An Asian perspective on the 2020 US elections

In the lead up to the US presidential elections on November 3rd, here are our investment teams' views on markets and economies:

- **The election outcome could be delayed or worse still contested, leading to an escalation in political instability and greater market volatility.**
- **US-China tensions are expected to continue but a full decoupling is unlikely given the importance of the Chinese consumer market and China's role in global supply chains.**
- **Asian countries with large working-age populations and relatively low-cost wage structures will be likely winners if supply chains diversify from China.**
- **US fiscal policy is likely to remain accommodative and a structurally widening fiscal deficit can weigh on the USD. This is positive for Asian currencies and local bonds.**
- **Geopolitical and deglobalisation risks will likely remain if Trump is re-elected whereas a Biden presidency suggests a more measured, multilateral and rules-based approach.**

WHAT WOULD BE THE IMPACT OF THE OUTCOME OF THE US ELECTIONS ON FINANCIAL MARKETS?

Kelvin Blacklock, Head of Eastspring Portfolio Advisors, Eastspring Singapore: First off, the election outcome could take weeks to process and the final tallies may change significantly after election day as a result of absentee and mail-in ballots that arrive after in-person ballots are counted. wSecond, recounts and legal disputes may result in a failure to produce a legitimate result, leading to an escalation in political instability and uncertainty. Third, a contested election is also possible in which it is not decided by the popular vote or Electoral College but requires the intervention of the US Congress or Supreme Court to determine the outcome. For these reasons, we expect to see increased market volatility in the coming weeks.

Even if the election outcome is uneventful, a re-election victory for President Trump will pose global risks. His second term in office could result in more trade wars with other trade surplus nations. Consequently, US equity outperformance could continue versus the world. In contrast, a Joe Biden victory suggests higher domestic risks. Higher taxation is a risk for Big Tech companies as is increasing regulation on energy and healthcare companies which in turn may cause US equities to underperform relative to the world. That said, the lobbying power of these companies in Washington is formidable and historically they have been much closer to the Democrats than the Republicans. Separately, ESG Investing could get a boost as Joe Biden has called for a USD2tr Green New Deal, which would benefit the alternative energy sector.

All considered, from a markets' perspective, the "best case" for equities is a Biden victory with a split Congress (Democratic House, Republican Senate) as there could be a moderation of the trade war risks and yet no new taxes. But the most meaningful change would come if the Democrats achieved a clean sweep of government as fiscal spending is expected to be larger. Under such a scenario, key winners are likely to be a) Materials due to infrastructure spending, b) Consumer Discretionary due to a higher minimum wage and c) EM Asian equities & currencies due to less impulsive trade policy. That said, the overall impact on equities, bonds and the US Dollar is less clear given the offsetting proposals of higher corporate taxes to fund higher spending.

Besides the election outcome, markets will also be influenced by the direction of monetary, fiscal and protectionist policies. For now, the monetary policy backdrop will remain accommodative, thus underpinning equities. Higher fiscal spending pledges by both Trump and Biden to build infrastructure is also supportive of equities. But the US' shift towards protectionism and the strategic need to counter China will remain an ongoing theme that will continue to rattle markets.

The last twenty years of rising capitalism and globalisation has been an enormous positive trend for global wealth and growth. For developing countries, it lifted millions out of poverty while consumers in developed countries benefitted from lower priced goods. Unfortunately, this trend combined with technology advances and increased immigration has hollowed out the blue-collar workers in many of these western democracies, leading to a swing in the political preference towards more socialist policies globally. And COVID-19 has further accelerated this trend.

