Let’s give employees the right tools — and the ability to opt out if they prefer to invest differently. In addition, underfunded defined benefit plans in states and municipalities need to make changes. This is not a federal issue per se, but one that has national implications. Plans need to increase assets and/or reduce liabilities through a mix of increased contributions, means testing, changes to cost-of-living formulas, reduced benefits and higher retirement ages, we believe. Social Security needs to take similar steps to ensure its sustainability.

What would be your second priority?
The need for upgrading infrastructure globally is great, and these investments can pay long-term dividends as modern infrastructure brings efficiencies. Infrastructure also creates construction jobs. Given budget constraints, we believe it will be important to create public-private partnerships that pool resources. This requires an element of certainty for investors to commit capital. For example, you can’t build a toll road and then outlaw collecting tolls five years later. We need to establish guidelines for projects and then commit to them as long-term investments. We see an opportunity to boost infrastructure in this country. Some combination of corporate tax reform, repatriation of corporate cash held abroad and infrastructure spending would be very beneficial.

What should investors be watching?
Policy does not just materialise; it is driven and implemented by individuals. Key positions in the administration, the Fed, agencies such as the Securities and Exchange Commission, as well as Congressional leadership and committees will be in flux. Watching the appointments is crucial.

BlackRock’s policy thoughts
Solve the retirement crisis
• Put Social Security on a fiscally sustainable path, strengthen public pension plans through a mix of measures and make it easier to set up private plans.
• Create incentives and mechanisms to address the problem of individual under-saving, including encouraging personal retirement contributions that gradually rise over time.

Bridge the global infrastructure gap
• Provide certainty to investors, including legal frameworks for enforcing contracts and stable policy regimes that encourage pooled funds.
• Align the interests of governments and investors by targeting public investment where it is needed rather than crowding out private capital.

Promote long-termism
• Reward long-term investment with lower capital gains tax treatment only after three years and decrease the tax rate for each year of ownership beyond that.
• Set standards for reporting and measurement of environmental, social and governance factors to help create long-term shareholder value and promote sustainability.

Modernise market structures
• Encourage initiatives by market participants to further help enhance corporate bond market trading liquidity.
• Build on efforts to refine market structures so that all segments of the equity market function smoothly and in harmony during periods of stress.

Reform housing finance
• Reinvent the Government Sponsored Entities as pure intermediaries, and maintain the government guarantee on mortgage securities for an appropriate fee.
• Attract private capital by standardising the securitisation process, set national servicing standards and support policies that respect investor rights.

See ViewPoints for details on our recommendations.
We see tough times ahead for many financials as the sales practices of large banks come under greater scrutiny, especially under a Clinton presidency. Health care stocks could be hit by renewed pressure to curb price increases on drugs, a crackdown on large-scale mergers as well as uncertainty over a likely shake-up of the Affordable Care Act (ACA).

Presidential elections typically have little lasting impact on equity markets, beyond a fleeting rise in volatility that quickly subsides post-election, our research shows. Yet policy shifts due to changes in government can ripple across sectors.

What have markets been signalling so far? The consumer durables, transportation and capital goods sectors have been rising in tandem with Clinton’s poll numbers. Health care stocks have fallen as Clinton’s odds rise. By contrast, semiconductors, banks and insurers benefited whenever Trump’s poll numbers rose. See the chart below. We zero in on the financials and health care sectors on page 11.

Beneficiaries of increased fiscal spending, such as construction and materials, have already rallied in anticipation of greater infrastructure spending post-election. Yet this outperformance may be premature, as new fiscal programmes take time to trickle down to corporate bottom lines. And any fiscal package could be stymied or watered down by a divided Congress.

Uncertainty is weighing on corporate behaviour already: capital spending is lacklustre and many companies are shying away from providing long-term guidance.

### Sector plays

**Equity sector correlations with US election polls, 2016**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Clinton</th>
<th>Trump</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer durables</td>
<td>37%</td>
<td>-37%</td>
</tr>
<tr>
<td>Transportation</td>
<td>53%</td>
<td>-14%</td>
</tr>
<tr>
<td>Capital goods</td>
<td>23%</td>
<td>-31%</td>
</tr>
<tr>
<td>Consumer services</td>
<td>16%</td>
<td>-25%</td>
</tr>
<tr>
<td>Automobiles</td>
<td>17%</td>
<td>-17%</td>
</tr>
<tr>
<td>Insurance</td>
<td>-17%</td>
<td>22%</td>
</tr>
<tr>
<td>Semiconductors</td>
<td>-3%</td>
<td>38%</td>
</tr>
<tr>
<td>Banks</td>
<td>-15%</td>
<td>29%</td>
</tr>
<tr>
<td>Health care</td>
<td>-48%</td>
<td>-4%</td>
</tr>
<tr>
<td>Pharmaceutical &amp; biotech</td>
<td>-36%</td>
<td>20%</td>
</tr>
</tbody>
</table>

Sources: BlackRock Investment Institute, S&P and RealClearPolitics, October 2016.

Notes: the table shows the correlation between the daily performance of S&P 500 sectors relative to the S&P 500 and RealClearPolitics polls this year. The five highest positive and negative correlations to the poll spread between Clinton and Trump are shown.

