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US Public Policy

2020 Vision: An Early Guide to the US Election

One year out, we identify election scenarios, the policies we expect they put in play, and what's most exposed (positively & negatively). Divided vs. unified government is the key macro variable, the latter a path to potential fiscal expansion. Yet sector impacts vary based on the party in control.

US PUBLIC POLICY

Skopos Labs

Welcome to 2020 US election coverage. In the coming months, we intend to address investment implications through a mix of deeper policy and "what's in the price" analyses across relevant sectors and markets. We also expect to introduce outcome probabilities to help identify market mispricings and opportunities once more polling data becomes available. Today, we start by presenting a collaborative effort across 20 research teams to identify stylized election outcome scenarios, contingent policy paths, and the markets that we expect will be sensitive to those outcomes.

Five key takeaways:

1. **Investors agree: Elections have consequences.**
2. **Reactive is better than proactive. Candidates move markets, but react with a view on total government outcomes and fundamental impacts.**
3. **The art of the possible: Expect policy ambitions to fall short in practice.**
4. **Macro impacts are more about unified vs. divided than Republican vs. Democrat.**
5. **Sector impacts vary more in magnitude and direction across scenarios.**

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Exhibit 1: Key Fundamental Exposures by Plausible Post-Election Policy Path

	Scenarios	Potential Pressure +	Potential Pressure –
Divided Government	**Blue Tide** **D President** **R Senate** **D House**	EM Energy (Non-US Oil & Gas, Renewables)	USD Energy (US-Focused Oil & Gas) Large Cap Banks Consumer Finance IT Hardware US Internet Telecom Pharma
Divided Government	**Thin Red Line** **R President** **R Senate** **D House**	Large Cap Banks Consumer finance Telecom US Energy Asset Managers	USD
Unified Government	**Blue Wave** **D President** **D Senate** **D House**	US GDP USD Large MCOs Transportation Energy (Non-US Oil & Gas, Renewables)	US Treasuries Pharma Large Cap Banks Consumer Finance IT Hardware US Internet Telecom Energy (US-Focused Oil & Gas) Asset Managers
Unified Government	**Red Redux** **R President** **R Senate** **R House**	US GDP USD Telecom Financials US Energy Asset Managers	EM US Treasuries

Source: Morgan Stanley

Skopos Labs (skoposlabs.com) is a technology company harnessing AI to anticipate risk and opportunity from significant events.

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Executive Summary - Five Key Takeaways

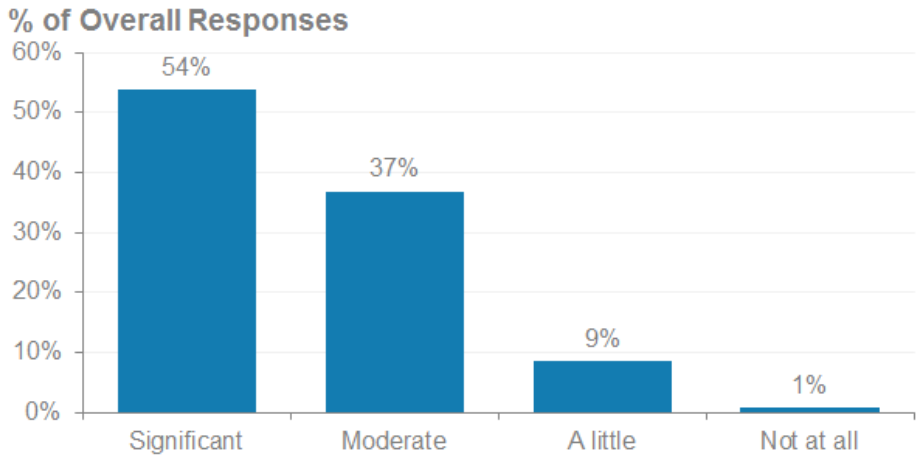
Skopos Labs provided key underlying data for this report. All commentary, including securities and industry impact, solely reflects the views of Morgan Stanley Research.

1. Investors agree: Elections have consequences.

We surveyed 645 investors on their expectations for the investment impact of the 2020 election. We came away with the following conclusions based on the responses:

1) Most investors expect the election to have a significant impact on their market outlook over the next 12 months, with 9 out of 10 expecting a moderate-to-significant impact.

Exhibit 2: Survey results: Question 4 - What impact, if any, does the US presidential election have on your market outlook over the next 12 months?

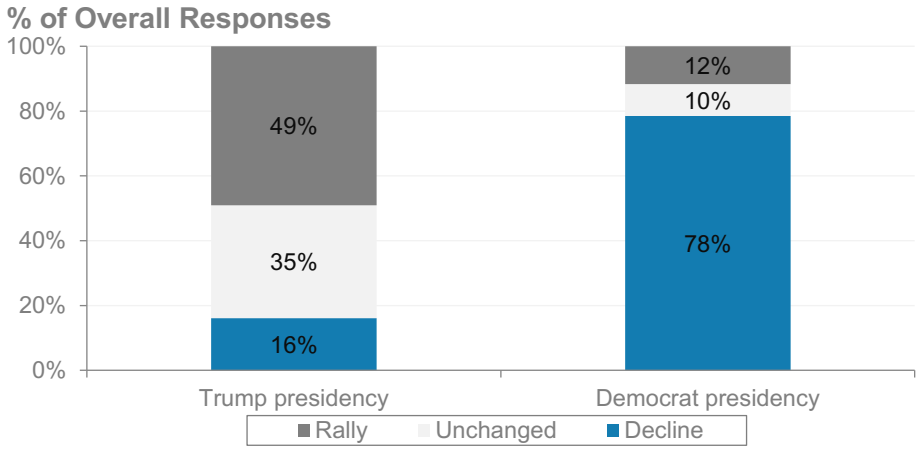


Source: Morgan Stanley Research

2) Fiscal policy and tax changes are the top two investor concerns (see Appendix: Survey Results for full results).