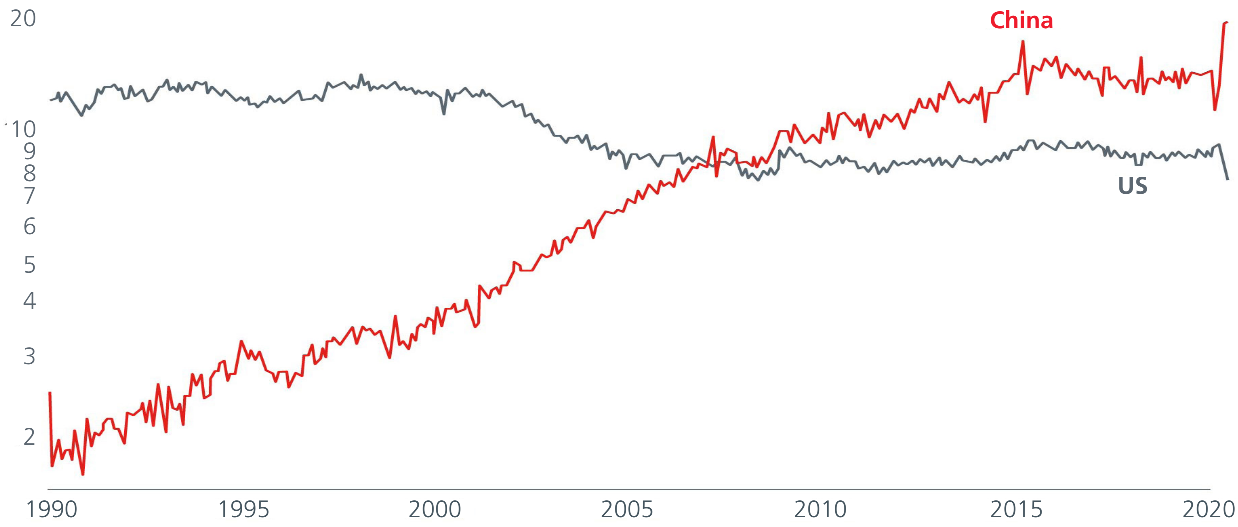
As the economic gap between the US and China narrows, many worry about the so-called Thucydides Trap – a situation that was first identified by an ancient Greek historian – in which a rising power (in this case China) displaces the ruling one (the US). Accordingly, it has been noted that in the past 500 years, there have been 16 cases in which a rising power challenges a ruling one, and on 12 occasions it ended with war. A military conflict is unlikely, but it could result in less globalisation.

HOW DO YOU SEE US-CHINA RELATIONS EVOLVING OVER THE NEXT FOUR YEARS?

Michelle Qi, CIO, Equities, Eastspring Investments, China: Given the intensifying economic, technological and geopolitical rivalry between the US and China, we believe that tensions between the two countries will continue regardless of who wins the US elections. Biden's approach towards US-China relations could however be less volatile. More importantly, we do not expect a full decoupling between the two economies given the deep linkages that have been forged over the past decades of globalisation.

It is interesting to note that Chinese exports to the US only declined 3.6% yoy on year-to-date basis despite the COVID-19 outbreak and higher tariffs imposed as part of the phase one trade deal. In July and August, Chinese exports to US grew at a healthy pace of 12% and 20% respectively. Not just for the US, in fact, China's share of global exports spiked in April due to significant exports of medical and electronic products. Fig. 1.

Fig. 1: China vs US: Share of global exports (seasonally adjusted)



Source: Refinitiv Datastream. As of May 2020.

Meanwhile China is one of the world's largest consumer market and a strategically important market to many US multinational corporations. According to McKinsey Global Institute, China's upper aspirant and above population, defined as those having an annual household disposable income of RMB138k (~USD21k) accounted for 49% of the total population in 2018, up from just 8% in 2010.

Although the COVID-19 outbreak has accelerated a rethink of how companies should configure their supply chains, China is still the world's largest manufacturing base. It boasts of competitive labour costs on top of a comprehensive supply chain eco-system. As such, moving supply chains completely out of China will be a costly and time-consuming exercise. Companies are more likely to diversify by having a factory in China and another in a developing country in the Southeast Asia region[1]. Meanwhile, China has been upgrading its manufacturing competencies and moving up the supply chain. Continued US-China tensions would only accelerate this trend.

