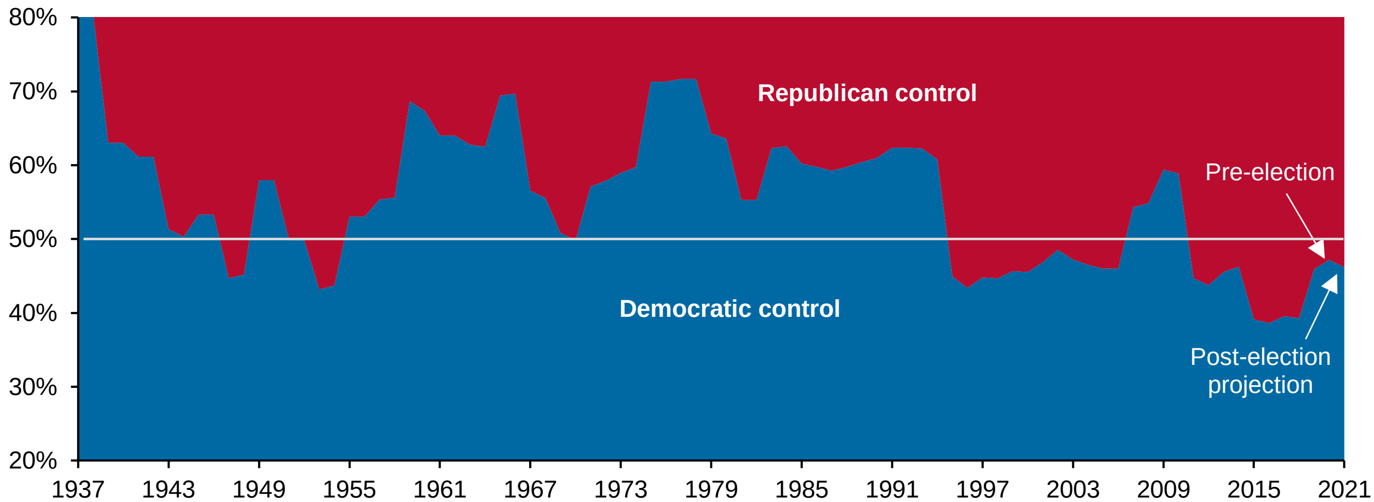
And Quiet Flows the Don[1]: A (possibly) divided government investor playbook, and the Pfizer vaccine news

Well, it happened: absent unexpected reversals from state recounts or from the Courts (see our note on election litigation last Friday), **for the first time in 100 years, a challenger unseated an incumbent President at a time of strong economic and market tailwinds** (see p.5). The rarity of such an outcome tells you how hard this is to accomplish. However, when looking at the full scope of Federal and state results, **the election delivered a clearer referendum on the President himself[2] than on policy issues dividing Democrats and Republicans**. Why is that? The chart below shows partisan control of the Senate, the House, Gubernatorial positions and State-level Senates and Houses (i.e., state legislatures). Forget about a "Blue Wave": according to our Partisan Balance index[3], the Democratic tide actually went *out* a little bit, falling relative to pre-election levels.

The chart illustrates the major party shifts in the 20th and 21st centuries: the decline in the Democratic share from its enormous level during the Great Depression; Eisenhower's popularity in a country not yet ready for Adlai Stevenson's liberalism; the two big post-war Democratic waves during the JFK/LBJ Great Society era and the Nixon impeachment era; the GOP rebound following the Reagan Revolution in the 1980's and Gingrich's "Contract with America" in 1994; the powerful but very temporary Obama wave in 2009; and the anti-Trump reaction during the 2018 midterms.

Blue Wave? At the Federal and State level, the Democratic tide actually went out
Federal/State Partisan Balance Index, 1937-2021
% control of the House, Senate, Governorships, State Senates & State Houses by party



Source: House.gov, Senate.gov, NCSL, Southeast Missouri State University, Ballotpedia, Klarnerpolitics, JPMAM. 2020.

