ElectionWatch

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Chief Investment Office GWM
Investment Research

Looking ahead to the 2020 US elections

2020 election coverage online

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Implications of impeachment

After weeks of partisan bickering, the US House of Representatives passed a resolution on 31 October directing its committees to continue their investigations into whether sufficient grounds exist to proceed with a formal vote to impeach the president. The vote on the floor of the House last week formalized a process already underway, foreshadowing another six weeks of public hearings and intensive media coverage. The vote was taken generally along party lines, with two Democrats joining their GOP colleagues to reject the resolution and an independent member voting in favor of proceeding with the inquiry.

The US Constitution specifies treason, bribery and other "high crimes and misdemeanors" as impeachable offenses. The first two transgressions are easily defined but the latter two violations of the public trust are more ambiguous. There is ample historical evidence to suggest that impeachable conduct is not limited to criminal behavior. Gerald Ford may have voiced the most succinct definition. As House Minority Leader in 1970, he declared that an "impeachable offense is whatever a majority of the House of Representative considers it to be at a given moment in history." The House has impeached 19 individuals holding federal office in the past 230 years. Fifteen were federal judges accused of bribery, perjury, or abuse of power. Only two presidents have suffered the same fate, and both were acquitted by the Senate.

In this edition of *ElectionWatch*, we examine the implications of impeachment on market behavior. We examine three prior instances when a president was either impeached or on the cusp of suffering that fate. In the two most recent examples, geopolitical events and financial crises were unfolding rapidly. In their wake, the US economy deteriorated in the first instance but rebounded strongly in the second, which may have contributed to the political outcomes.

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Is impeachment a market risk?

The US Constitution was written and ratified during an era of profound distrust of unfettered executive power. After a successful revolution against colonial rule, delegates to the Philadelphia Convention in 1787 were reluctant to concentrate political influence in a single office. The framers of the constitution initially favored the creation of a weak presidency and a more powerful bicameral legislature[1]. Endowing the presidency with greater discretion to manage foreign relations was accomplished only after extended debate. And yet, entrenched skepticism regarding vesting too much influence in a single executive persisted.

Proponents of the new Constitution, led by Alexander Hamilton, argued that unbridled executive power would be constrained for two reasons. First, a president would need to seek reelection every four years, thereby subjecting the individual to renewed scrutiny. Second, any violation of the public trust would expose a president to a bill of indictment by the House of Representatives and a trial in the Senate[2]. Conviction would result in summary dismissal from office. With these arguments, Hamilton prevailed upon other delegates to accept a powerful presidency despite their misgivings. So it should come as little surprise that the US Constitution sets forth procedures for the removal of a president for "high crimes and misdemeanors"[3]. Article I describes the authority of the House of Representatives to impeach a president, followed by a trial in the Senate.

Article I, Section 2

The House of Representatives shall chuse (sic) their Speaker and other Officers, and shall have the sole Power of Impeachment.

Constitution of the United States

Article I, Section 3

The Senate shall have the sole Power to try all Impeachments … And no Person shall be convicted without the Concurrence of two thirds of the Members present.

Constitution of the United States

The framers might have been genuinely surprised by how infrequently the power to impeach a president has been exercised. We have had only two such trials for presidential misconduct in the past 150 years. President Andrew Johnson was impeached in 1868 for violating the Tenure in Office Act, a statute that was subsequently deemed unconstitutional. He was acquitted in the Senate by a single vote. More than a century later, President Bill Clinton was impeached for lying under oath and obstruction of justice. He was acquitted on both charges after senators voted to reject the indictment presented by the House[4]. A third impeachment was avoided when Richard Nixon chose to resign his office before the House adopted articles of impeachment for presentation to the Senate.

Which brings us to present day

The prospect of impeaching President Donald Trump in advance of the next election has generated passionate public debate and partisan rancor on Capitol Hill. The political tumult was foreseen by Hamilton, who predicted that impeachment trials would "seldom fail to agitate the passions of the whole community, and to divide it into parties more or less friendly or inimical to the accused"[5].

