



The Impact of the U.S. Elections on its Neighbours to the North

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- According to forecasts and recent polls, Democratic candidate Hillary Clinton is projected to win the 2016 U.S. Presidential Election against her Republican opponent Donald Trump; estimates¹ now indicate a 84% chance of victory for the former, compared to a 16% chance for the latter
- The policy agendas of both candidates are radically different, with Clinton expected to deliver “much of the same” as the Obama Administration, while Trump has promised to implement profound changes if elected. Both candidates, however, agree on the need for fiscal stimulus, namely through infrastructure spending. This could lead to increased Federal budget deficits and debt issuances.
- A Republican win may have mixed results for Canada, initially striking a positive note, but facing headwinds over the medium to long term as anti-immigration, anti-trade, and U.S. government debt weigh on the U.S. economy
- A Democratic win is expected to have more muted effects on the Canadian economy given a relatively status quo scenario

Current Situation and the Importance of the Upcoming Weeks

The 2016 Presidential election is among one of the most closely run races in U.S. elections history. Thus, the last few weeks of Hillary Clinton’s and Donald Trump’s campaigns are all the more critical as last minute campaign boosts or flubs could ultimately determine who becomes President.

One more debate remains before the election that will allow candidates to reinforce their views on policies as they relate to such things as economic policy, taxes, foreign policy, trade and immigration.

Upcoming Events:

October 19, 2016 - 3rd Presidential Debate
November 8, 2016 - Election Day

The Electoral Process

The U.S. presidential electoral process is one of the most complicated in the world. Presidents are appointed based on the Electoral College system that assigns 538 votes to each of the 50 states and is reflective of the number of members an individual state has in Congress.

¹ Who will win the presidency? *Five Thirty Eight*. Retrieved from: <http://projects.fivethirtyeight.com/2016-election-forecast/>

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With the exception of Maine and Nebraska, each state operates under a winner-takes-all approach, whereby all votes within a state are automatically given to the candidate who gathered the majority of votes within that state. For instance, Florida is allotted 29 electoral votes, but in a scenario in which one party wins 16 (the majority) of the votes, all 29 of the votes would be allocated to them. Thus, it is entirely possible for a U.S. Presidential candidate who wins the popular vote to lose the Presidential election. In order for a candidate to secure the White House, the candidate must win 270 electoral votes.

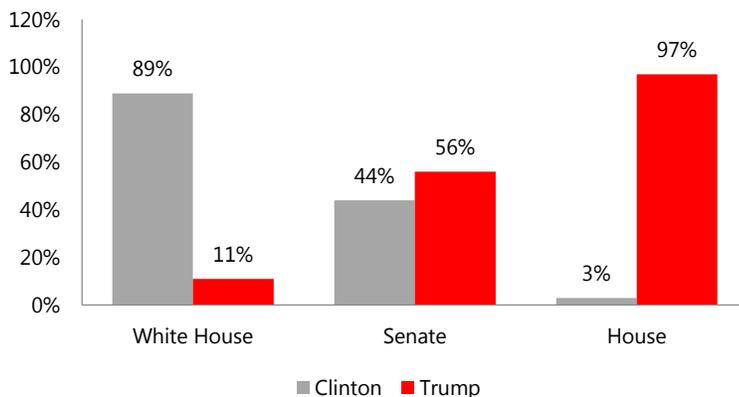
U.S. Congress

The U.S. Congress is the legislative body of the federal government and is made up of two chambers: the House of Representatives and the Senate. During this election, all seats in the House of Representatives and one third of the Senate are up for election on November 8th. Currently, the Republicans dominate the Senate and hold a majority in the House of Representatives.

A victory by Hillary Clinton would likely result in the status quo - a Democratic President with a Republican Senate, which would likely result in much of the same policy gridlock experienced by President Obama. If Donald Trump were to be elected President, he would likely usher in a Republican sweep. Generally this would imply more room for changes to legislature as the a Republican President and Congress typically share similar views, however, many Republican Senators have revoked their support for Trump,² which could limit the degree of legislative reform should he win the election.

Chart II shows the U.S. Election odds broken down by Congress and the White House.

Chart II U.S. Elections Odds



Source: pivit.io/politics, Scotia Wealth Management GPAG

The Current Landscape

The U.S. is divided among parties with specific states favouring either Republicans or Democrats. States that do not have a clear preference for any one party are known as swing or battleground states. These include places like Nevada, North Carolina, Ohio or Florida. Chart II shows a breakdown of preferred parties by state based on preliminary polls.