[1] "**And Quiet Flows the Don**" is an epic novel by Mikhail Sholokhov from the early 20th century, describing the lives of self-governing militarized Cossack populations living along the Don River during the Russian Civil War

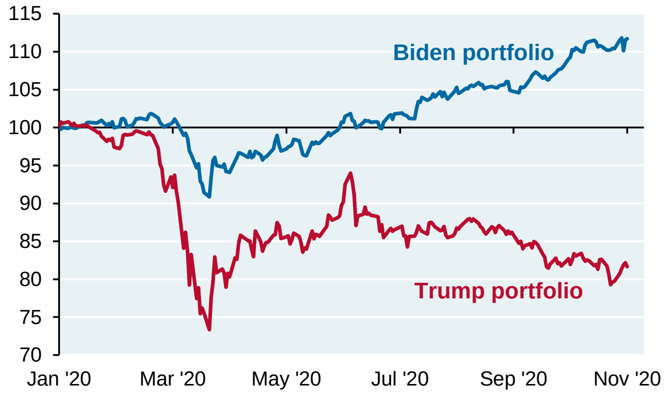
[2] Was the Trump administration an actualization of what might have happened had Louisiana Senator **Huey Long** become President, if he had run against FDR in 1936 and won? Examples: a piece by Adrian Mercer on the LSE American Politics and Policy Blog in April 2018, a piece by Annika Nelson in *The Atlantic* in March 2019 and "*The Demagogue's Playbook*" by Eric Posner at the University of Chicago, which compares Trump to Huey Long, as well as Andrew Jackson, Joseph McCarthy and George Wallace

[3] **Partisan Balance Index** weights: Senate 25%, House 25%, Governorships 25% and State Senates and Houses 12.5% each. We assume that the partisan balance in the Senate is 51-49 in 2021 (i.e., NC/AK Senate seats go to the GOP, and the GOP wins one of the two Senate runoffs in Georgia), and that the balance in the House ends up at 223 DEM, 212 GOP once outstanding House elections are called and all vacancies are filled

As we explained on our webcast last week, a divided government would still give President Biden room to maneuver on energy, immigration, healthcare, trade, net neutrality and antitrust. However, while there might be *some* personal or corporate tax increases tacked onto an infrastructure bill, the huge tax/spending expansion that Biden ran on (see p.5) is probably off the table unless Democrats can pull off both victories in Georgia runoff elections, *and* unless Democrats decide to jettison the Senate filibuster despite not having a majority in the Senate (they would need to rely on VP Harris for tie-breakers). On page 5, we show the **rising use of the Senate filibuster** over the last century by both parties, which may explain the hesitance by some to scrap it.

Since July 2020, markets have been favoring our "Biden portfolio" of stocks and sectors, and punishing the "Trump portfolio". **If divided government becomes a reality, the path forward may benefit a "purple" mix of both.** The sectors we feel strongest about owning: renewable energy, infrastructure stocks, tax cut beneficiary stocks (based on the 2017 tax bill), stocks with high levels of international exposure and banks. The sectors we would still be cautious about: China trade war stocks, and large cap pharma. Neutral: the Big 4 antitrust targets.

Biden vs Trump portfolio performance
Jan 2020 = 100



Biden portfolio
Long: Renewable energy; infrastructure (construction & engineering, industrial machinery); China trade war stocks; companies with high international sales exposure; healthcare equipment and supplies
Short: Large cap pharma; labor intensive stocks (UPS, MCD, UBER, WMT, SBUX) sensitive to minimum wage increases; antitrust targets (FB, AAPL, AMZN, GOOGL); diversified banks

Trump portfolio
Long: Largest tax cut beneficiaries; oil and gas; aerospace and defense; healthcare; diversified banks
Short: China trade war stocks

Source: Bloomberg, Barclays Research, JPMAM. November 06, 2020.