The two most recent impeachment inquiries occurred after Presidents Nixon and Clinton had been reelected, making them lame ducks in office and ineligible for a third term. The hearings now underway, by contrast, are taking place in the context of a heated presidential election campaign. If an indictment is passed by the House, which now appears likely, the Senate trial could occur in early 2020. The timing is awkward for the five senators still seeking the Democratic nomination, all of whom may be forced to suspend personal appearances on the campaign trail to serve as jurors.

The division of powers related to impeachment between the two branches of the legislature, assigning to one the right of accusing, to the other the right of judging, avoids the inconvenience of making the same persons both accusers and judges and guards against the danger of persecution.

Alexander Hamilton

Paradoxically, an impeachment may encourage the leadership in both political parties to hold votes on other legislation, if only to demonstrate that Congress is able to function amidst the resulting acrimony. Our colleagues in the UBS US Office of Public Policy believe a vote on the

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US-Mexico-Canada free trade agreement will occur before year-end[6]. To the extent it passes, President Trump will claim an important legislative victory and House Speaker Nancy Pelosi will be better positioned to reject criticism that her caucus has been focused solely on removing the president from office.

Market implications

Impeachment inquiries are rare events in US history so any analysis of their market impact must be accompanied by a disclaimer that an indictment of a sitting president is, by its very nature, an idiosyncratic event. While there is no shortage of inflammatory headlines warning investors that an impeachment trial will trigger market turmoil, history suggests that other factors play a more prominent role in investor behavior. Notwithstanding President Trump's warning that "the markets would crash" if he were impeached, we are inclined to believe that global markets are more concerned with trade disputes, geopolitical tension in the Middle East, and decelerating economic growth[7].

The impeachment of Andrew Johnson provides us with little guidance because the US equity and fixed income markets have evolved dramatically since the middle of the nineteenth century. The entire episode was also blessedly brief. The House commenced its inquiry on 24 February and impeached the president on 2 March 1868. He was acquitted by the Senate of both charges by 26 May. The US equity and bond markets outperformed their UK counterparts for the first half of that year[8].

The impeachment inquiries undertaken by the House of Representatives in 1973-74 provide more precise market data. Equities plunged in value from January 1973 through early December 1974, with the S&P index down by 45% over a two-year period[9]. And while Congressional hearings may have played a small part in the decline, they constituted noise surrounding more fundamental challenges. An Arab oil embargo, military conflicts in the Middle East, a spike in inflation, devaluation of the US dollar, and the imposition of wage and price controls were more important contributors. It's also worth noting that patient investors recouped their losses in subsequent years; the Dow Jones Industrial average rose 38% in 1975.

The impeachment and subsequent trial of President Clinton played out in similar fashion, with financial markets distracted by other developments. Clinton's admission that he had an inappropriate and wrong relationship with a White House intern coincided with a decision by Russia to devalue the ruble and impose a moratorium on the payment of foreign debt. The subsequent failure of a prominent hedge fund, Long Term Capital Management, threatened to destabilize financial markets and precipitated a rescue by a consortium of major US financial institutions. The accompanying market volatility was short-lived. The S&P 500 rose by more than 28% from the commencement of the impeachment inquiry to Clinton's acquittal by the Senate[10]. The index continued to rise thereafter as investors gravitated toward tech stocks at the turn of the millennium.

Conclusion

There is insufficient evidence to conclude that impeachments alone dictate the performance of either equities or bonds. In two previous instances where the House of Representatives commenced an impeachment inquiry, other factors played more decisive roles in driving market returns. In the first, an impending impeachment played out against a background of adverse geopolitical and economic developments. In the second, the impeachment and trial were accompanied by two shocks to the global financial system, but the equity markets shrugged off both and rallied on economic optimism.

We believe investors are well-advised to avoid trading on news items related to the impeachment inquiry. Occasional market volatility is unavoidable but longer-term performance will be determined by strategic asset allocations in a diversified portfolio. US economic growth is decelerating as we enter the late stage of the normal business cycle. While it's difficult to predict how long this stage will last, the Fed appears willing to adopt looser monetary policy to avoid an imminent recession. Positive returns are still possible, provided investors are willing to exhibit patience, commit capital for the long-term, and accept the inevitability of short-term volatility.

