Red or blue is not the question with climate change

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The US election won't be a significant game changer

While the world is focused on the outcome of the US election, a quick look at the past shows that it does not matter significantly who sits in the White House for financial markets, that are mostly driven by macro and micro realities.

Both equities and bonds thrived under Obama and under Trump, while the US dollar strengthened marginally under Obama and weakened under Trump. The small differences in performance recorded under these two presidents hardly justifies all the agonizing by investors.

But, does politics matter when it comes to sectors?

Again, the answer is quite straightforward as illustrated by the two times-series which display the performances of various sectors during the Obama and Trump eras. The change of presidents made little difference to S&P's sector return ranking.

- Under Obama and Trump, the three best performing sectors were identical: consumer discretionary, technology and healthcare.
- Also, during both administrations, the two worst performing sectors were financials followed by energy.

Source: Bloomberg

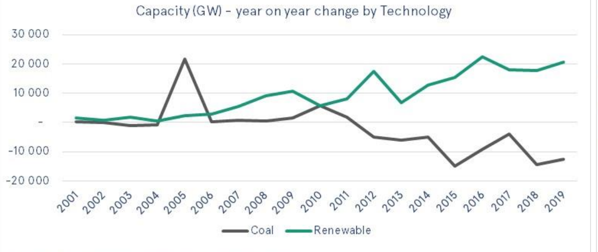
This sector breakdown discredits conventional expectations, held at the start of the Trump presidency:

- At the time, hopes were high in the financial sector that a wave of deregulation would boost returns. Yet, financials finished next to last, again.
- With all of Trump's promises to "make America great again", bring manufacturing jobs home and impose tariffs on "unfair" competition, investors expected the industrial sector to thrive under Trump. However, industrials finished in sixth place, just as they did under Obama.
- With a former property developer in the White House, many expected a better performance from the real estate sector. Real estate, despite benefitting from extremely low interest rates, slipped from just short of the podium in the Obama years, to eighth place under Trump.
- Big Tech, openly hostile to Trump, expected to suffer from a vindicative president unleashing regulatory hell on players, but not much happened.
- Fossil energy returns were bad in the Obama years, but at least they were positive. In the Trump years, energy was the only sector to deliver negative returns; an unusual outcome under a Republican administration, especially one that proudly cut regulatory burdens for fossil energy extractors.

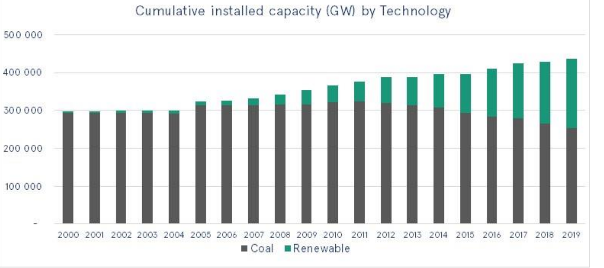
The first four points can be relatively simply explained by citing former President Bill Clinton's "*it's the economy, stupid*" i.e. meaning that long-term fundamental macro trends cannot be displaced. However, the last point concerning energy, is worth a more in-depth analysis, in particular from a sustainable investment standpoint:

Fossil energies are certainly not reserved for Republicans only; during the Obama years, US oil production increased by over 75% as fracking and horizontal drilling allowed to extract hydrocarbons efficiently from layers of tight rock formation. It was also President Obama, who not only signed a bill ending a four-decade ban on crude oil exports, but who allowed the highly contested Keystone pipeline project to move forward.

Despite the massive campaign promises of candidate Trump, coal-fired power-generation dropped by close to a quarter during the Trump years because of cheap gas and increasingly cheap renewables. In 2016, American coal produced twice as much power as renewables did; in 2020 renewable electricity is poised to match coal-fired electricity according to the government's most recent forecast.



Source: BNEF (Renewable includes solar and wind only)



However, if Trump is re-elected, there is a greater risk that his new rules become permanent, particularly if the Supreme Court, which he has copiously staffed during his presidency, affirms his interpretation of the Clean Air Act. and coal plants stay open longer and emit more harmful gases. However, they would not prevent the sector from declining. If that fundamental trend continues, more coal plants will have shut down during the four years (2017-2020) of the Trump administration - an estimated 42,000 MW - than during Obama's second term (2013-2016) - around 35,000 MW.

Also, if the current administration remains in the White House, it is likely that less efficient cars will remain on the road, boosting demand for petrol. Coal plants might avoid installing new scrubbers, making them dirtier and, by lowering their costs, extending their lives. It would be harder to curb emissions of methane, a greenhouse gas which, over 20 years, is 84 times more potent than carbon dioxide. More land could see drilling, including the Arctic National Wildlife Refuge.