² Congressional candidates stampede to ditch Trump. *Politico*. Retrieved from <http://www.politico.com/story/2016/10/donald-trump-congress-republicans-229343>

Donald Trump

Policy:

- Fiscal expansion – increased spending on infrastructure, education, child care, military, veterans
- Critical of the Federal Reserve and its overly accommodative monetary policy
- Approves Keystone XL, supports coal production and will allow energy production on Federal lands in appropriate areas
- Cancelling of the Paris Climate Agreement

Impact:

Trump's large economic spending plan and tax cuts is expected to increase growth to a far greater extent, at least for a period of time, compared to Hillary's growth proposals. Increased growth in the U.S. is very positive for the Canadian economy currently. However, a key concern surrounding Mr. Trump's proposals is the amount of debt spending that is likely associated with the ability to achieve his policies, which could hamper the overall impact of Mr. Trump's economic stimulus plan. The impact of expanded growth in the U.S. would be similar for both Mrs. Clinton and Mr. Trump; increase growth leads to more inflationary pressures in turn causing a steepening yield curve. However, with the greater fiscal stimulus plan expected from Mr. Trump, these outcomes would likely be to a greater degree compared to a Clinton Presidency. These policy implications would also significantly influence the US\$ with the US\$ expected to strengthen far more under Trump than Clinton. A stronger US\$ fares better for Canadian exports.

After Mr. Trump's outward criticism of the Federal Reserve for its overly accommodative monetary policy causing an overheating in the equity markets, we would likely see him replace current Fed Chair Janet Yellen with a more hawkish chairman come 2018 when Ms. Yellen is up for re-election. With a more hawkish replacement bond yields would likely rise in the U.S. as well as Canada as Canadian rates typically move in line with those of the U.S. Rising yields in Canada is a net benefit for certain industries, mostly financials (Insurance & Banks), as it helps to boost margins, while a negative for others (REITs, Utilities, Telecom).

One of the most direct policy implications for Canada in Mr. Trump's platform is his support of TransCanada Corp's Keystone XL pipeline. The Keystone XL pipeline, which was denied the required Presidential permit on November 6, 2015, if approved by Mr. Trump has the ability to help rejuvenate the Canadian energy markets that have been hampered by the last two years of low oil prices. This would be a large win for the Canadian energy space as the U.S. is the largest net importer of Canadian crude; importing \$1.157 billion barrels in 2015 resulting in 43% of all U.S. crude imports⁴.

II. TAXES

Hillary Clinton

Policy:

- Increase taxes on the wealthiest households including a 4% increase on incomes above \$5M and a minimum 30% tax rate on earnings above \$1MM
- Does not want to raise taxes on the middle class or change the corporate tax rate
- Eliminate the loophole for carried interest
- Increase the estate tax to 65% from 40% and apply the new rate to estates worth more than \$3.5MM on an individual basis and \$7MM for married couples

Impact:

Mrs. Clinton's plans would likely add some stimulus to the U.S. economy, but to a lesser extent than Trump's tax policies. Although any increased growth prospects for the U.S. are positives for the Canadian economy, these policy implications are quite similar to the policies under President Obama's administration and therefore aren't expected to cause a significant change to the current outlook should she be elected.

⁴ U.S. Energy Information Administrative. *Energy Information Administration*. Retrieved from http://www.eia.gov/beta/petroleum/imports/browser/#/?vs=PET_IMPORTS.WORLD-US-ALLA

Donald Trump

Policy:

- Reduce the tax rate for corporations from the current 35% to 15% and eliminate the corporate alternative minimum tax
- Provide a deemed repatriation of corporate profits that are currently held offshore at a one-time tax rate of 10%
- Collapse the current seven income tax brackets into three brackets with a maximum individual tax rate of 33%.

Impact:

The significant tax reductions that Mr. Trump has imposed would be expected to drive strong U.S. economic growth, at least for a period of time. This would greatly benefit the Canadian economy as the U.S. remains Canada's largest trading partner. Also, strong growth in the U.S. would strengthen the US\$ which would also benefit Canadian exports making them cheaper for Americans to buy.

On the other hand, Canada has long benefited from its more favorable corporate tax rates compared to the U.S., which will be eliminated with Mr. Trump's corporate tax reduction. Trump's proposal would lead to the U.S. having one of the most attractive corporate tax rate compared to other developed nations⁵. This has the ability to drive top talent from Canada and elsewhere to the United States.

Although the one-time tax break for repatriation back to the U.S. is expected to add some stimulus to the U.S. economy, the economic impact is likely to be far less than some would expect. In the 2005 Homeland Investment Act, a study⁶ showed only a small percentage of the approx. \$300 billion repatriated was placed directly into the economy whereas a majority of the funds were used to increase shareholder dividends or fund share buybacks. The impact of repatriation would likely come in the form of a strengthening US\$ as corporations convert foreign earnings into US\$, which again should benefit exports.