3) The election's impact on the business cycle may be more important than its impact on the most recent policy risk to markets: US trade policy. Investors see Democrats as de-escalating tariffs with China, which in our view would boost near-term growth expectations (Exhibit 80). Yet investors also are more likely than not to associate a Democratic victory with an equity market sell-off.

Exhibit 3: Survey results: Question 12 - How do you expect equities to perform during the first three months of a Trump/Democrat presidency?



Source: Morgan Stanley Research

Perhaps that's because investors see Democrats as less likely to pursue fiscal expansion (Exhibit 80). We think this could suggest investors' general late-cycle concerns and the need to combat those with more traditional policy countermeasures,

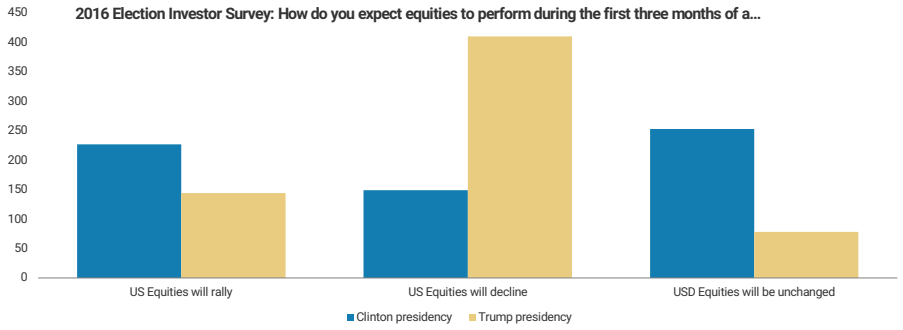
These concerns are valid to us. As we detail in later sections, the difference between Republicans and Democrats on key policy issues is indeed stark.

2. Reactive is better than proactive. Candidates move markets, but react with a view on total government outcomes and fundamental impacts.

Investor expectations and market pricing appear at odds, making markets vulnerable to volatility on swings in the race for the White House. While investors expect outcomes could drive policy in meaningfully different ways, option markets are currently not pricing in meaningful policy changes. Options for the broad equity index, or technology and financials sectors, for example, are not pricing in potential pressure from equities that our surveyed respondents expect from a Democratic victory. Current pricing suggests a trust for status quo to continue, but it also means that small changes in the campaign narrative can potentially shake investors' outlooks and turn markets more volatile. Key option markets we'd focus on as market bellwethers for 2020 elections and policy outcomes include SPX (for tax policy), Financials (for financial regulation), Healthcare (for prescription drug reforms), and Technology (for tech regulation).

Yet we think being reactive is better than proactive. Don't play for those swings — we think it is better to prepare to react with a view on total government outcomes and resulting implications for the economic cycle and individual sectors. While it would be reasonable to deduce from our survey that moves toward a Democratic victory could initially weigh on risk markets, we wouldn't have confidence in the durability of such a reaction. The 2016 election serves as a cautionary tale here. In our same survey that year, respondents overwhelmingly identified a Trump victory with an equity market sell-off.

Exhibit 4: Our 2016 Investor Survey Showed Investors Thought a Trump Victory Would Lead to an Equity Sell-off, Which it Did, but Only for a Few Hours



Source: Morgan Stanley Research

And on election night 2016, that's what investors got in the futures market...for a few hours. The subsequent risk asset rally is well known. In our view, investors realized that a unified Republican government was a path to tax-cut stimulus. **Hence, we think investors must consider the total government outcome of the election, the policy path it drives, and whether that path is reflected "in the price" in order to react appropriately to election-driven market volatility.**

3. The art of the possible: Expect policy ambitions to fall short in practice.

While the policy ambitions of each party contrast in both direction and magnitude, that doesn't mean investors should assume those policies will actually be implemented if the party takes control of the White House. We agree that "elections have consequences," but argue those consequences don't simply align with the campaign platform of the future president. Rather, post-election policy paths tend to conform more in direction than precision to a candidate's platform, as they are moderated and constrained by the makeup of Congress. So while it is rational to deeply investigate candidates' policy proposals, we wouldn't conflate its ambition with a high likelihood of implementation just because its sponsor wins the White House.

Rather, we argue that "plausible policy paths" are better projected by applying the following guidelines:

1. **At most, we'd expect only a portion of a candidate's platform to be enacted:** Only about 3% of bills are ever enacted. In the first year in office, presidents typically can deliver legislatively on only 1/2 of their campaign promises, even when their party also controls Congress. Hence, a presidential candidate's campaign promises should be treated not as a "to-do" list but as an indication of policy objectives.

2. **When transformative legislation happens, it is likely to have a more moderate flavor.** A study from Skopos Labs argues that, historically, legislation that is more likely to be enacted is typically sponsored by more moderate members of Congress. We think this pattern would carry into the next administration, even in a unified government scenario. Consider, for example, that a unified Democratic government would likely feature at least two Senators from states that lean Republican, likely a sufficient number to ensure successful legislation will be moderated.

3. **Total government makeup is therefore more important than a presidential candidate's platform.**

Hence, we establish stylized scenarios for government makeup and resulting "plausible policy paths." Building on observations of the electorate from 2016 and 2018, we establish four stylized scenarios for the 2020 outcome (in no particular order): 1) Thin Red Line (Republican President/Senate, Democratic House); 2) Blue Tide (Democratic President/House, Republican Senate); 3) Blue Wave (Democratic President/Senate/House); 4) Red Redux (Republican President/Senate/House). We then guide investors on "plausible policy paths" — which policy proposals to take seriously under each scenario (i.e., ones that have a meaningful, though not necessarily likely, chance of implementation), and which to ignore. To do so, we apply the above guidelines and substantiate our conclusions using the findings of a model built by Skopos Labs on the attributes of legislation that impact its likelihood of enactment.

