

September 25, 2019

Q&A: Impeachment and the Growing Equity Market Headache

Paul Christopher, CFA
Head of Global Market Strategy

Darrell Cronk, CFA
President, Wells Fargo
Investment Institute
Chief Investment Officer, Wealth
and Investment Management

Key takeaways

- » *A whistleblower report has upended Washington politics and launched an impeachment inquiry of President Trump.*
- » *It is too soon to tell whether the House inquiry will reveal any impeachable offense, much less lead Congress to remove the president. But we foresee some potential impacts on legislation that could matter to investors.*

What it may mean for investors

- » *We do not view this recent announcement as any material reason to alter our current investment strategy—yet. We have reduced portfolio risk exposure systematically and thoughtfully over recent months where we do not believe we are being compensated to take risk currently.*

What happened?

The whistleblower report, which stems from a July phone call between President Trump and Ukrainian President Volodymyr Zelensky, along with the \$391 million halt in military aid used as potential leverage to investigate former Vice President Joe Biden and his son, Hunter Biden, for corruption, has upended Washington and launched an announcement by House Speaker Nancy Pelosi that the House will move forward with an impeachment inquiry.

Is this an impeachable offense, if true?

The Constitution provides for impeachment for “high crimes and misdemeanors,” as interpreted by Congress. President Trump is the fourth president in history to face an impeachment inquiry. All three prior cases (Presidents Andrew Johnson, Richard Nixon, and Bill Clinton) either resigned (President Nixon) or were impeached by the House.

What comes next?

Six House committees (Judiciary, Intelligence, Foreign Affairs, Oversight, Ways and Means, and Financial Services) will investigate the allegation. If the committees find a basis to proceed with charges, one committee, typically the Judiciary, would recommend one or more articles of impeachment (i.e., formal charges against the president). It is not clear yet which committee the House leaders will charge with that task. If a simple majority of the House votes to impeach, then Senate rules oblige the Senate to try the president on the charges, with the Supreme Court's Chief Justice as the presiding judge. The House would appoint impeachment managers to prosecute the case with witnesses and any evidence, and the president would have a defense counsel. To remove the president from office, two-thirds of the senators present must vote to convict. It's important to remember that the House votes to impeach, but the Senate must convict in order to remove the president from office.

Is impeachment likely, and if it occurs, is the president likely to be convicted?

It is too soon to tell whether the House inquiry will reveal any impeachable offense, much less lead Congress to remove the president. The inquiry itself could take several months, and the House is in session for only 32 more days this year. Even if the House votes to impeach, conviction in the Senate has proven to be a high bar. The House has initiated impeachment proceedings or inquiries more than 60 times, according to the House historian's office, and previously voted to impeach 15 federal judges, one senator, one cabinet secretary, and two presidents.

What is our base case?

No U.S. president has been removed from office by impeachment. For President Trump to be impeached, 20 Republican Senators would need to cross over and vote to convict, which seems unlikely to us based on the available evidence. However, the impeachment effort could impact other legislation that are of interest to financial markets.

- **U.S.-China.** Could bad news (impeachment) be met with good news (U.S.-China Trade deal) as a way to distract the attention of the electorate? While possible, it is not likely probable. A recent tough stance during the President's United Nations speech and continued negotiations, which have displayed little progress on key issues, likely does not alter the timing or outcome of any deal. President Trump and President Xi are tentatively scheduled to meet in Santiago, Chile, on November 16-17, perhaps to ink the interim deal or truce on additional levied tariffs. If President Trump doesn't attend, the chances of any interim deal this year become very low.
- **USMCA.** The U.S. Mexico Canada Agreement (USMCA) on trade is the other big trade issue that few are talking about but could receive collateral damage from an impeachment proceeding. The ticking legislative clock is not USMCA's friend as Congress has refused to ratify President Trump's signature policy deal up to this point. Any delay in impeachment proceedings reduces the prospects for Congress to debate and ratify the deal this year.

- **Healthcare/drug pricing.** Following the August Congressional recess there was optimism for a deal on prescription drug pricing, since President Trump and House Speaker Pelosi share similar views and aspirations on this topic. Impeachment proceedings will slow—if not block—progress. The House may still pass legislation on a prescription drug bill prior to year-end, but it has a tall hurdle within the Senate. This will be a popular issue discussed at great lengths within the 2020 election campaigns, but the impeachment inquiry likely will delay any legislative progress.
- **Infrastructure.** Since President Trump’s inauguration, there has been little progress or even debate on an infrastructure program, despite it being one of the key campaign priorities of the 2016 election. Impeachment proceedings reduce the odds of enacting legislation prior to the 2020 election for many of the same reasons as USMCA. While bipartisan agreement exists on the critical need to invest within the country’s infrastructure, divisions remain firm on how to define and how to fund infrastructure.

What has been the reaction in financial markets?

Market reactions, up to this point, have been somewhat muted toward the impeachment announcement. Equities have sold off slightly; rates have moved lower; gold and the U.S. dollar are both stronger following the news (Sept. 25) reflecting a small flight-to-quality as yet another political risk premium gets stacked into market pricing. We do not view this recent announcement as any material reason to alter our current investment strategy—yet. There was other, unrelated market-negative news on the same day, including the largest monthly decline this year in consumer confidence, new concerns about possibly applying anti-trust regulation to technology companies, and new remarks from President Trump about negotiating a tough trade deal with China.

What does the impeachment inquiry potentially mean for financial markets?

It is not unusual for the beginning of an impeachment inquiry to rattle equity markets. Congress announced its impeachment inquiry of President Clinton on October 8, 1998, and the news sent the S&P 500 Index to its lowest level in nine months. The index rebounded in the following months, thanks to the resolution to the Long-Term Capital Management and the Asia financial crisis. That 1998 experience is not necessarily a reliable pattern to expect in 2019, however, because today’s economy is not at the same point in its expansion, and the political issues are very different.

What should investors do?

We believe the 1998 impeachment history is most useful as a reminder that (i) the bar to impeach a president is not necessarily high—but to remove one has been high; and (ii) while an impeachment absorbs Washington’s attention, investors should keep most of their focus on the economy, which is in a consistent slowdown, but is still a positive for equities.

More to the point, we believe the economy is likely to keep growing in the coming 12 months, and an economic recession does not seem imminent. Yet, the increase in risks—especially political risks—has been a significant headwind to markets since May, and we expect additional volatility in the coming weeks and months.

In order to reduce portfolio exposure to politically-driven volatility, we have reduced portfolio risk exposure systematically and thoughtfully over recent months. Therefore, we do not yet view this recent announcement as any material reason to alter our current investment strategy. Our September Asset Allocation Strategy Report, available to investors, continues to highlight the asset classes we favor and those where we have reduced exposure.

Risk Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors.

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