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Strategy after U.S. Election

Buy on dips in case of contested election

U.S. Presidential Election took place on 3 Nov, and results hang in the balance with votes still being counted in key swing states. We look at the impact on economy, U.S.-China relations and stock markets under three possible scenarios.

- **Scenario 1 – Biden wins with Congress split. Economic recovery is likely to be stronger if Biden is elected.** So is the job market. We expect a new round of stimulus and policy clarity to lift market sentiment. Biden's economic agenda involves massive government spending with priorities on infrastructure, green energy, health care and etc, which could outweigh tax increases.
- **Short-term impact on markets should be slightly positive**, as Biden's victory has been by and large expected and priced in, and uncertainties have been removed. Biden's policies are believed to be reflationary, favouring financial like banks and insurers. Clean energy sector will also benefit from higher demand, and TMT equipment sector sentiment will improve with expectation of a slightly better U.S.-China relations.
- **Scenario 2 – Trump wins with Congress split.** Trump is likely to roll out tax cuts, infrastructure plan, but spending cuts on nondefense programs to narrow fiscal deficit. **Between US and China, strategic competition prevails in the long run regardless of who gets elected.** What might make a difference is that Biden tend to take a less confrontational approach than Trump, and he will reunite American's allies and pressure China in a multinational way. In the case of Biden being elected, some tariffs may be removed although national security measures will be kept in place. Phase One Deal will remain in force.
- **In the very short term, Trump winning against the odds may cause some elevated volatility in the markets,** but his support for low interest rates and low tax rates should bode well for the U.S. corporate profits and stock market valuation in the medium term. For HK/China stocks, sectors which are more sensitive to U.S. policies could be under pressure in the medium term, such as TMT equipment and export sectors. In contrast, **investors should favour sectors driven by China's domestic demand** and benefit from "inner circulation" strategy.
- **Scenario 3 – Contested election.** If a losing candidate takes it to the court to challenge the validity of the election results, bringing uncertainties for weeks, then the market would probably move lower, in similar fashion to the 2000 Election. That said, those uncertain few weeks alone should not change outlook of economy and corporate earnings in the next four years. When are uncertain about Biden or Trump wins, stick with China domestic plays we suggested in the Trump-win scenario, i.e. Consumer, Capital Goods and Internet giants.

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Market Data

Hang Seng Index	24,886
52-week High / Low	29,175/21,139
3-month avg. daily t/o	HK$125.3bn

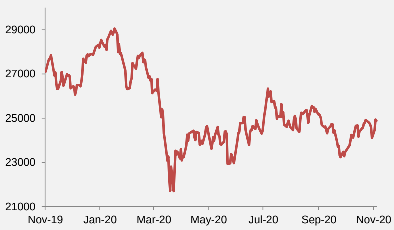
Source: Bloomberg

Indices Performance

	HSI	HSCEI
1-month	6.1%	7.5%
3-month	-0.2%	-1.0%
6-month	5.4%	5.2%

Source: Bloomberg

12-month HSI Performance



Source: Bloomberg

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Unprecedentedly tight race

■ Counting may take days; Trump files lawsuit

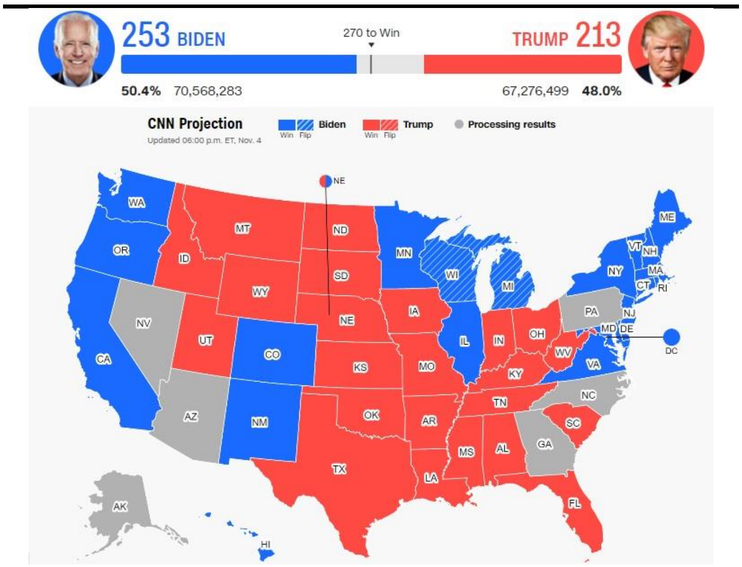
At the time of writing, we are still waiting for the results of U.S. Presidential Election. The battle is much closer than polls suggested. While there have been other very tight races in the past, e.g. year 2000, this election is unprecedented in terms of record number of absentee votes and mail-in votes amidst COVID-19 impact. What is known so far, according to the U.S. media:

- Joe Biden is leading Donald Trump by about 2.4 percentage points in terms of popular votes, much narrower than the 7.2% lead according to polls.
- Biden is leading 253 vs 213 in electoral votes (270 is needed to win) (Fig. 1).
- Six states are still undecided, with Biden leading in Arizona and Nevada, and if he wins these two states, he will reach 270 to win.
- With record number of absentee votes and mail-in votes, it takes more time to count all the votes. For instance, Pennsylvania expects most votes will be counted by 6 Nov, while North Carolina accepts ballots postmarked by Election Day until 12 Nov. Apparently certain swing states will be decided by such mail-in votes, which are more inclined towards Biden in general.
- Both Trump and Biden expressed confidence in winning when the votes were being counted. Trump said, “we did win this election.” Biden said, “we believe we are on track to win."
- Trump said, “we’ll be going to the U.S. Supreme Court” to stop ballot counting, referring to mail-in votes which arrived after polling stations have closed. His team is filing lawsuit in Pennsylvania and Michigan, and demands recount in Wisconsin.

■ Congress likely to remain split

While Trump vs Biden is taking all the headlines, Congress is another battleground. So far, it seems more likely to remain status quo, i.e. Republicans control the Senate, Democrats control the House. A much talked-about “Blue Sweep” (Democrats winning the Presidency, Senate and the House) is rather unlikely.

Figure 1：U.S. Presidential Election projected results



Source: CNN, as of 6:00pm E.T., 4 Nov

Scenario 1 – Biden wins with Congress split

This was the more likely case (might be equally likely as “Blue Sweep”) according to pre-election polls.

Stronger recovery of the U.S. economy

- **First focus on U.S. economy and fighting the virus**

Economic outlook is stronger under the scenario that Biden is elected, if his economic agenda is fully implemented. We expect a new round of stimulus and policy clarity to lift market sentiment, with a priority on reviving the economy and fighting the virus. Biden may reverse some of Trump’s policies on environmental protection, immigration, trade and etc. Although taxes may be raised higher, expansion in government spending with priorities on infrastructure, green energy and health care could outweigh.

- **Advance U.S. interests and lead international efforts**

Biden is likely to revitalize foreign policies to reunite with its allies and to ensure that U.S. remains the world’s pivotal power. It will re-engage international institutions so that U.S. leads in “shaping the rules, forging the agreements and steering the institutions that guide international relations” (according to *Democrat Party Platform*). We would expect a more responsible U.S. to play leading role and work in common cause with the rest of the world.

Will U.S.-China relations be re-established?

- **U.S.-China relation may become a bit more sound**

In the short run, we might expect a bit of reset of U.S.-China relations in the sense that Biden is likely to take a less confrontational approach. He will not copy Trump’s brute tactics of imposing tariffs or close ties. **We expect some of Trump’s China tariffs may be removed**, as Biden said during the election campaign. However, Biden may likely keep most of the national security measures in place and protect U.S. interest.

Under Biden’s Administration, U.S. and China may also share more common grounds to abide by, for example regarding climate change and renewable energy.

- **Phase One Deal may not be cancelled**

It remains uncertain whether China can fulfil its 2020 target of purchasing U.S. goods and services given the COVID-19 effects on global trade and economy. According to PIIE, through the end of September, China’s purchase of U.S. goods only reached 53% of the expected annual target. USDA reported China has purchased approximately 71% of target for agricultural products.

However, Phase One Deal was not just about enlarging U.S. exports to China. There are other important and reached-with-effort agreements, for example those related to intellectual property and market open-up, that will bring mutual benefit to both countries. We believe Phase One Deal will remain one of the important rules defining U.S. and China economic relationship.

- **Re-engaging with allies to deal with China**

Unlike his predecessor, Biden's administration opts to reunite allies and renew efforts to multilateralism. It is likely that Biden may repair relations with allies and implement multinational strategies to pressure China, just as he said during the campaign that he will "stand up to China by working with our allies to negotiate from the strongest possible position".