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Takeaways from the CIO Global Forum

Pictured from left to right: Mike Ryan, Chief Investment Officer Americas, UBS Global Wealth Management; Elliot Hentov, Ph.D., Head of Policy Research, State Street Global Advisors; Admiral Jonathan Greenert, Former Chief of Naval Operations, United States Navy; Andy Blocker, Head of US Government Affairs, Invesco; John Savercool, Head of US Public Policy, UBS Americas Inc.

We recently hosted our initial 2019 CIO Global Forum in Los Angeles. The theme of this year's event was *Risk: From chance to choice*, and panelists throughout the day discussed how to better understand and manage risk across politics, geopolitics, markets, the economy, business, technology, and the environment. Below we highlight insights from our first panel on politics and geopolitics.

What is the risk of impeachment? What does impeachment mean for markets and investors?

On the question of impeachment, our panelists agreed that there is a real risk of impeachment but that its impact on markets would likely be minimal even though it could serve as a real distraction for the government.

John Savercool: The risk of impeachment is very real and it's clear that it will happen. People shouldn't mistake impeachment for removal from office. But I think the impeachment process in the House is certainly going to happen. It should happen by the end of the year.

Admiral Jonathan Greenert: The impeachment is totally distracting. If I'm analyzing the market impact, I would look at what else should be happening and isn't happening due to the distraction, and what are the repercussions of that?

Who do you think will win the 2020 US presidential election and what can we expect from Congress?

When asked about the election outcome, our panelists were in a general consensus that it is the incumbent's election to lose but maintain it's too early to predict who will rise from the Democratic party to oppose President Trump.

John Savercool: I think Democratic voters are looking for something that Republicans were looking for in 2016, someone who really wants to shake Washington up, like Warren or Sanders. But, overall, Trump is probably the favorite to win the election unless the impeachment further personally damages him.

John Savercool: If a Democrat wins the presidency then the Senate will likely flip, but probably by a narrow margin. That begs the question, would there be enough support in the Senate to pass all these ambitious bills we're seeing Democrats debating? You need 60 votes to pass major tax legislation. What wouldn't require 60 votes would be regulatory reform, which could undo changes from Trump that really reversed the Obama regulatory agenda. So you could see new regulations or old regulations re-imposed.

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Which specific policy areas should we be paying attention to ahead of the election?

Panelists agreed that tax policy changes could be the most impactful policy on markets and listed other key areas to focus on such as trade and immigration.

Elliot Hentov: Under the current administration, we had a redistribution of wealth from government balance sheets to corporate balance sheets; that's been a great tailwind for equities broadly. I think the way you have to think about a potential Warren presidency is you'll have a wealth transfer not from government to corporates, but this time from corporate balance sheets to household balance sheets. And that's very mixed. Within equities, you'd have to be much more selective.

Andy Blocker: With respect to China and Donald Trump's approach—we can see the impact that's had so far. But if you think about Bernie Sanders and Elizabeth Warren—you talk about the political spectrum being a circle, the far right and the far left actually coming back together, I think you have the same baseline with Bernie Sanders and Elizabeth Warren.

What geopolitical risks are most impactful and what are people missing?

Panelists agreed with a majority of risks also expressed by our audience members—Trump, China, Russia, Iran, trade, impeachment, elections—but pointed out deeper issues that may underpin what we're seeing.

Admiral Jonathan Greenert: Our nation since World War II has been the global leader in just about everything. A lot of issues that create risk come from the willingness or non-willingness of the US to be the one out in front. Our position around world security hasn't changed much, but what we say and how we go about what we're going to do tends to confuse people.

Elliot Hentov: The issues we're facing are systemically about de-globalization, whether it's about China, trade, or Trump. It's about the system as we know it falling apart and de-globalizing.