On the technology front, there appears to be bipartisan support to contain China's ambitions for economic and national security reasons. The current US administration's focus has moved from hardware (e.g. Huawei) to data flow (e.g. TikTok). While some of the punitive actions by the US could hurt China's technological advancement in the near term, it has also led China to place increasing emphasis on domestic substitution, independent innovation as well as accelerate the development of its domestic industries.

With regard to financial decoupling, tighter regulatory scrutiny by the US Securities and Exchange Commission scrutiny on US-listed Chinese companies will likely accelerate the dual-listing trend into the Hong Kong market. In addition, with the recent reforms implemented by both the Hong Kong Stock and onshore exchanges

Source: [10]International Institute for Strategic Studies (IISS). COVID-19: Global trade and supply chains after the pandemic. August 2020.

(STAR & ChiNext), these markets are likely to become more attractive listing destinations for many of China's new economy stocks.

DO YOU SEE US-ASIA TRADE RELATIONS IMPROVING UNDER A BIDEN PRESIDENCY?

John Tsai, Head of Core Equities, Eastspring Singapore: In 2017, President Trump withdrew the United States from the Transpacific Partnership (TPP) that had been ratified by 12 nations in 2016. This was the start of the US disengagement in the Asia-Pacific region, with President Trump's foreign policy focusing on an "America First" vision. Trump's no-show at key Asian summits further reiterated the United States' lack of commitment to the region. Four more years of a Trump presidency will likely see no change in the United States' trade protectionist stance, especially now with the US economic recovery post COVID-19 forecast to be uneven and fragile.

Joe Biden, on the other hand, has traditionally backed free trade agreements and has been a vocal proponent of the TPP. However, it remains doubtful that he will push aggressively to re-join the TPP given that some Democrats see the TPP as giving too much leeway to multinational corporations. In fact, both Trump and Biden want to bring more American manufacturing jobs home. Nonetheless, a Biden presidency will seek to mend frayed relations and to work with the traditional US allies. The US will also likely revert to a more normalised level of commitment to multilateral institutions such as the World Trade Organisation and NATO. This would be welcomed by countries and markets as sign of restoration of the rules-based approach for world trade order.

That said, Asian countries with large working-age populations, attractive demographics, relatively low-cost wage structures (i.e. Cambodia, Myanmar, Laos, Vietnam, Bangladesh, Pakistan, Sri Lanka), and high skill levels and infrastructure capacity would likely emerge as relative winners if supply chains undergo diversification away from China. This has positive implications for foreign direct investment flows, external trade balances, and overall economic growth in these countries.