### Dealing with fewer deals

A merger and acquisitions (M&A) boom is showing signs of fizzling out. The number of deals has dropped sharply from a peak earlier in the year. Such peaks have historically signalled tops in the equity market. See the chart above. M&A deals, especially large-scale deals primarily done to gain tax advantages, could see greater scrutiny under a Clinton presidency.

Clinton has singled out pharmaceuticals, airlines, and broadband Internet service as industries with increasing concentration of large corporations. She plans to beef up anti-trust authorities to curb the rising dominance of these companies and boost competition.

An M&A crackdown could hit the shares of potential acquisition targets in the equity market. Yet it would likely benefit investment-grade credit. M&A deals often are debt financed, which hurts the creditworthiness of the acquirer.
Financials: old whipping horse
Bank bashing is back in vogue after a US scandal involving the setting up of accounts customers did not ask for. We expect more scrutiny on the sales practices of all financial institutions and more regulations for the sector in the case of a Clinton win. This would be bad news for mega-banks, even as they stand to benefit from economic reflation and steepening yield curves boosting their lending margins.

A Trump presidency would likely be friendlier to the financial sector but would involve greater uncertainty. Example: Republicans have called the post-crisis Dodd-Frank regulations a ‘legislative Godzilla’ and proposed to pare them back. Yet uncertainty surrounding potential changes may turn investors off. And the law may simply be replaced with simpler and blunter, but equally onerous rules.

Cash held abroad by US-based companies
We see regional banks as a bright spot. Politicians on both sides of the aisle support raising the asset threshold that determines whether a bank is designated a ‘systemically important financial institution.’ A proposed lifting of the cut-off to $250 billion from the current $50 billion would loosen the regulatory shackles on regional banks. This would likely lower their compliance costs and potentially reduce overall capital requirements. As a result, we expect regional banks to be in prime position to grow faster, pursue M&A, and return capital to shareholders.

See the table below for our views on potential winners and losers in the financial sector under each presidential candidate.

Financials scoreboard
BlackRock view of potential US election impact on financials

<table>
<thead>
<tr>
<th></th>
<th>Democratic victory</th>
<th>Republican victory</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mega-cap banks</td>
<td>–</td>
<td>=</td>
</tr>
<tr>
<td>Regional banks</td>
<td>=</td>
<td>=</td>
</tr>
<tr>
<td>P&amp;C insurance</td>
<td>=</td>
<td>=</td>
</tr>
<tr>
<td>Life insurance</td>
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<td>=</td>
</tr>
<tr>
<td>Consumer finance</td>
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Source: BlackRock Investment Institute, October 2016.
Notes: a ‘-’ sign indicates an expected negative impact. A ‘+’ sign indicates positive impact. A ‘=’ sign indicates a neutral impact. P&C refers to property and casualty insurers.

Health care scoreboard
BlackRock’s view on potential US election impact on healthcare

<table>
<thead>
<tr>
<th></th>
<th>Democratic victory</th>
<th>Republican victory</th>
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</thead>
<tbody>
<tr>
<td>Commercial HMOs</td>
<td>–</td>
<td>+</td>
</tr>
<tr>
<td>Medicaid HMOs</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Drug distributors</td>
<td>–</td>
<td>+</td>
</tr>
<tr>
<td>Pharma, biotech</td>
<td>–</td>
<td>+</td>
</tr>
<tr>
<td>Medical devices</td>
<td>=</td>
<td>+</td>
</tr>
<tr>
<td>Hospitals</td>
<td>+</td>
<td>=</td>
</tr>
</tbody>
</table>

Source: BlackRock Investment Institute, October 2016.
Notes: a ‘-’ sign indicates an expected negative impact. A ‘+’ sign indicates positive impact. A ‘=’ sign indicates a neutral impact. HMO refers to health maintenance organisations.

Watch your health
The health care sector has been on tenterhooks ever since Hillary Clinton fired off a tweet in September 2015 accusing biotech companies of price fixing, sparking a $38 billion sell-off in just a day. Drug pricing is likely to remain a political target as consumer and insurer frustration rise. A Clinton presidency could pose more risk to the health care sector, particularly biopharma. See the table above.

Fast-rising insurance premiums are likely to spur fixes to the ACA (also known as Obamacare), resulting in regulatory uncertainty. We would not expect direct drug price controls under a Clinton administration, yet we could see it implementing some long-term drug payment reforms. And the private sector could become more aggressive in negotiating drug prices and coverage.

Even under a Trump presidency, drug price increases would likely slow, we believe. Intense media and political scrutiny has made it tough for pharmaceutical companies and drug distributors to raise prices as fast as before. This is a global trend, but we see increased pricing pressures in the US having a disproportionate impact on global drug companies because the US tends to be the most lucrative market.

Any tax holiday on overseas earnings repatriation should benefit large-cap pharmaceutical, biotech and medical device companies that earn substantial revenues abroad, in our view.

“The regulatory screws for mega-cap banks seem likely to be tightened further, regardless of who wins the White House.”

Todd Burnside – Portfolio Manager, BlackRock’s Large Cap Series Team
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