- **In the long run, however, strategic competition prevails**

Although Biden and Democrats may not resort to unilateral tariff wars or run the risk of a new cold war, we believe their approach to China will remain "tough". This is guided by American's interests under the circumstances of an emerging China. Therefore, strategic competition may dominate U.S.-China relation in the long run. Moreover, U.S. will deal with China with greater confidence and coordinated efforts with its allies.

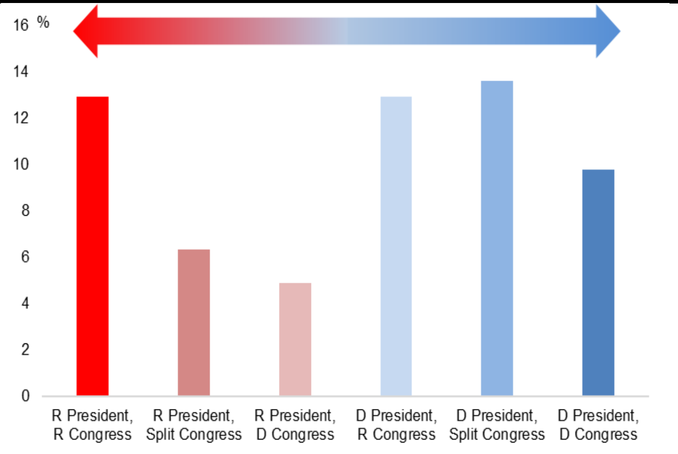
Impact on markets and sectors

- **U.S. stocks slightly positive in the short term**

Short-term impact on markets should be slightly positive, as Biden's victory has been by and large expected and priced in, and uncertainties have been removed.

With Biden as President, a split congress may arguably be better for the stock market than a Democrat-controlled one, as Biden's tax hike plan may be not as drastic with some resistance from Republicans. In fact, a Democrat President with a split Congress gave the best average returns over the years (Fig. 2).

Figure 2: S&P 500's average returns when Congress is united with / opposite to the President since WWII



Source: Bloomberg, CMBIS

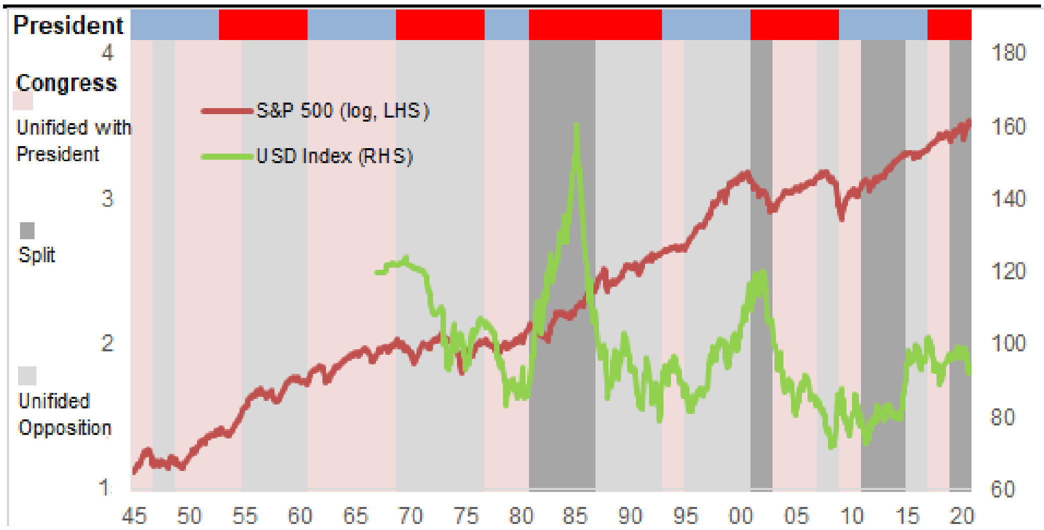
■ **Split Congress => Stronger USD**

With a split Congress, USD tended to be stronger than with one unified with the President (Fig. 3), possibly because aggressive fiscal stimuli (thus higher fiscal deficit and debts) are more difficult to be passed by a split Congress. If Biden wins, he is expected to be more hands-off with the Federal Reserve (vs. Trump's pressure for low interest rates), which might lend more support to the USD too.