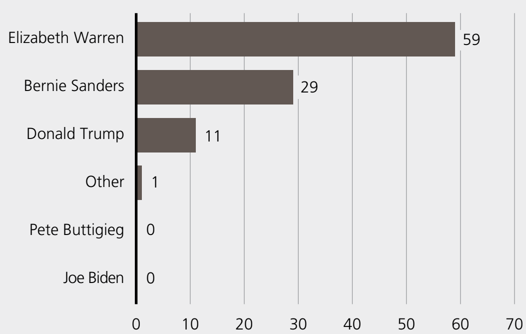
Andy Blocker: Populism is what is underlying a lot of the developments we're seeing. And populism is growing throughout the world —not just in the United States —and is impacting politics and ultimately policy.

What did our audience think?

During the panel we asked our audience for their thoughts on various election-related topics. Below is a sample of their views (in %):

Figure 1

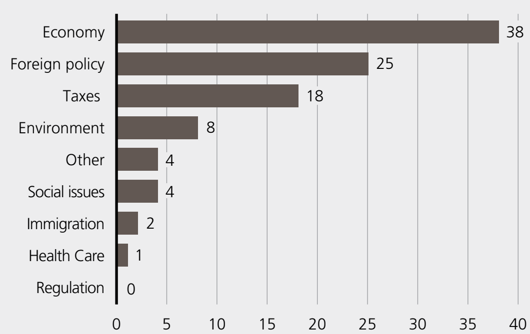
Which presidential candidate's policy agenda do you believe presents the greatest risk to financial markets?



Source: UBS

Figure 2

What is the most important issue to you in this election?



Source: UBS

Timeline of key events

2019

26-27 June	First Democratic debates (Miami)	✓
30-31 July	Second Democratic debates (Detroit)	✓
12 September	Third Democratic debate (Houston)	✓
15-16 October	Fourth Democratic debate (Westerville, Ohio)	✓
20 November	Fifth Democratic debate (Atlanta)	
19 December	Sixth Democratic debate (Los Angeles)	

2020

TBD January/ February	Seventh, eighth, ninth, and tenth Democratic debates
3 February	Iowa caucuses (Democratic and Republican)
11 February	New Hampshire primaries (Democratic and Republican)
22 February	Nevada caucus (Democratic)
29 February	South Carolina primary (Democratic)
TBD March	Eleventh Democratic debates
3 March	Super Tuesday (Alabama, Arkansas, California, Colorado, Maine, Massachusetts, Minnesota, North Carolina, Oklahoma, Tennessee, Texas, Utah, Vermont, and Virginia primaries [Democratic and Republican]; Democrats Abroad preference vote through 10 March)
8 March	Puerto Rico primary (Republican)
10 March	Hawaii caucus (Republican); Idaho, Michigan, Mississippi, Missouri, and Washington primaries (Democratic and Republican); North Dakota firehouse caucus/primary (Democratic)
17 March	Arizona primary (Democratic); Florida, Illinois, and Ohio primaries (Democratic and Republican)
21 March	Kentucky caucus (Republican)
24 March	Georgia primaries (Democratic and Republican)
29 March	Puerto Rico primary (Democratic)
TBD April	Twelfth and final Democratic debates
4 April	Alaska and Hawaii primaries (Democratic); Wyoming caucus (Democratic); Louisiana primary (Democratic and Republican)
7 April	Wisconsin primaries (Democratic and Republican)
28 April	Connecticut, Delaware, Maryland, New York, Pennsylvania, and Rhode Island primaries (Democratic and Republican)
2 May	Kansas primary (Democratic)
5 May	Indiana primaries (Democratic and Republican)
12 May	Nebraska and West Virginia primaries (Democratic and Republican)
19 May	Kentucky primary (Democratic); Oregon primaries (Democratic and Republican)
2 June	District of Columbia primary (Democratic); Montana, New Jersey, New Mexico, and South Dakota primaries (Democratic and Republican)
13-16 July	2020 Democratic National Convention (Milwaukee, Wisconsin)
24-27 August	2020 Republican National Convention (Charlotte, North Carolina)
29 September	Presidential debates (South Bend, Indiana)
7 October	Vice Presidential debate (Salt Lake City, Utah)
15 October	Presidential debates (Ann Arbor, Michigan)
3 November	Election Day

2021

5 January	Electoral votes formally counted before a joint session of Congress; the President of the Senate formally announces the electoral result
20 January	Inauguration Day

Source: UBS

Is a wealth tax possible?