Exhibit 5: 2020 Election Stylized Scenarios

	Divided Government		United Government	
	Thin Red Line (RRD)	Blue Tide (DRD)	Red Redux (RRR)	Blue Wave (DDD)
Stylized Scenarios	• **Strong Economy Works in Trump's Favor:** Trump wins a close re-election by persuading voters not to take a chance on change given a strong economy • **Status Quo Triumphs Over Policy Change in Key Swing States:** Democratic policies are not as animating in swing states as the status quo. • **Incumbency Advantage and Continued Support from the Base of Both Parties:** results in unchanged control for the White House and both chambers of Congress.	• **Swing States Voters see Democrats as the Preferred Option for Advancing Policies:** Democrats return to being seen by swing state voters as the more credible vehicle for addressing popular policy issues, such as healthcare reform • **Regional Economic Slowdowns Are Relevant:** Pressures in key states from US-China trade tensions help Democrats on the margin. • **Impeachment Hurts Presidential Approval** • **Yet Policies and Impeachment May Be Polarizing in Senate Races:** Yet that same issues may be polarizing in Republican-leaning states (AL, AZ, GA, NC) where Senate seats are in play, keeping Democrats from clearing the high hurdle to take control of the Senate.	• **Strong Economy Works in Trump's Favor:** The labor market and wage growth remain steady • **Strong Impeachment Backlash:** The impeachment inquiry fails to persuade moderates and independents. • **Trump Coalition Based on Economic Stewardship, Social Issues, Opposition to Policy Transformation:** Trump builds a coalition based on perception of his economic stewardship and populism, limiting the appeal of Democrats as an untested alternative. • **Pump up the Base, Hold Steady with Moderates and Independents:** This shows in strong poll numbers for Republicans among moderates and independents, as well as building enthusiasm among the Republican base, boosting turnout. Republicans are also able to regain control of the House.	• **Slowing Economy or Growing Inequality Puts Trump's Economic Stewardship at Risk:** Clear decline in growth, or outright recession, makes Trump vulnerable to criticism that his economic policies (trade escalation, tax cuts) make him a failed populist. • **Impeachment Hurts Presidential Approval:** A persuasive impeachment inquiry would prime this message, particularly with swing-state independents. • **Pump up the Base, Outperform in Moderate-Leaning Senate States:** Democrats win the White House with a comfortable margin, and are able to pick up three Senate seats by performing strongly in moderate states such as CO, AZ, and ME and either holding AL or picking up in GA, IA or NC.
Potential Key Issues	• Steady Economy • Trade De-escalation Helps Farm States • Impeachment Backlash Sways Independents • Discomfort with Transformative Democratic Proposals in Swing States	• Healthcare • Impact from Trade Tensions Hurts in Manufacturing States • Impeachment Support Among Independents and Moderates	• Impeachment backlash • Immigration • Economic Strength • Social Issues Important to Republicans	• Economic Weakness • Trade Tensions Escalating • Impeachment support among independents and moderates • Social Issues Important to Democrats
Polls to Watch	• Most Important Issues to Voters: The Economy • Presidential Approval in Swing States: PA, WI, AZ, FL, NC • Congressional Ballot: Flat or Slight Dem +	• Most Important Issues to Voters: Healthcare • Presidential Approval in Swing States: PA, WI, AZ, FL, NC • Congressional Ballot: Flat to Moderate Dem +	• Most Important Issues to Voters: The Economy; Immigration • Presidential Approval in Swing States: PA, WI, AZ, FL, NC • Congressional Ballot > +10 for Reps	• Most Important Issues to Voters: Healthcare • Presidential Approval in Swing States: PA, WI, AZ, FL, NC • Congressional Ballot >+10 for Dems

Source: Morgan Stanley Research

4. Macro impact is more about unified vs. divided than Republican vs. Democrat

Divided government outcomes tend toward legislative gridlock. And though divided governments could still influence the outlook through regulatory reinterpretations and resulting impacts to business sentiment, they are unlikely to deliver transformative policy in a macro sense. **Hence, divided government is unlikely to deliver policy that**

counteracts the current late-cycle economic condition.

A more surprising observation might be that we see some symmetry to the potential direction of the macro impact in both unified government scenarios. While far from assured, both open the possibility of fiscal expansion, fueled in part by messaging driven implicitly by ideas such as the Laffer Curve and MMT.

Exhibit 6: Democratic and Republican Unified Government Scenarios May Both Lead to Fiscal Expansion, but of Different Kinds

Blue Wave	Red Redux
Demand-Side Expansion	**Supply-Side Expansion**
• Possibility of enacting programs with additional spending	• Possibility of early extension of expiring tax cuts
• Difficult to raise taxes to the extent that would offset the cost	• Unlikely to be accompanied by entitlement spending cuts

Source: Morgan Stanley Research

This conclusion appears to cut against investor expectations, at least as it pertains to the "Blue Wave" scenario. Our survey suggests investors see a Democratic White House as both less likely to pursue cycle-extending policies like fiscal stimulus and more likely to coincide with risk-asset weakness. Perhaps it is because investors also see Democrats as more likely to pursue policies that will challenge profitability in key sectors, such as prescription drugs and health insurance.

Yet our US economics team counters that this conclusion is not necessarily true, at least in the near term. A policy of net stimulus, even with tax increases, can be a directional positive for growth, depending on its composition. Hence, markets may reflect a reflation theme over time if a larger margin of victory for either side becomes more likely, though the sectors that would benefit most will differ based on the winning party.