Renewable energy: no Green New Deal, but the President can still increase the cost of capital on oil & gas by disallowing further LNG export permits, tightening fracking/methane rules (particularly on public lands), increasing climate risk disclosure requirements and reinstating automobile mileage standards which Trump softened last spring. Biden can also try to boost penetration of grid renewables through subsidies and Federal eminent domain decisions on HVDC transmission infrastructure for wind/solar projects. Remember as well that US states set their own renewable portfolio standards, they are not set at the national level

Infrastructure: if there's one point of agreement between both parties, it's the need for reinvestment in dilapidated US transportation, maritime and aerospace infrastructure; modest bipartisan bill possible in 2021

China trade war: Biden is likely to go *very* slow here, and is unlikely to remove Trump tariffs in his first 18 months, particularly since China is only 25%-45% compliant with Phase I trade deal purchases from the US. Anti-China policies are now firmly bipartisan, albeit for a mix of reasons (mercantilism and human rights). Rules requiring Chinese companies to delist from US exchanges for disclosure shortfalls will probably move forward, and Biden may be reluctant to remove any Chinese firms from the Commerce Department "Bad Actor" entity list (such firms are ineligible to purchase US exports, directly or through intermediaries. Note: Trump's tariffs raised import prices on US firms and consumers but didn't make money for the US government, since almost the entire tariff increase has been used to pay US farmers (as per Benn Steil at CFR)

Companies with high international sales exposure and companies that benefited from the 2017 tax cuts: more stimulus should boost the global economy in 2021, and a substantial US corporate tax hike is unlikely

Large cap pharma: bipartisan prescription drug bill is possible, and the Executive Branch can also implement demonstration projects that bring Medicare Part D drug prices down to international levels

Antitrust targets (FB, AAPL, AMZN, GOOGL): the most punitive outcomes are probably off the table (i.e., those in the October House Judiciary report: "Glass-Steagall" legislation for tech, rules to prevent discrimination and self-preferencing, merger prohibition, prohibition on abuse of bargaining power, strengthening antitrust law). Even so, there's still the Justice Dep't case against Google, and a possible one pending vs Facebook

Where to from here, for investors?

A client once asked me to compute the table below, which shows equity market returns broken down by Presidential and Congressional party permutation since 1945. The highest returns occurred during "gridlock" periods with a Democratic President, **but I don't think we should pay too much attention to these results**. The sample sizes are very small, and the return differences largely reflect when recessions occurred and how the Fed reacted to them. Unless you think Presidents and Congress can cause recessions, and/or that they should get the credit for inheriting a recovery, these equity market returns by party affiliation are largely random.

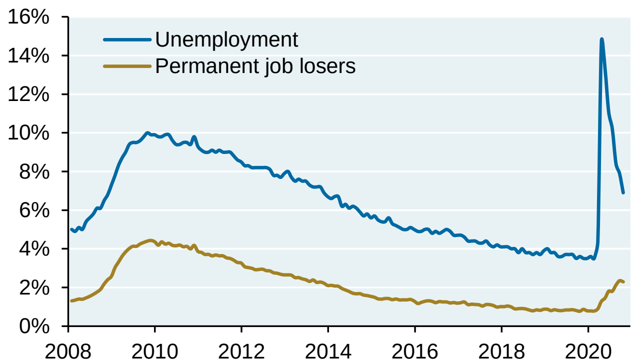
Instead, let's look at the business cycle: the US and Europe are in a race against time. US employment is improving: roughly half the increase in unemployment is permanent, but the other half is temporary. As the global recovery continues, we expect US unemployment of ~5% by the end of 2021. Another important sign: the number of unemployed people and job seekers relative to job openings is *much* lower than in prior recessions. That's a sign that when/if COVID is conquered, there could be a strong and rapid further recovery in employment and wages. **Based on the explosion of monetary and fiscal stimulus unleashed on the world in 2020 (see p.5), we expect the current recovery to continue into 2021**.