III. FOREIGN POLICY

Hillary Clinton

Policy:

- Follow suit on policies established during the Obama administration
- Supports NATO, and the Iran nuclear deal
- Believes co-operation with China is beneficial for the country
- Intensify the coalition air campaign against ISIS fighters, leaders and infrastructure

Impact:

From an international relationship standpoint, Clinton is viewed as the more moderate choice. Sectors of the U.S. economy that stand to benefit from a Clinton victory include those most driven by international revenue, like consumer discretionary and industrials. Clinton is viewed as the safer choice which means less volatility and potentially a sideways dollar. This should cause little shake up from a Canadian perspective.

Donald Trump

Policy:

- Critical of NATO
 - Looking to rebuild the U.S. military
 - Interested in renegotiating the nuclear deal put in place by the Obama Administration.
 - Increased screening procedures to identify potential terrorists and work with Russia and the U.S.' Arab allies to defeat ISIS
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⁵ Public Sector, Taxation and Market Regulation. *OECD*. Retrieved from <http://stats.oecd.org/Index.aspx?QueryId=58204>

⁶ Dharmapala, D. Foley, C. Forbes, K. Watch What I Do, Not What I Say: The Unintended Consequences of the Homeland Investment Act. *The National Bureau of Economic Research*. Retrieved from <http://www.nber.org/papers/w15023>

Impact:

Global uncertainty could increase substantially if Trump were to win presidency as a warmer relationship with Russia is contrary to the current Obama administration stance with the country. This could benefit Russia as it would allow its influence to grow in Eastern Europe, especially if Trump were to revisit the NATO agreement and decrease the U.S.' involvement in helping NATO members from further Russian attacks.

Renegotiation of the Iran nuclear deal has the potential to put Iranian barrels at risk, which could boost Canadian crude and investment in the oil sands in general as supply becomes tighter. However, Trump's stance on drilling could result in an oversupply of the commodity, which has the ability to negate such benefits over time. Winners given a Trump presidency include commodities based on U.S. demand.

Trump's plans to rebuild the military require significant spending, which analysts are predicting can only be attained via substantially heavier U.S. debt. This has the potential to weaken the U.S. economy, driving it into a lengthy recession, should all other proposed policies become law.⁷

IV. GLOBAL TRADE

Hillary Clinton

Policy:

- Supportive of multinational trade agreements that meet certain criteria
- Tougher enforcement of trade agreements already in place
- Oppose the Trans-Pacific Partnership (TPP)

Impact:

Hillary's support towards trade agreements isn't likely to impact the Canadian economy either negatively or positively post-election as this is by all means an extension of the Obama Administrations platform. If Clinton were to win, this should reduce market concerns over the numerous unknowns surrounding current trade agreements that would exist with a Trump victory. Thus, a Clinton victory is likely to lead to a strengthening in the US\$ as the risk-off tone dissipates, once again benefitting Canadian exports.

Donald Trump

Policy:

- Renegotiate the terms of the North American Free Trade Agreement (NAFTA), or if no agreement can be made, withdraw from the deal
- Bring trade cases against China, both in the U.S. and at the World Trade Organization (WTO) for its unfair subsidy behavior and deem China as a currency manipulator and favors a 45% tariff on Chinese imports
- Opposes the Trans-Pacific Partnership (TPP)

Impact:

If Trump were unable to renegotiate the terms of NAFTA and instead decides to eliminate the trade agreement this would be very detrimental to Canadian growth via the plunge in exports to U.S. A more domestic focused economy in the U.S. would likely lead to a weakening of the US\$ against most developed economies including the Canadian dollar as investors look to dispose of their US\$ based on a weaker global trade regime.

Although Canada is not likely to be directly impacted by Trump's trade implications with China, if this were to lead to a "trade war" between two of today's largest economies this would have negative implications globally. A trade dispute with China could lead to a further slowdown in global growth due to the interconnectedness of today's global economies. This could significantly impact growth in the United States as China was the top importer of goods to the U.S. in 2015⁸; China imported

⁷ The Macroeconomic Consequences of Mr. Trump's Economic Policies. Moody's Analytics. Retrieved from <https://www.economy.com/mark-zandi/documents/2016-06-17-Trump-Economic-Policies.pdf>

⁸ Office of the United States Trade Representative. Retrieved from <https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china>

\$497.8 billion in goods and services in 2015. A slower U.S. economy would likely weaken demand for Canadian goods. In addition, any increased tensions between the two largest global economies, would likely spark a flurry of unknowns, which equity markets tend to shy away from. This could lead to increased volatility in equity markets and spread widening in credit.