■ **Moderate returns in 1st year of Presidency**

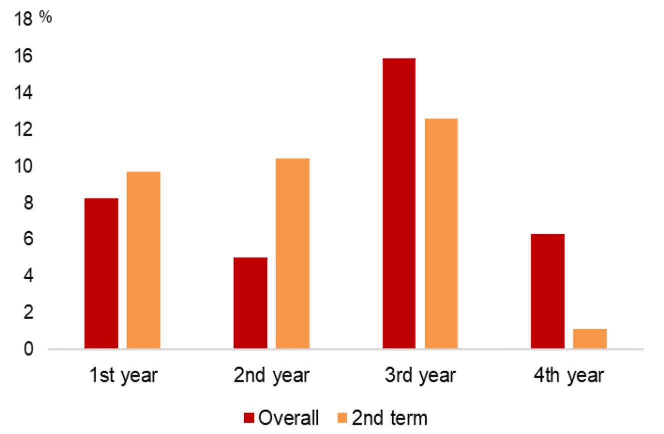
If we look beyond the short-term post-election volatility, U.S. stocks on average posted moderate return (8.2%) in the first year of Presidency (Fig. 4). In the first year of a President's second term (like Trump in case he wins), stocks on average posted slightly higher returns (9.7%).

Figure 3: U.S. stocks and USD under various President / Congress combinations



Source: Bloomberg, CMBIS

Figure 4: S&P 500's performance by year of Presidency terms since WWII



Source: Bloomberg, CMBIS

- **HK stocks – favour reflationary plays and clean energy**

Biden vows to raise corporate and top-bracket personal income taxes, among others, while launch a new round of stimulus and boost government spending on infrastructure and clean energy projects to offset the negative impact of higher taxes. These are believed to be reflationary. The rise in U.S. Treasury yields in recent months as Biden's lead in polls widened partly reflects such expectation.

Financials: Banks and insurers should benefit from higher bond yields and steepening yield curves. Chinese financial stocks should benefit from a stronger CNY due to slightly better U.S.-China relations and therefore better exports outlook for China. Key names include **China Life (2628 HK; BUY)**, **CPIC (2601 HK; BUY)**, **PSBC (1658 HK; BUY)**.

Clean energy: A rise in demand for solar panels. General boost in sector sentiments. Key names include **Xinyi Solar (968 HK, BUY)**, **China Longyuan (916 HK, BUY)** and **Goldwind (2208 HK, BUY)**.

TMT equipment (short-term): Investors may expect a slightly better U.S.-China relations, and thus a lower risk in China's technology sector. But China-U.S. tensions seem unlikely to improve significantly, and thus U.S. policies over the medium term remains a risk to the sector. Key names include **BYDE (285 HK, BUY)** and **Luxshare (002475 CH, BUY)**.

Scenario 2 – Trump wins with Congress split

Status quo. Not the most likely scenario according to pre-election polls, but not a "black swan" either.

Implications on U.S. economy

- **First focus on fiscal stimulus and fighting the virus**

Based on market consensus, economic outlook is weaker under the scenario that Trump wins the election. Both economic growth and job market may take longer to come back to normal, compared to the scenario of Biden in the White House. To roll out a new round of fiscal stimulus and effective measures of fighting the virus, will be the first priority for Trump's policy agenda during his second term.

- **Tax cuts, but less expansive government spending**

Trump is likely to propose tax cuts for higher-income households and businesses, by US$ 1.1tn through 2030. On government spending, Trump proposes a nearly US$ 1tn infrastructure plan as part of its push to spur U.S. economy and will likely increase spending on defense programs. However, spending cuts may be proposed on nondefense programs to narrow fiscal deficit, such as health care, education and social welfare programs.

- **Turbulence to continue**

Given Trump's approach to domestic and foreign policies, one should be prepared to embrace another four years of turbulence during his term. We might see protectionism trade policies, restrictive immigration policies, unilateralism to continue.

U.S.-China tensions still prevail

■ **Strategic competition dominates in the long run**

Regardless of who wins, we believe strategic competition may dominate U.S.-China relation in the long run. The only difference is that Trump's tactics are confrontational and brute, e.g. imposing tariffs or cutting off ties, whereas Biden proposed to reunite allies and implement multinational strategies to deal with China.

■ **Phase One Deal still in force**

It remains uncertain whether China can fulfil its 2020 target of purchasing U.S. goods and services given the COVID-19 effects on global trade and economy. According to PIIE, through the end of September, China's purchase of U.S. goods only reached 53% of the expected annual target. USDA reported China has purchased approximately 71% of target for agricultural products.