5. Sector impacts vary more in magnitude and direction across scenarios

While many of the existential legislation proposals that investors have expressed concerns about seem unlikely across our scenarios, more likely but less ambitious initiatives would still have a meaningful impact to fundamentals. That's in part due to regulatory changes that can be initiated by the president. While those changes typically take years to implement, we think it is fair to recognize the potential impact of such moves.

While our table below focuses on key fundamental exposures, sector analysts in their dedicated sections later in this report also focus on how scenarios can influence investor sentiment in the near term. Hence, in some cases the view of potential near-term market influences may be different from the view on the potential policy impact of a scenario. Healthcare is a good example of this, where concerns around Medicare-for-All could

pressure insurer stocks even though we view that policy as unlikely even in a Democratic sweep.

Exhibit 7: Key Fundamental Exposures by Plausible Post-Election Policy Path

	Scenarios	Potential Pressure +	Potential Pressure –
Divided Government	**Blue Tide** **D President** **R Senate** **D House**	EM Energy (Non-US Oil & Gas, Renewables)	USD Energy (US-Focused Oil & Gas) Large Cap Banks Consumer Finance IT Hardware US Internet Telecom Pharma
Divided Government	**Thin Red Line** **R President** **R Senate** **D House**	Large Cap Banks Consumer finance Telecom US Energy Asset Managers	USD
Unified Government	**Blue Wave** **D President** **D Senate** **D House**	US GDP USD Large MCOs Transportation Energy (Non-US Oil & Gas, Renewables)	US Treasuries Pharma Large Cap Banks Consumer Finance IT Hardware US Internet Telecom Energy (US-Focused Oil & Gas) Asset Managers
Unified Government	**Red Redux** **R President** **R Senate** **R House**	US GDP USD Telecom Financials US Energy Asset Managers	EM US Treasuries

Source: Morgan Stanley Research

Plausible Policy Paths: The Art of the Possible

Michael Zezas, CFA & Meredith Pickett

Key Takeaways

- Policy outcomes are a functions of the entire election, not just the presidential race.
- While executive authority is important for regulatory and foreign policy, a sweep by either party is likely required to catalyze legislative changes of consequence to investors.
- Policy transformation is difficult, infrequent, and the fundamentals of this election suggest it will require a unified government and a moderated vision.

As we discussed in the previous section, much is at stake. But how will election outcomes influence policy outcomes? To answer this question, we establish the following framework: 1) Create four stylized scenarios for election outcomes based on the expected makeup of the electorate. 2) Explain guidelines for what types of policy changes are possible given different types of government makeups. 3) Combine points 1 and 2, and check our scenarios against the Skopos Labs Platform to limit human bias, to assess how the likelihood of policy outcomes changes with each style of election outcome.

What Policy Changes Have Been Proposed?

Later sections of the report will discuss fundamental impacts on a sector-by-sector basis, but here we map out the spectrum of current policy changes that major Democratic presidential candidates have proposed:

Exhibit 8: 2020 Democratic Candidates Propose Many Policies, Most of Which Are Unlikely to Gain Republican Support

	Policy Proposal	Authority	Biden	Warren	Sanders	Buttigieg	Harris	Yang	O'Rourke	Klobuchar	Booker	Castro	Gabbard
Trade Policy	Support the Goal of Challenging China but Change the Approach	Executive		✓	✓	✓	✓		✓		✓	✓	
	Less Supportive Overall of Challenging China	Executive	✓										
	Support joining CPTPP if Adjusted	Executive/ Legislative	✓					✓	✓				
	Want Changes to USMCA	Executive/ Legislative	✓	✓	✓	✓	✓		✓	✓	✓	✓	
Healthcare	Medicare for All (Abolishing Private Insurance)	Legislative		✓	✓								
	Medicare for America (Path to Universal Coverage with Private Insurance)	Legislative					✓	✓	✓		✓	✓	✓
	ACA Improvements with Public Option	Legislative	✓			✓				✓			
	Medicare Buy-in at 50	Legislative	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Government Authority to Negotiate for RX Drug Costs	Legislative	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Taxes	Raise Top Individual Tax Rate/Limiting Deductions for Top Bracket Filers	Legislative	✓		✓	✓	✓			✓		✓	
	Raise Capital Gains Tax	Legislative	✓		✓	✓	✓			✓	✓	✓	
	Raise Corporate Tax Rate	Legislative	✓				✓			✓	✓	✓	
	Create Wealth Tax/Exit Tax on High Net Wealth Individuals	Legislative		✓	✓	✓					✓		
	Impose 7% tax on corporate profits over $100mn	Legislative		✓									
	Supports Financial Transactions Tax	Legislative			✓		✓	✓	✓				
	Increase Estate Tax	Legislative			✓	✓						✓	
	Supports Taxing Carried Interest at Ordinary Rates	Legislative		✓				✓					
	Increase Social Security Taxes on High Earners, Contribution on Investment Income	Legislative	✓	✓	✓								
	Value Added Tax	Legislative						✓					
	Increasing Personal Tax Credits	Legislative	✓				✓	✓	✓	✓		✓	
	Additional Medicare for All Pay-fors	Legislative		✓									
Infra-structure	Supports $1T + Infrastructure plan, with payfors	Legislative							✓	✓			✓
	Supports $1T + Infrastructure plan, Unspecified Payfors	Legislative	✓		✓	✓		✓				✓	
Financial Regulation	Bring back Glass- Steagall	Legislative	✓	✓									✓
	Reducing the Consumer Cost of Borrowing and/or Banking	Legislative			✓						✓		
	Private Equity Overhaul	Legislative		✓									
Tech Regulation	Break Up Large Tech Companies	Executive/Legislative		✓	✓								✓
	Supports Protecting Consumer Data Privacy	Executive/Legislative		✓		✓		✓		✓			
Energy/Climate Policy	Carbon Tax or Cap and Trade	Legislative	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	
	Stricter EPA Regulations	Regulatory		✓	✓								
	End New Oil and Gas Leases on Federal Land and End Offshore Drilling	Executive/ Regulatory; or Legislative	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Ban Fracking Everywhere	Executive/ Regulatory; or Legislative		✓	✓		✓				✓		✓
	Support Goal of Moving Completely to Clean Energy	Executive/ Regulatory; or Legislative		✓	✓						✓		
	Support Banning Fossil Fuel Exports	Legislative		✓	✓						✓		✓
Other	Raise Minimum Wage to $15/hr	Legislative	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓
	Cancel All Student Debt	Legislative			✓								
	Support Eliminating Filibuster	Senate Caucus		✓	/	/	/	/	/	/	/	/	/