V. IMMIGRATION

Hillary Clinton

Policy:

- Advocates further immigration liberalization than the Obama Administration
- Remove the cap on the annual number of green cards that can be given to the spouses and single children of permanent residents
- Increase the amount of temporary visas that skilled and unskilled workers can obtain
- Create a points system for potential immigrants based on things like English fluency and level of education
- Allow undocumented immigrants to become legal immigrants if they meet specific criteria

Impact:

According to a report by Moody's, Clinton's immigration's policies have the potential to add approximately 6 million jobs over ten years due to further demand for goods and services. Productivity is also expected to increase considerably as skilled immigrants would add to technological improvements that could help with efficiencies in the production process. These combined are expected to provide a meaningful boost to real GDP.⁹ Canada serves to benefit from a better functioning U.S. economy and higher demand from a growing U.S. population as the U.S. is one of Canada's largest trade partners, with the country taking in approximately 76% of all Canadian exports.

Donald Trump

Policy:

- Keep immigration close to its historical average
- Ensure Americans have access to jobs before immigrants
- Build a physical wall between the U.S. and Mexico
- Deport 11.3 million undocumented immigrants from the U.S., which would reduce the labour force by 5.1%
- Accept only those immigrants who the US deems to be self sufficient and those who have a high likelihood of success in the U.S. from an employment perspective

Impact:

Twenty percent of Canada's entire population is made up of immigrants, which is roughly double that of the U.S. Skilled immigrants have been and continue to be a valuable part of Canada's labour force.¹⁰ As immigration policies in the U.S. tighten, Canada stands to benefit by way of a larger immigration pool to select from. An area of the Canadian economy that could improve from Trump's policy is technology as some of the most frequently filled positions by immigrants in Canada are in this sector.¹¹

On the other end of the spectrum, Trump's immigration policies could act as a negative supply shock to the U.S. as millions of undocumented immigrants leave the country, resulting in a severe labour shortage and potentially higher labour costs (based on dwindling labour supply). This could increase the costs of production for businesses that may need to increase prices of their products as a result. The U.S. is almost at full employment, meaning that there is little slack to hire workers. As a result, many jobs could go unfilled. This would contribute to a U.S. recession which Moody's is forecasting will hit in early 2018 under Trump.¹² This would be detrimental to Canada as it would significantly reduce the amount of exports we sell to the U.S.

⁹ The Macroeconomic Consequences of Mr. Trump's Economic Policies. *Moody's Analytics*. Retrieved from <https://www.economy.com/mark-zandi/documents/2016-06-17-Trump's-Economic-Policies.pdf>

¹⁰ Jobs Report: The State of the Canadian Labour Market. *Department of Finance Canada*. Retrieved from <http://www.budget.gc.ca/2014/docs/jobs-emplois/pdf/jobs-emplois-eng.pdf>

¹¹ Canadian Immigration: Food Workers Best Chance of Express Entry. *Work Permit*. Retrieved from <http://www.workpermit.com/news/canadian-immigration-food-workers-best-chance-express-entry-20160426>

¹² The Macroeconomic Consequences of Mr. Trump's Economic Policies. *Moody's Analytics*. Retrieved from <https://www.economy.com/mark-zandi/documents/2016-06-17-Trump's-Economic-Policies.pdf>

Bottom Line

With the election polls currently predicting a Hillary Clinton victory, a surprise Trump victory may lead to a near-term pull back in equity markets, while bonds would likely rally as the markets typically react first and ask questions second. As the markets adjust to what a Trump victory actually could mean economically for the U.S. and globally may lead to far different behaviors than the initial reaction.

The economic implications for each of the candidates are very difficult to discern as many of the policies within Mr. Trump's and Mrs. Clinton's political platforms are contradictory for markets. In certain instances, one would expect the fiscal stimulus of each of the platforms to be beneficial for equity markets in the U.S. as well as for Canada; on the other hand, the potential debt burden and increased inflationary pressures from Mr. Trump's platform could offset those expectations, while Hillary's increased tax plan could slowdown growth.

The result and impact of the election will also be heavily weighed by the Congressional results as this impacts the ability to which any of the candidates policies may be implemented. It is likely that regardless of which candidate is victorious on Election Day, a number of their policies will not pass Congress or will have to be tempered. The market is likely to remain cautious into the November 8th election day and upcoming Presidential debates, with plenty of uncertainty surrounding the actual outcome.

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