S&P 500 returns during periods of US political unity & gridlock, 1945-2020

Political scenarios	Total return	# years
Unified government	**13.8%**	**30**
Democratic president	13.1%	22
Republican president	15.6%	8
Unified congress	**9.8%**	**32**
Democratic president	16.4%	10
Republican president	6.9%	22
Split congress	**10.5%**	**14**
Democratic president	16.7%	4
Republican president	8.1%	10
All years	**11.5%**	**76**

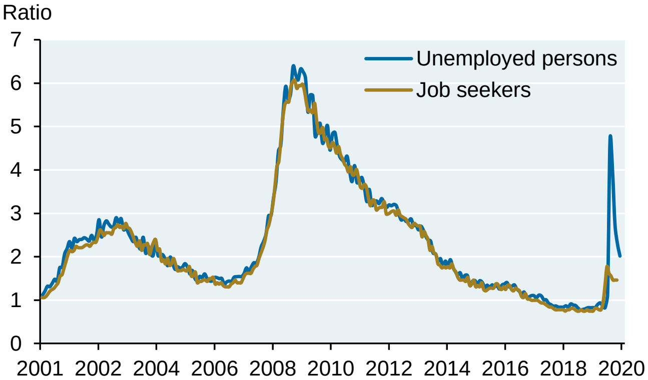
Source: House.gov, Senate.gov, Southeast Missouri St Univ, Bloomberg. November 2020. Returns start in November of the election year.

Unemployment rate vs permanent job losers
% of civilian labor force



Source: BLS. October 2020.

Unemployed people and job seekers per job opening
Ratio



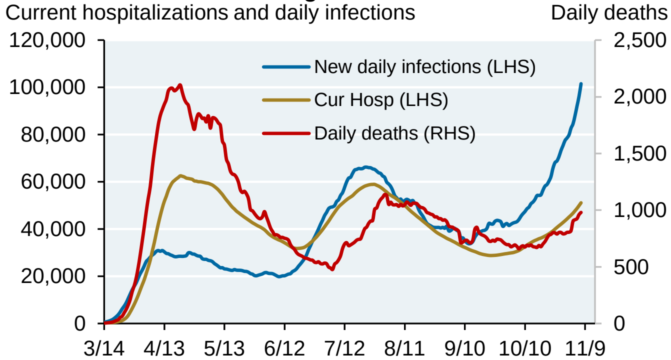
Source: BLS, GS. October 2020.

However, the race against time is getting short: COVID infections, hospitalizations and deaths are rising again. This increases chances of lockdowns (which could jeopardize the employment and spending recovery), and highlights the importance of **vaccine APPROVAL, DISTRIBUTION and ACCEPTANCE**, three distinct hurdles to overcome on the road to herd immunity.

Pfizer reported 90% efficacy from its mRNA vaccine Phase III trials this morning (which my COVID science advisory group has not had time to fully dissect yet). That addresses the first hurdle, which is obviously a critical one; Pfizer expects to have Emergency Use Authorization by late November. Pfizer's earlier Phase II results were similar to those reported by Oxford and Moderna, boding well for the possibility of additional vaccine approvals in the months ahead.

That leaves **distribution**, which is no small feat given the need for millions of vaccinations, cold storage at negative 94˚F/-70˚C (!!) and a booster shot 21 days later, and then **acceptance**. A September 2020 Pew Research poll found that only 51% of US respondents would get a COVID vaccine, while another September poll from USA Today found that only 27% of respondents would get a vaccine as soon as it became available. The US ranks in the lower third globally on the issue of vaccine acceptance and trust in science, as we have discussed in prior notes. **Greater adherence to scientific principles in Washington can only help**, as could a decision by Trump not to fire Dr. Fauci, who has served in his NIAID role since 1984. And on **herd immunity**, don't hold your breath: as shown below, most US states are a still long, long way off.

