

Investment Event

Democrats set to control US Senate

The US Democratic Party is set to win two seats in a Senate run-off election in Georgia

If victory is confirmed, President-elect Biden would have more scope to enact his fiscal and regulatory agenda

However, Biden would still face constraints, including resistance in the Senate and the US Supreme Court

Our views

While we retain a constructive long-term stance on US and global equities, the prospect of higher bond yields poses a risk to valuations

Further US fiscal and monetary policy support creates an environment for US dollar weakness, benefitting non-US equities

We continue to favour US Treasuries over other government bonds



The US Democratic Party on course to win Senate elections

In the US, the Democratic Party is set to win two Senate seats contested in a run-off election in Georgia to take control of the US Senate. At the time of writing, Democratic candidate Raphael Warnock has defeated incumbent Republican Senator Kelly Loeffler. Vote counting is ongoing in the race between Democrat Jon Ossoff and Republican David Perdue; the candidates are near-tied but the remaining count covers mostly Democratic counties.

The result means the number of senators who typically vote with the Democrats will rise to 50, tied with the Republicans. In such a scenario, the Vice President casts a deciding vote, giving the Democrats a majority in the Senate when President-elect Biden takes office on 20 January.

The Senate is an important arm of Congress – the legislative branch of US government – along with the House of Representatives, in which the Democrats already have a majority. If the Democrats take both seats, President-elect Biden would have more scope to enact his fiscal and regulatory agenda. However, it is important to note that he will still face constraints; Biden could still face resistance in the Senate as well as from the US Supreme Court.

Fewer constraints on fiscal policy

A Democratic-controlled Congress substantially reduces risk of policy under-delivery if further fiscal aid is needed to support demand during the Covid-19 pandemic. While lawmakers agreed a sizeable USD900 billion (4% of GDP) fiscal deal on a bipartisan basis in December, there was extended wrangling between the parties leading to delay.

Additional relief measures – particularly a boost to cash payments to households – could now follow, increasing already elevated household savings and pent-up demand. Spending in areas such as national infrastructure, where there is cross-party and bipartisan support, is also likely. This additional policy support is expected to expedite the US economic recovery if Covid-19 restrictions are lifted following successful virus control and vaccine rollout.

However, beyond these measures, we do not expect further substantial easing of fiscal policy. During 2020, House Democrats passed extensive fiscal proposals ranging between USD2.2 trillion-USD3.2 trillion. These proposals – as well as measures to sharply increase corporate and personal wealth taxes – are unlikely to find support among conservative Democratic senators.

Greater enforcement of regulations

A Democratic-controlled Senate also supports moderate parts of Biden's regulatory agenda. Appointments to Biden's executive administration are more likely to be approved, which means the government will be better able to implement and enforce existing regulations.

The Biden Administration could use the broad scope of the 1963 Clean Air Act to tighten environmental rules, the 2010 Dodd-Frank Act to regulate banks, and the 1890 Sherman Antitrust Act to limit concentration of corporate power. However, the government may face legal challenges from a conservative Supreme Court regarding regulatory overreach.

Furthermore, new regulations covering other parts of Biden's agenda (such as strong rises in the minimum wage and healthcare reform) are not expected to come into law, as – unlike fiscal measures – they are likely to require a minimum of 60 votes to pass in the Senate.

Investment implications

A strong US economic recovery is likely to lead to higher Treasury yields. Although we expect the Federal Reserve to maintain low long-term interest rates, the potential for higher yields creates a risk to equity market valuations. Other downside risks such as delayed vaccine rollout and the impact of Covid-19 mutations on virus control must also be closely watched.

Nevertheless, further fiscal stimulus – if delivered – would strengthen the US economic recovery and support domestically generated profits. As we outlined in our 2021 outlook – *The Restoration Economy*, we think it makes sense to stay selectively constructive US equities in the long-term to benefit from the recovery, while keeping a close eye on risks and maintaining realistic return expectations. Elsewhere, strong US fiscal and monetary policy supports an environment of a weaker US dollar, benefitting non-US equities including emerging markets.

Lastly, although we remain underweight US Treasuries, higher bond risk premiums and improved valuations in this asset class lead us to favour it over other government bonds.

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