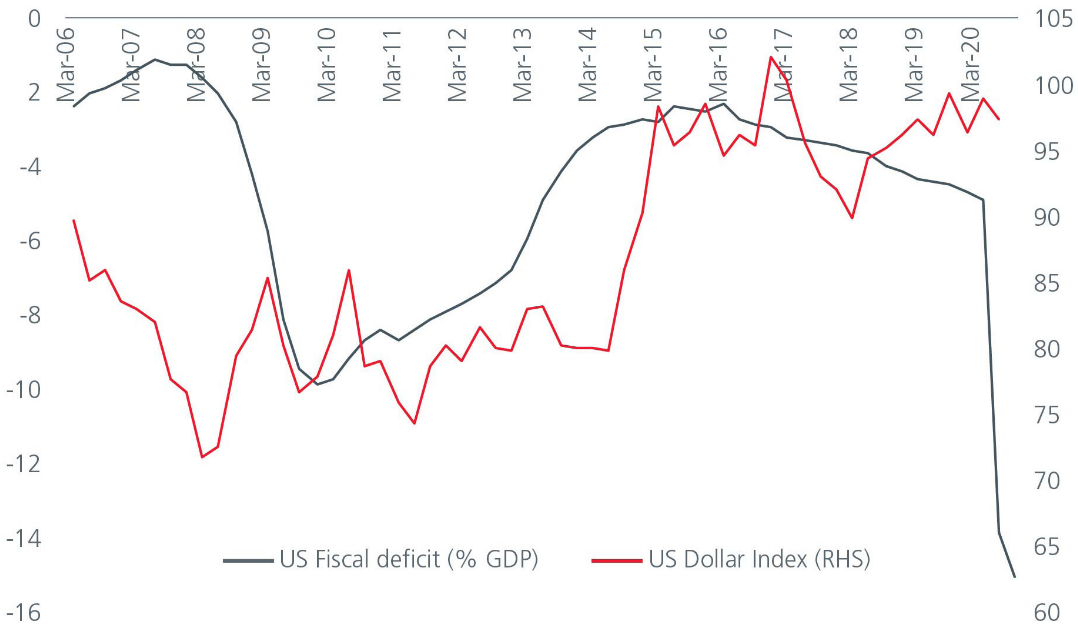
All the same, the trade-off between skill levels and labour costs potentially limits the ability of higher-wage economies to aggressively capitalise on the United States' diversion from China dependency. To avoid punitive tariffs, production of high-end electronics may move to Korea, Taiwan, Japan, and Singapore, while low-end manufacturing diverts to other ASEAN markets. A Biden win will also be good for Japan, Korea, and Taiwan, as a softer approach in dealing with China would reduce the risk of military escalation and lower geopolitical risks in the region.

WHAT WILL BE THE IMPACT OF THE US ELECTIONS ON THE US ECONOMY AND THE USD? AND WHAT DOES THIS MEAN FOR ASIAN CURRENCIES AND BONDS?

Goh Rong Ren, Portfolio Manager, Fixed Income, Eastspring Singapore: The US economy will be a key focus for whoever wins the US elections. The US economy is expected to contract this year by the most since the Great Depression. The unemployment rate reached 8.4% in August – below April's peak of 14.7% but still substantially above pre-COVID-19 levels. In the absence of a vaccine, crippled sectors such as aviation, tourism as well as broad swathes of the services industry are unlikely to recover meaningfully.

US fiscal policy is therefore likely to remain accommodative with the elected president obliged to maintain strong economic support, which potentially includes continued fiscal pay outs to furloughed workers and affected industries. The fiscal policy adopted by the new administration, which in turn affects the trajectory of the fiscal deficit, will impact the longer-term outlook of the USD. The extreme monetary accommodation from the Federal Reserve to date, combined with the massive fiscal stimulus package, have caused the US Dollar index to fall by 2.3% year-to-date.

Fig. 2: US fiscal deficit as % of GDP



Source: Bloomberg, September 2020.

The USD is likely to remain under pressure, given the US' widening current account and fiscal deficits. Fig. 2.

On the margin, we believe that Biden is more likely to set the US' fiscal policy on a more sustainable path. Compared to Trump, he is also likely to embrace a more multilateral approach to trade issues. This can help preserve the USD's coveted reserve currency status.

The new administration's stance towards China will invariably impact investor sentiment towards Asian markets. How the administration prioritises somewhat conflicting goals – containing China's economic and technological ambitions while not hurting global trade or domestic growth – will determine its policy mix. On balance, given that the administration's foremost priority is to get the US economy back on track, we do not expect the new policies to derail the current benign investment environment. As such, we see Asian currencies benefitting amid a weak USD backdrop.

Meanwhile, accommodative monetary policies and aggressive quantitative easing programmes globally will keep liquidity flush. A significant portion of this liquidity is likely to make its way to Asian local markets in search of better yields. This will in turn support Asian currencies and local bonds. Asian central banks have cut policy rates aggressively in response to the pandemic and are committed to keep them low for the foreseeable future to support growth. This should help to anchor Asian bond prices going forward.

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