United States virus tracking
Current hospitalizations and daily infections

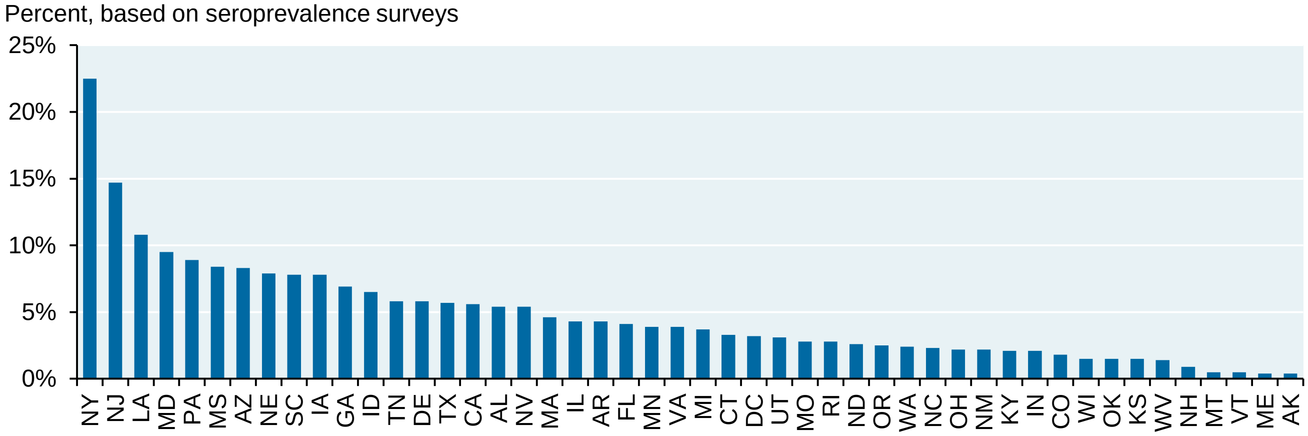


Source: COVID Tracking Project, JPMAM. 11/7/2020. 7 day avgs.

CDC Vaccine Priority Groups

1. **Healthcare personnel (~17-20mm):** Includes workers in hospitals, long-term care facilities, outpatient, home health care, pharmacies, EMS and public health
2. **Essential workers (~60-80mm):** Includes workers in food & agriculture, transportation, education, energy, water/wastewater and police/fire
3. **Adults ≥ 65 years old (~53mm):** Represents 16% of population; ~3mm live in long-term care facilities
4. **High risk medical conditions (>100mm):** Examples include obesity, diabetes, chronic obstructive pulmonary disease (COPD), heart conditions, chronic kidney disease
5. **Everyone else (around 50% of the population)**

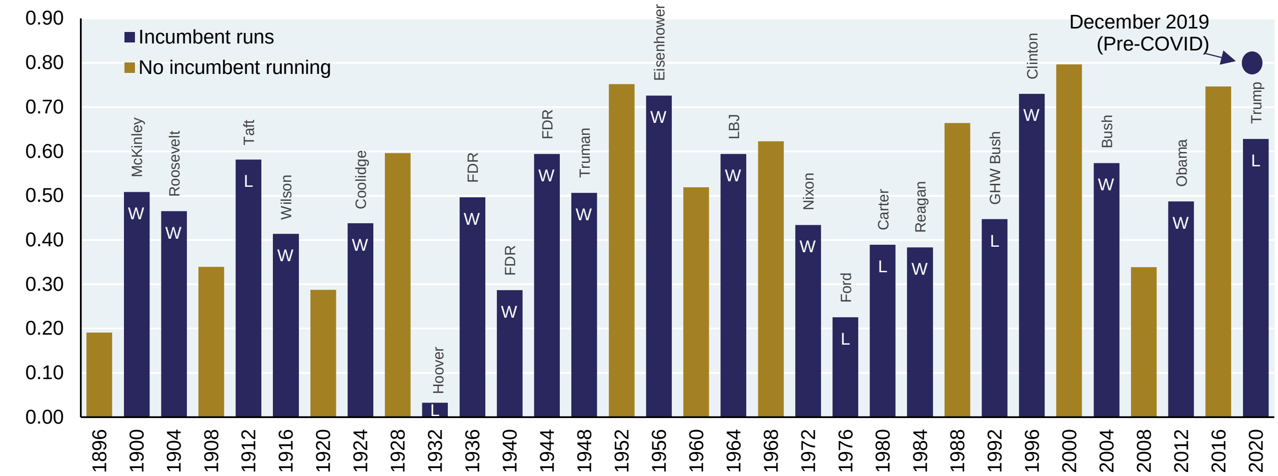
Estimated COVID prevalence by state as of early August 2020
Percent, based on seroprevalence surveys



Source: CDC Nationwide Commercial Laboratory Seroprevalence Survey. August 1, 2020. *No seroprevalence data for HI, SD and WY.