However, Phase One Deal was not just about enlarging U.S. exports to China. There are other important and reached-with-effort agreements, for example those related to intellectual property and market open-up. We believe Phase One Deal will remain one of the backbones to define U.S. and China economic relationship in the future.

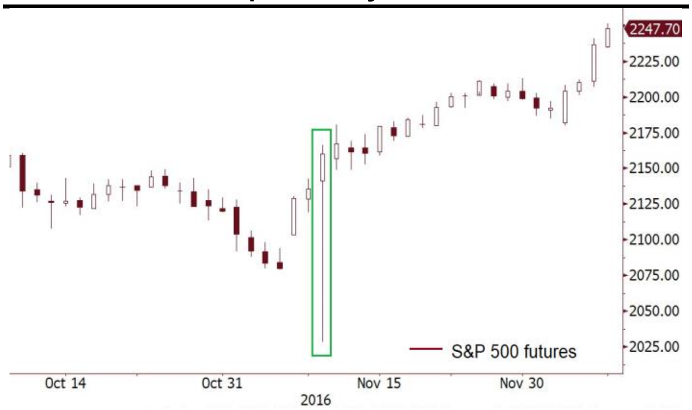
Impact on markets and sectors

■ **U.S. stocks more short-term volatility; medium term positive**

Trump has always put great importance on the economy and stock market, and his support for low interest rates and low tax rates should **bode well for the U.S. corporate profits and stock market valuation in the medium term**.

In the very short term, Trump winning against the odds may cause some elevated volatility in the markets, but do not expect the markets to be as volatile as right after Election Day, when the S&P 500 futures slumped as much as 5% and then closed up 1% (Fig. 5). Back then, Trump had no political background and would bring huge uncertainties to the U.S. policies. Now, having served his first term, polices outlook are much less uncertain.

Figure 5: Stocks swiftly rebounded from initial slump in reaction to Trump's victory in 2016



Source: Bloomberg, CMBIS

- **HK stocks – favours China domestic plays**

With any slim chance of a better U.S.-China relations (in case Biden wins) gone, HK/China stocks which are more sensitive to U.S. policies could be under pressure in the medium term, such as TMT equipment and export sectors. In contrast, investors should **favour sectors driven by China's domestic demand and benefit from "inner circulation" strategy**.

Consumer: Staples such as dairy and apparels have better earnings visibility. Discretionary may have stronger recovery momentum post-pandemic, but will also be more sensitive to COVID-19 news flow and vaccines development progress. Prefer industry leaders with strong brand names, such as **Mengniu (2319 HK, BUY)** and **Anta Sports (2020 HK, BUY)**.

Capital goods & machinery: Ongoing or even heightened U.S.-China tension may bring downward pressure to China's economy, and more infrastructure spending may be applied to stabilise economic growth, boosting demand for heavy-duty trucks, cranes, concrete machines, etc. Key calls include **Weichai Power (2338 HK / 000338 CH, BUY)**, **Jiangsu Hengli (601100 CH, BUY)** and **SANY Heavy (600031 CH, BUY)**.

Internet: most of the Chinese internet giants such as **Tencent (700 HK, BUY)** and **Meituan (3690 HK, BUY)** generate most of their income/profits from Mainland China. Overseas revenue mix is usually less than 10%, making them not so vulnerable to potential deterioration in U.S.-China relations.

Bearish (short-term): Renewable energy upstream players, as hopes on Biden's new energy policy wane. But it is more sentiment-driven. Long term development trend is intact. Take solar industry as an example. U.S. solar farm installation represents only about 10-15% of global demand. During the past four years under Trump's administration, solar demand maintained rapid growth in U.S.