Source: Morgan Stanley Research. Politico; Washington Post; Bloomberg; Vox; CNN; Candidate Websites Note: "/" indicates open to the position or to a lesser extent than a check mark.

Election Outcomes: Four Stylized Scenarios

To narrow election outcomes to a set of plausible stylized scenarios, we reviewed the state of the US electorate based on voter behavior in 2016 and 2018. What issues might bring voters to the polls? Is one party or the other starting from a structurally advantageous position in the race for the White House and/or control of Congress? In the end, three key principles influenced how we established our stylized scenarios:

1) Polarization is high

This point may be evident, but it bears repeating. Measures of political polarization suggest that Republicans and Democrats are more divided on fundamental political values than ever, and that party gaps describe more differences than demographics on questions of fundamental values [Pew Research, 10/15/17]. In addition, an analysis of the margin of victory in races for US Senate and gubernatorial races in midterm elections shows that voters are increasingly voting for the same party rather than splitting tickets [FiveThirtyEight, 11/19/18].

Exhibit 9: Recent Major Legislation Votes - Sponsor Party Unable to Gain Bipartisan Support

	Senate Chamber	Senate Vote	House Chamber	House Vote
ACA (First Vote) - 2009	60 D 40 R	60 Y 40 N	258 D 177 R	220 Y 215 N
AHCA - 2017	51 R 49 D	49 Y 51 N	237 R 193 D	217 Y 213 N
TCJA (Reconciliation) - 2017	51 R 49 D	51 Y 49 N	240 R 194 D	227 Y 205 N

Source: Morgan Stanley Research, Congress.gov

2) Status quo bias

We think it will be challenging for either party to take control in a way that gives it legislative carte blanche. Given the point on polarization, and the structure of the House and Senate races, we think investors' working assumption should be that the 2020 elections are a "60/40" race. That means that we expect that, at any given point, it is unlikely that evidence will be available to confidently conclude that either side has a much better than 60% or much worse than 40% chance of gaining control of the White House. The same is true of Congress.

Consider the Senate, where Democrats need to win in Republican-leaning presidential states to take control. Democrats need to gain four Senate seats to gain the majority if they do not win the presidency, and three to gain the majority if they do win the presidency (the vice president serves as the tiebreaker if the Senate is split 50-50). Note that they would both have to gain these seats and not lose their seat in Alabama, a toss-up race for the seat currently held by Sen. Doug Jones. If they lose that seat, gaining the majority becomes more difficult.

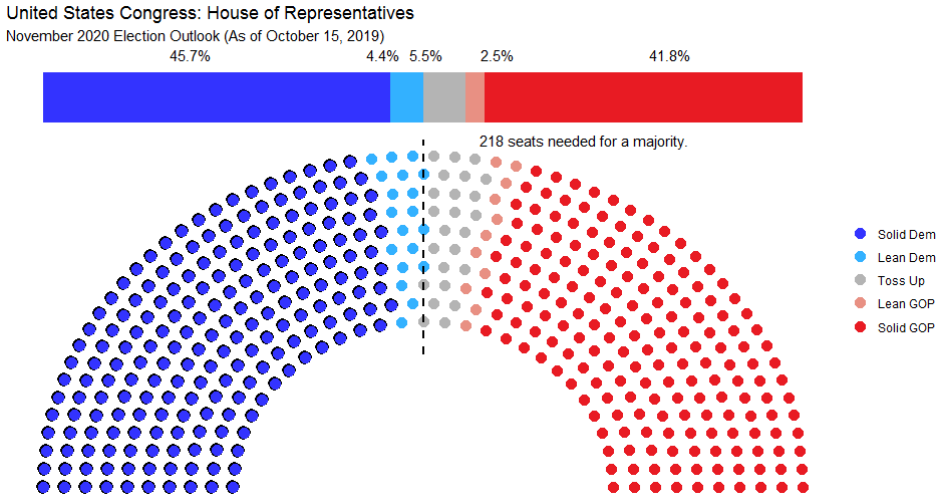
Exhibit 10: Republicans are Defending More Seats than Democrats in 2020

			Cook Political Report Rankings			
	Current	Up in 2020	Toss Up	Lean	Likely	Solid
Democratic	**47**	12	**1** • Jones – AL	**1** • Peters – MI	**2** • Smith – MN • Open – NM	**8** • Coons – DE • Durbin – IL • Markey – MA • Shaheen – NH • Booker – NJ • Merkley – OR • Reed – RI • Warner – VA
Republican	**53**	23	**3** • McSally – AZ • Gardner – CO • Collins – ME	**1** • Tillis – NC	**7** • Open – GA • Purdue – GA • Ernst – IA • Open – KS • McConnell – KY • Hyde-Smith – MS • Open – TN	**12** • Sullivan – AK • Cotton – AR • Risch – ID • Cassidy – LA • Daines – MT • Sasse – NE • Inhofe – OK • Graham – SC • Rounds – SD • Cornyn – TX • Moore Capito – WV • Open – WY

Source: Morgan Stanley Research, Cook Political Report rankings as of October 25

In the House, the bias is toward small changes, which favors Democrats maintaining control. After large gains in the 2018 midterms, Democrats hold a healthy majority in the House of Representatives. All house seats are up for election every two years. Currently Democrats hold 233 seats and Republicans hold 197 (there is also 1 Independent who recently left the Republican Party and 3 vacant seats). Republicans need to gain 18 seats to gain the majority (assuming they also win back the 2 vacant seats that were held by Republicans).