Senators Elizabeth Warren and Bernie Sanders, two of the top contenders for the Democratic presidential nomination, propose to implement wealth taxes that would apply to the country's richest households. The goal would be to raise revenue to fund new government programs while also reducing wealth inequality, which has reached extremes not seen since the 1920's.

Under Warren's proposal, wealth above USD 50mn would be taxed 2% annually, with the rate rising to 3% for wealth above USD 1bn. Warren cites a study of her plan that estimates that it would raise USD 2.75tr over 10 years. The top rate could also rise further to 6% under her Medicare For All plan. Sanders' proposal goes even further, with a tax rate of up to 8%, raising USD 4.35tr.

Another candidate who has proposed a wealth tax may come as more of a surprise: President Donald Trump. Back in 1999, Trump proposed a one-time "net worth tax" of 14.25% on fortunes above USD 10mn, with the aim of raising enough revenue to pay off the entire US national debt. He further proposed to use the money saved on interest payments on the debt to shore up the Social Security trust fund and implement middle class tax cuts.

Experience with wealth taxes in other countries shows that they are difficult to administrate and usually raise less revenue than expected. Wealth taxes encourage capital flight; it also may be difficult to assess the value of an asset, such as a privately held business, until it is sold. Back in 1990, there were 12 OECD countries using wealth taxes, but this had dropped to four by 2017.

In our view, rather than introduce a new kind of tax, it would be more politically expedient to make adjustments to the existing tax system. For example, the estate tax, which goes back to the 18th century, has been changed many times throughout history, most recently by the Tax Cuts and Jobs Act of 2017. Reducing the size of the exemption and/or raising the estate tax rate would generate more revenue based on wealth. A progressive personal income tax system and an increase in capital-based income taxes (especially capital gains) also would reduce wealth inequality over time.

Finally, stricter enforcement of existing tax laws and working with other countries to make it more difficult for multinational corporations to avoid taxes could potentially raise as much revenue as the candidates' wealth tax proposals without having to pass a controversial new tax through Congress.

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CIO Global Wealth Management
1285 Avenue of the Americas, 20th Floor
New York, NY 10019

Authors
Mike Ryan
Tom McLoughlin
Brian Rose

Contributors outside CIO
John Savercool
Shane Lieberman

Editor
Kate Hazelwood

Project management
John Collura
Paul Leeming
Matt Siegel
Simran Chahal

Report design
Cheryl Seligman

Graphics support
Cognizant Group
Basavaraj Gudihal
Pavan Mekala
Virender Negi

Endnotes

[1]Office of the Historian, Constitutional Convention and Ratification, 1787-1789.
[2]Alexander Hamilton, Federalist Paper No. 65, 7 March 1788, "The subjects of its jurisdiction are those offenses which proceed from the misconduct of public men, or, in other words, from the abuse and violation of some public trust."
[3]Representative Gerald Ford, as minority leader of the House of Representatives in April 1970, stated that an impeachable offense is "whatever the majority of the House of Representatives considers it to be at a given moment in history." See Kenneth C. Davis, *The History of American Impeachment*, Smithsonian Magazine, 12 June 2017.
[4]President Clinton was acquitted of the perjury charge when 55 senators voted for acquittal. The obstruction of justice charge also failed on a 50-50 tie vote, well short of the two-thirds majority required for conviction.
[5]Alexander Hamilton, Federalist Paper No. 65, 7 March 1788.
[6]UBS US Office of Public Policy, Washington Weekly, 25 October 2019.
[7]Caitlin Webber, *Trump warns of market crash in flurry of anti-impeachment tweets*, Bloomberg, 26 September 2019.
[8]Craig Botham, "The impact of presidential impeachment on markets", Schroders Capital Management, June 2017.
[9]Craig Botham, "The impact of presidential impeachment on markets", Schroders Capital Management, June 2017. See also Howard Gold, "History shows presidential impeachment usually doesn't move the stock market", 25 September 2019.
[10]Ben Winck, *The stock market's performance during the last US impeachment inquiry suggests investor fears may be overblown*, Market Insider, 25 September 2019.

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