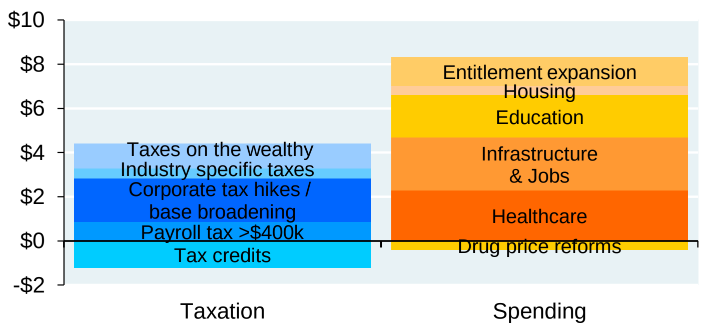
Appendix charts: Presidential tailwind tracker, Biden's proposed tax/spending agenda, the monetary/fiscal stimulus explosion in the wake of COVID, and the rising frequency of filibusters in the Senate

For the first time in 100 years, an incumbent with strong tailwinds lost the Presidency
Market/economic conditions at each election, derived from inflation, equities, employment, home prices and per capita GDP (higher score = more favorable conditions)



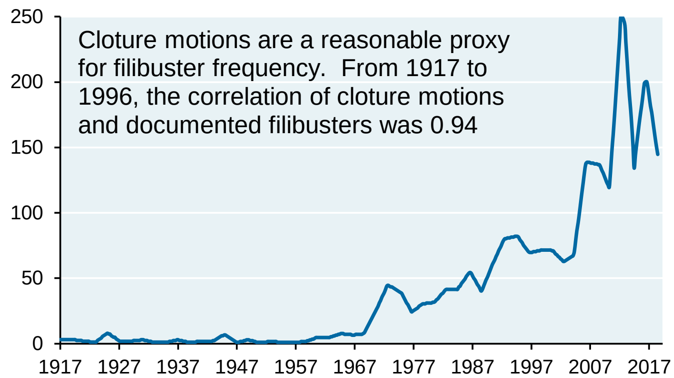
Sources: Home prices (S&P/Core Logic/Shiller/BLS); consumer and producer prices (BLS); US large cap equity returns and volatility (Shiller/Bloomberg); unemployment levels and changes (BLS, C. Romer/UC Berkeley); US per capita GDP vs G10 (Conference Board, Maddison/University of Groningen); JPMAM, 2020. Inflation percentiles based on deviation from target 2% level.

Biden Agenda: $3 trillion in taxes, $8 trillion in spending
$, trillions over 10 years



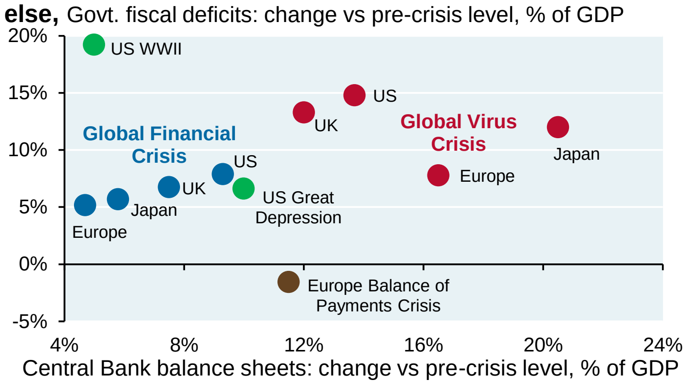
Source: Cornerstone, Tax Policy Center, Tax Foundation, U. Pennsylvania, JPMAM. October 2020. Tax credits: for homebuyers, renters, caregivers, IRA savers and reshoring manufacturers.

Cloture motions filed (motions to end debate)
Number of cloture motions filed, 65th Congress - 116th Congress



Source: Brookings Institution, Washington Post. 2020.

Debt monetization response to GVC eclipses everything else, Govt. fiscal deficits: change vs pre-crisis level, % of GDP



Source: Central bank sources, OMB, St Louis Fed, JPM Global Economic Research. JPMAM. 2020. GVC = Global Virus Crisis.