According to *Cook Political Report*, there are currently 18 Democratic toss-ups and 5 Republican toss-ups, meaning that Republicans would need to sweep the D toss-ups without losing any seats. David Wasserman of *Cook Political Report* points out that while this looks doable on paper, "Democrats have history on their side: the House majority hasn't flipped twice in a row since 1954 and hasn't flipped during a presidential cycle since 1952. Democrats have gained House seats in five of the past six presidential elections (save for 2004, when Republicans benefited from a new map in Texas) and in seven of the past eight presidential cycles, the net partisan seat shift in the House has been in the single digits." [*Cook Political Report*, 3/1/19]

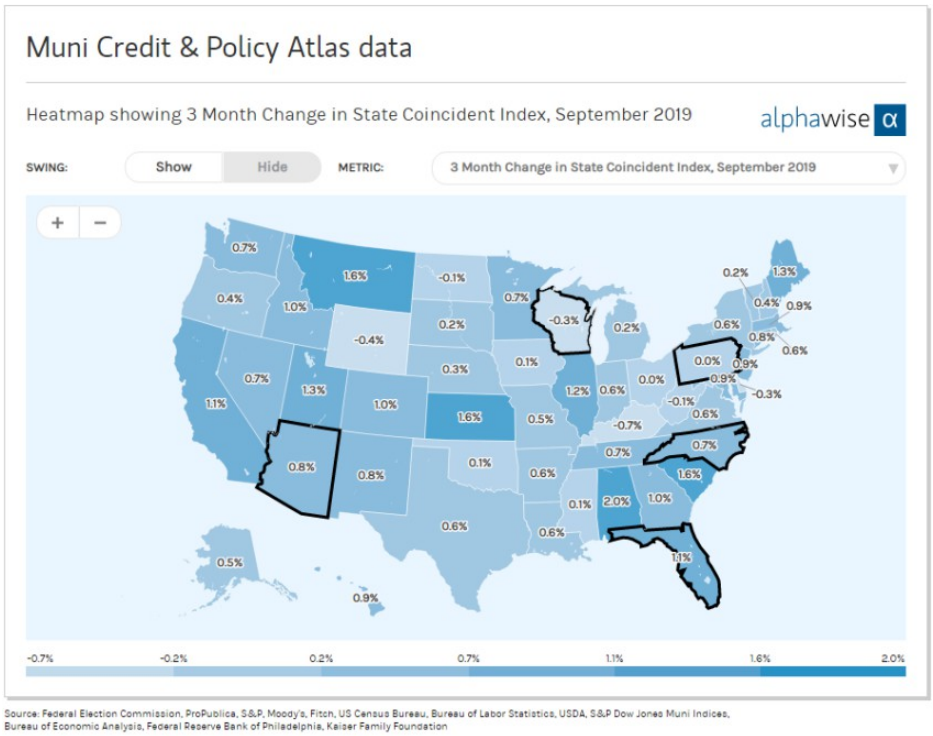


Source: Morgan Stanley Research, *Cook Political Report*

As in 2018, we suggest following the congressional ballot polling question for an overall look at the trend for the 2020 election. An analysis by FiveThirtyEight found that generic ballot polling is as predictive in presidential years as it is in midterm years. Since 1996, the final generic poll of the cycle was within an average of two percentage points from the actual House national popular vote margin. The analysis also found that early generic ballot polls in presidential years (defined as from January to June in the election year) were predictive as well, given that the results of the poll are pretty stable over the election cycle. They consider generic ballot polls to be a good measure of the national mood [FiveThirtyEight, 6/19/2019]. **Democrats have been holding steady with an approximately 6 percentage point lead over Republicans in the generic ballot this year** [FiveThirtyEight, 10/25/19].

3) The interaction between US trade policy and the economy is potentially important

President Trump's ability to replicate his 2016 success in Pennsylvania and the upper Midwest may depend on how those local economies perform. Softening economies in Wisconsin and Pennsylvania bear watching. Other "swing" states are doing well economically: Arizona, North Carolina, and Florida have all posted above-average growth in coincident indicators. **Readers can gauge how swing state economies look across more than 25 variables in our full Muni Credit & Policy Atlas (click here).**



Source: Federal Election Commission, ProPublica, S&P, Moody's, Fitch, US Census Bureau, Bureau of Labor Statistics, USDA, S&P Dow Jones Muni Indices, Bureau of Economic Analysis, Federal Reserve Bank of Philadelphia, Kaiser Family Foundation

Source: Morgan Stanley Research

Accordingly, we are tracking the following four scenarios for 2020 outcomes:

Exhibit 11: 2020 Election Stylized Scenarios

	Divided Government		United Government	
	Thin Red Line (RRD)	Blue Tide (DRD)	Red Redux (RRR)	Blue Wave (DDD)
Stylized Scenarios	• **Strong Economy Works in Trump's Favor:** Trump wins a close re-election by persuading voters not to take a chance on change given a strong economy • **Status Quo Triumphs Over Policy Change in Key Swing States:** Democratic policies are not as animating in swing states as the status quo. • **Incumbency Advantage and Continued Support from the Base of Both Parties:** results in unchanged control for the White House and both chambers of Congress.	• **Swing States Voters see Democrats as the Preferred Option for Advancing Policies:** Democrats return to being seen by swing state voters as the more credible vehicle for addressing popular policy issues, such as healthcare reform • **Regional Economic Slowdowns Are Relevant:** Pressures in key states from US-China trade tensions help Democrats on the margin. • **Impeachment Hurts Presidential Approval** • **Yet Policies and Impeachment May Be Polarizing in Senate Races:** Yet that same issues may be polarizing in Republican-leaning states (AL, AZ, GA, NC) where Senate seats are in play, keeping Democrats from clearing the high hurdle to take control of the Senate.	• **Strong Economy Works in Trump's Favor:** The labor market and wage growth remain steady • **Strong Impeachment Backlash:** The impeachment inquiry fails to persuade moderates and independents. • **Trump Coalition Based on Economic Stewardship, Social Issues, Opposition to Policy Transformation:** Trump builds a coalition based on perception of his economic stewardship and populism, limiting the appeal of Democrats as an untested alternative. • **Pump up the Base, Hold Steady with Moderates and Independents:** This shows in strong poll numbers for Republicans among moderates and independents, as well as building enthusiasm among the Republican base, boosting turnout. Republicans are also able to regain control of the House.	• **Slowing Economy or Growing Inequality Puts Trump's Economic Stewardship at Risk:** Clear decline in growth, or outright recession, makes Trump vulnerable to criticism that his economic policies (trade escalation, tax cuts) make him a failed populist. • **Impeachment Hurts Presidential Approval:** A persuasive impeachment inquiry would prime this message, particularly with swing-state independents. • **Pump up the Base, Outperform in Moderate-Leaning Senate States:** Democrats win the White House with a comfortable margin, and are able to pick up three Senate seats by performing strongly in moderate states such as CO, AZ, and ME and either holding AL or picking up in GA, IA or NC.
Potential Key Issues	• Steady Economy • Trade De-escalation Helps Farm States • Impeachment Backlash Sways Independents • Discomfort with Transformative Democratic Proposals in Swing States	• Healthcare • Impact from Trade Tensions Hurts in Manufacturing States • Impeachment Support Among Independents and Moderates	• Impeachment backlash • Immigration • Economic Strength • Social Issues Important to Republicans	• Economic Weakness • Trade Tensions Escalating • Impeachment support among independents and moderates • Social Issues Important to Democrats
Polls to Watch	• Most Important Issues to Voters: The Economy • Presidential Approval in Swing States: PA, WI, AZ, FL, NC • Congressional Ballot: Flat or Slight Dem +	• Most Important Issues to Voters: Healthcare • Presidential Approval in Swing States: PA, WI, AZ, FL, NC • Congressional Ballot: Flat to Moderate Dem +	• Most Important Issues to Voters: The Economy; Immigration • Presidential Approval in Swing States: PA, WI, AZ, FL, NC • Congressional Ballot > +10 for Reps	• Most Important Issues to Voters: Healthcare • Presidential Approval in Swing States: PA, WI, AZ, FL, NC • Congressional Ballot >+10 for Dems

Source: Morgan Stanley Research

Three Guidelines for How Elections Impact the Policy Path

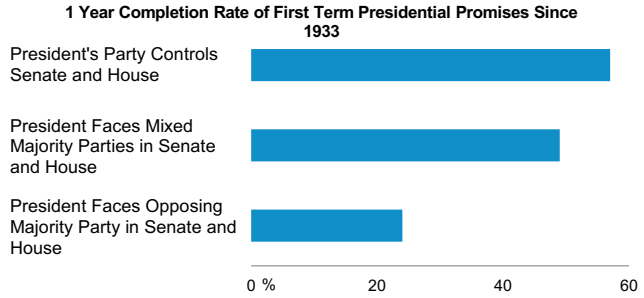
The next step in our framework is translating total government control scenarios into "plausible policy paths." We define "plausible policy paths" as the set of policies that have a reasonable, though not necessarily >50%, chance of being implemented. As we further explain below, there's considerable uncertainty around predicting policy. Hence, rather than offer false precision we'd rather highlight policy paths that have plausible (subjectively 20% or higher) odds of implementation, likely sufficient to influence markets if its related election outcome starts to appear more or less likely.

1) Expect only a portion of a candidate's platform to be enacted

Only about 3% of bills are ever enacted [1]. Furthermore, in our 2016 Election Outlook, we noted that making good on campaign promises is also difficult. Going back to 1933, looking at elections in years when there was no incumbent on the ticket, we compared the key campaign promises of candidates with the enacted policies in their first year in office, the timeframe we are most concerned with here. What we found in aggregate is that presidents have converted less than half their campaign promises into action. Furthermore, that success rate appears to be declining over time, a testament to rising political polarization. Importantly, the success rate improves when examining periods where the presidency and Congress were controlled by the same party, but even then the success rate is only just above 50% since 1933 and 35% since 1970. Presidents facing a Congress controlled at least in part by the opposition have a lower, and also declining,

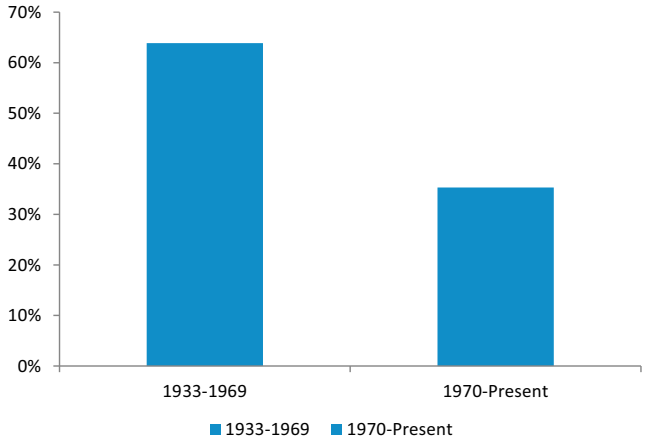
success rate.