None of this, however, would ensure a revival for coal or a sustained surge in oil and gas production.

Biden's ambitious Clean Energy Program

Even if Trump's support of the fossil-fuel industry has done close to nothing to improve the fundamental prospects of the fossil energy sector, the industry would still far prefer a second Trump to Biden term; the Democratic challenger who puts climate change and cleantech jobs at the top of his priorities.

Biden's US$2tn clean energy and infrastructure spending plan includes US$1.7tn in clean energy spending over a decade, expanding the existing budget of less than US$100bn per year. The Democratic candidate would not ban fracking per se, but he would seek to end new oil and gas leasing on federal lands.

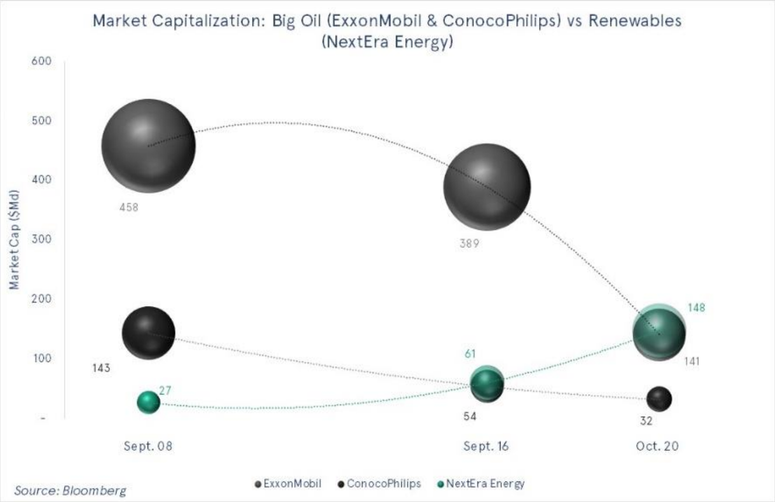
More important are Biden's efforts to reduce greenhouse-gas emissions. For example, he has a target for clean power and supports infrastructure and electric cars, which would decrease the broader demand for hydrocarbons and cause a real shift:

- Among Biden's goals are **to cut the carbon footprint of the national building stock in half by 2035** and make dramatic investments in energy efficiency in existing buildings, including completing four million retrofits.
- **To achieve 100 percent carbon-free electricity by 2035**, Biden proposes **extending clean energy and efficiency tax credits** as well as **installing millions of solar panels and thousands of onshore and offshore wind turbines**. In 2019, fossil fuels still accounted for nearly 63% of U.S. electricity generation according to the Energy Information Administration.

Underlying these ambitious goals, is the wish of the Democratic candidate to **rejoin the Paris Climate agreement** and hence lead the world on cutting CO2 emissions. Biden understands the science behind Climate Change and the imminent threats to the US economy and population that derive from it. Democrats seem to be well aware of the cost of doing nothing and the humanitarian and economic prices to pay if action is delayed further.

The US taking again the lead on CO2 reduction would send an important signal to every country still undecided or delaying its efforts to meet the Paris Agreement.

Equity markets have started pricing Big Oil's endgame a while ago, and since the start of the year, the S&P Global Clean-Energy Index has climbed by over 70% (as of 23 October 2020). Even before Covid-19 ravaged oil demand, investors had fallen out of love with American shale, fed up with poor returns and the continuous need for reinvestment. During the Trump era, Big Oil's market capitalization accelerated their decline.



As America's oil industry suffers, its most valuable utility, NextEra, has soared. It is already the world's top generator of wind and solar electricity. At its latest earnings call in October , management said it now has about 15 gigawatts of renewable projects in its pipeline, more than its entire existing renewables portfolio. Large parts of its solar and wind farms are in deep Republican territory such as Florida and Texas, same as most of its existing production installations. Given the low cost of installation and small maintenance cost, renewables have won the economic race.

Whatever the outcome of the upcoming US presidential election, there is no stopping the structural fundamental macro trends which will prevail over any short-term policy decision, regardless of the sector.

Within the energy sector, these trends are accentuated by the Climate Crisis; its inherent risk and potential costs and losses should be on the mind of every leader or candidate.

While one can hope that a Biden administration would not only reverse some of the regulatory harm done by most of the former administrations, a continuation of the current administration will continue to delay making much needed change to combat the climate catastrophe.

Internationally however, a Biden presidency could have a more significant impact especially if general geopolitical tension abated and a concerted climate effort led by the US, Europe & China gained in traction.

Whatever the outcome of the upcoming presidential election, financial markets will continue to price the end of fossil energy and add stranded assets, a more stringent application of the polluter-payer principle and declining demand to the already dire prospects, **expecting even higher returns for this industry** whose prospects are undeniably withering.

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