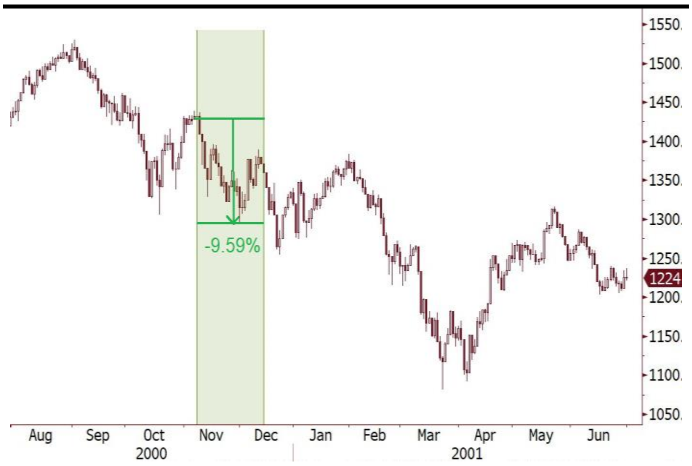
Scenario 3 – Contested election

If the losing candidate concedes when all counting has been finished, markets should not react badly even if it means waiting for a few days counting a record number of mail-in ballots. In the **worst scenario**, however, a losing candidate takes it to the court to challenge the validity of the election results, keeping people waiting for weeks, then the **market would probably move lower, in similar fashion to the 2000 Election**.

- **Stock market hit by uncertainties**

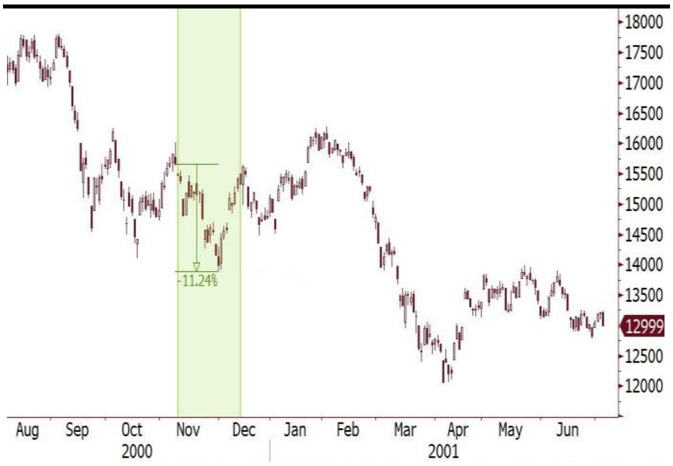
In the 2000 Presidential Election, a recount in Florida and a series of legal battles left the race undecided until a Supreme Court decision five weeks after the Election Day. In that uncertain period, the S&P 500 slumped by almost 10% (Fig. 6). Hong Kong markets' sentiment was hit too, with the Hang Seng Index dropping by as much as 11% (Fig. 7).

Figure 6: S&P 500 during the 5-week contested election in 2000



Source: Bloomberg, CMBIS

Figure 7: Hang Seng Index during the 5-week contested election in 2000



Source: Bloomberg, CMBIS

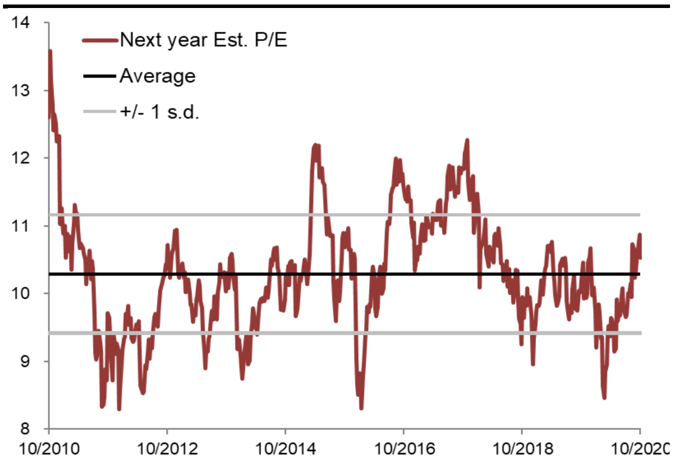
Should this election turn out to be a contested one, HK stock market should have a smaller downside than the U.S. market, due to the large valuation gap.

The S&P 500 is trading at 20.4X next year's P/E ratio, two s.d. higher than 10-year average (Fig. 8). The Hang Seng Index is trading at 10.9X, just slightly higher than 10-year average (Fig. 9).

Figure 8: S&P 500's next year's P/E

Source: Bloomberg, CMBIS

Figure 9: Hang Seng Index's next year's P/E



Source: Bloomberg, CMBIS

Impact on markets and sectors

- **Buy on short-term dips**

While any legal battles may take weeks, and that could be painful for investors in that period, there WILL eventually be an official election result. Those uncertain few weeks alone should not change outlook of economy and corporate earnings in the next four years. When we are uncertain about Biden or Trump wins, stick with China domestic plays we suggested in the Trump-win scenario, i.e. Consumer, Capital Goods and Internet giants.

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