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## If stimulus and higher taxes are ahead, it could be time to rotate

◆ As the probability of a Democratic sweep increases, investors are starting to price in much more stimulus.

◆ The prospects of that, and of higher taxes, favour some sectors over others.

◆ Technology, the best-performing sector so far this year, could see lower earnings if corporate taxes rise.

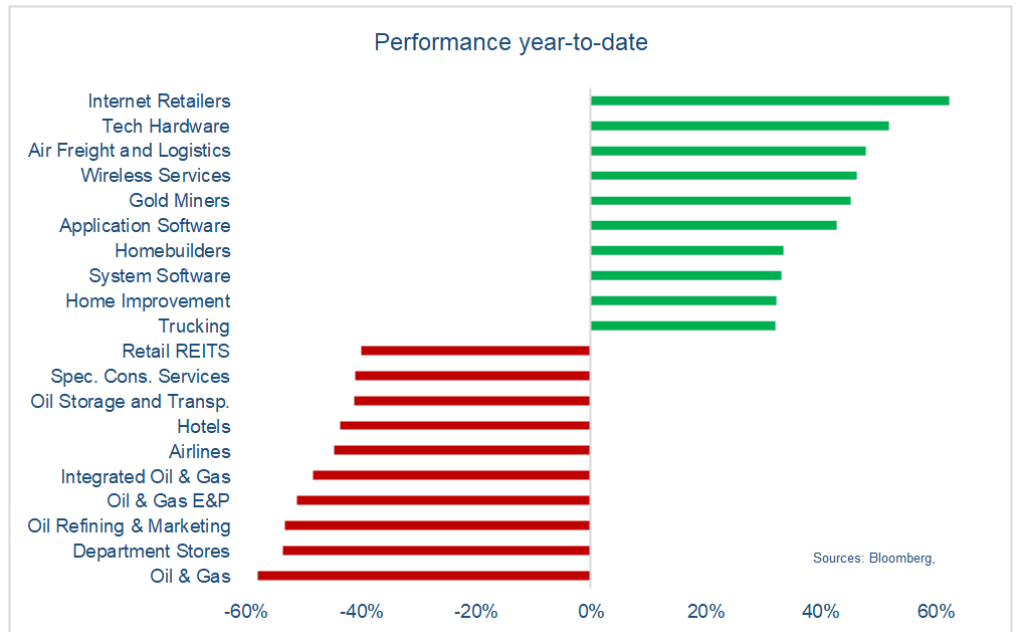
◆ Meanwhile, cyclical sectors would benefit from a potential reflation due to more fiscal stimulus.

◆ The FAB AAC continues to maintain a defensive tilt in its equity allocation.

A CNN opinion survey published today, for which the data was partly collected after President Donald Trump revealed he had tested positive for Covid-19, indicated 57% of respondents planned to vote for former Vice-President Joe Biden, while only 41% said they would vote for the incumbent.

While national polls need to be taken with a grain of salt, given the dynamics of the US election, a recent poll by WDIV/Detroit News showed the Democratic contender leading President Trump in Michigan 48% to 39%. The state was one of the key battlegrounds won by Republicans in 2016 which resulted in the ultimate victory.

To be sure, opinion polls need to be watched with caution 28 days before the election. In the last presidential election, former Secretary of State Hillary Clinton was showing similar wide leads to President Trump around this time. The key to who wins will be how many of the supporters on each side actually cast their votes. Even among likely voters, however, President Trump is behind.



These opinion polls have many analysts and investors talking about a higher probability of a Democratic sweep. And, initially, markets are not necessarily reflecting that negatively. Stocks finished last week higher, following a flood of donations to the Biden campaign after the debate between the two candidates.

The main narrative that justifies such excitement about a potential Democratic sweep relates to stimulus. All added, Democrats could approve as much as US\$3.8 trillion in stimulus if they capture both the White House and the Senate. About US\$1.3 trillion of that is supposed to be earmarked for infrastructure.

Such stimulus, coupled with ultralow rates, suggests that there could be a lot of construction, and related jobs, ahead. It also could entail higher inflation, something that the bond market has reflected in higher yields in longer-dated Treasuries over the past two weeks.

### Tech stocks were the best performers this year while cyclical have been the worst

If these things do play out like this, it would be a boon for earnings of companies in cyclical sectors, such as materials, industrials and financials. Some of these have lagged this year. In fact, the two worst-performing sectors in the S&P 500 so far this year are energy, down 49.82%, and financials, which lost 19.75%.

On the flip side, a Democratic sweep would entail higher corporate and capital gains taxes. The latter could prompt selling of the best-performing stocks before year-end, and the former would hit the most profitable corporations, which are also in technology. In summary, a Democratic sweep may not be bad for markets, but investors may have to consider moving more to cyclical sectors.

# Investment Strategy Update

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