Exhibit 12: Making Campaign Promises into Law Is Difficult With Divided Government



Source: Morgan Stanley Research survey of 77 first term Presidential campaign promises accomplished during the first 12 months of an incoming President's term, based on review of historical press and Congressional record

Exhibit 13: Over Time Campaign Promises Have Become Less Likely to be Enacted



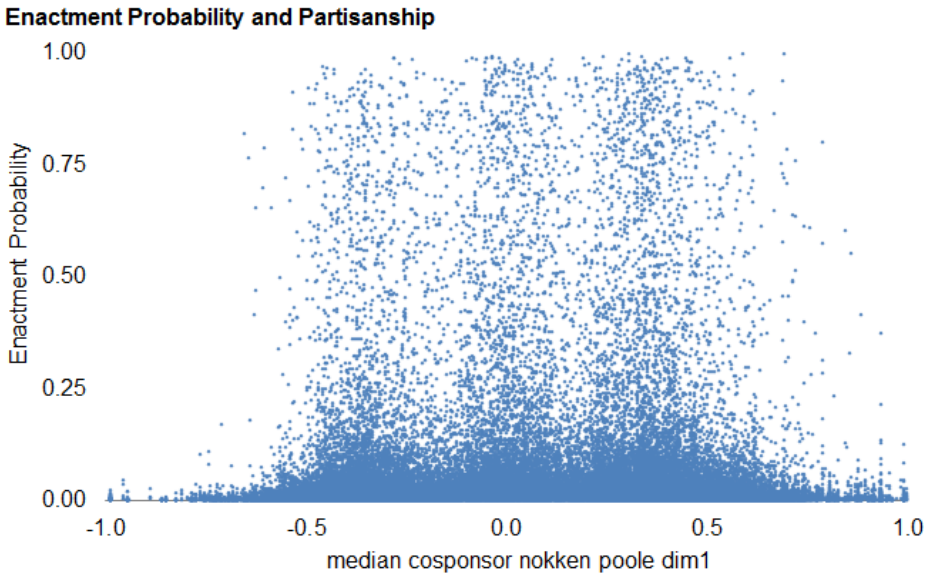
Source: Morgan Stanley Research. N=77.

2) Policy transformation is hard, and when it happens it likely requires a unified government and a moderated vision

Reiterating our earlier points on political polarization, we argue the gulf in legislative vision between Republicans and Democrats likely means one party would need to control the White House and Congress in order to enact legislation beyond more garden variety, operational bills. That syncs with the experience of recent administrations, where periods of unified government (e.g., Obama 2009-10; Trump 2017-18) saw some transformative bills enacted (i.e., ACA/ARRA, TCJA), whereas other periods were devoid of such actions.

In addition, when it does happen, it is likely to be a moderate version of whatever policy is under consideration. The below chart from Skopos Labs (see A Note on Methodology for discussion of the Skopos Labs platform) demonstrates that bills with more moderate sponsors have, historically, carried a higher probability of enactment. The three peaks below represent left-moderate, centrist, and right-moderate, while legislation introduced by members on the farther ends of the partisanship scale tends to have a low probability of enactment.

Exhibit 14: Legislation Sponsored by Moderates has a Higher Probability of Passage



Source: Skopos Labs Platform. Note: Nokken- Poole estimates are a measure of a member of Congress' ideology in one particular Congress.

This syncs with a more common sense observation: successful legislation will likely require persuading moderate members of the Senate. Consider the challenges that would face the Democrats in a "Blue Wave" scenario. In that scenario, they would have hypothetically gained Senate control by winning some seats in decidedly more moderate or Republican-leaning states such as Arizona, Colorado, Maine, North Carolina, and Alabama. Using healthcare as an example, with a likely slim, simple majority, the question wouldn't be "Does the president support Medicare-for-All?", but rather "What form of healthcare reform can get votes from both a Senator from deep-blue Vermont and one from a red-leaning state such Arizona?" In our view, the answer is likely something meaningfully less ambitious than Medicare-for-All.

Exhibit 15: Toss Up and Lean Senate Races, Except for Alabama, Are in Moderate States

2020 Senate Toss Up/ Lean	State	2016 Election
Jones - Dem	Alabama	Trump + 28%
McSally - Rep	Arizona	Trump +4%
Gardner - Rep	Colorado	Clinton +5%
Collins - Rep	Maine	Clinton +3%
Peters - Dem	Michigan	Trump + <1%
Tillis - Rep	North Carolina	Trump +4%

Source: Morgan Stanley Research, Cook Political Report Rankings

We know this from recent experience too — the Affordable Care Act was a much more moderate bill than it would have been if the public option was included (as some Democrats were pushing for). In the Trump administration, repealing the ACA fell short because there was no form of the bill that could satisfy both conservative and moderate concerns. Furthermore, during tax reform some of the sharper cuts were

passed over to create the package of proposals that would be able to pass muster with the more moderate members of the party.

Consider the Filibuster

If it is unlikely for either party to capture 60 seats in the Senate, then shouldn't investors expect little-to-no impactful legislation? Gridlock is always a distinct possibility, but unified control with a simple majority in the Senate opens two possible workarounds.

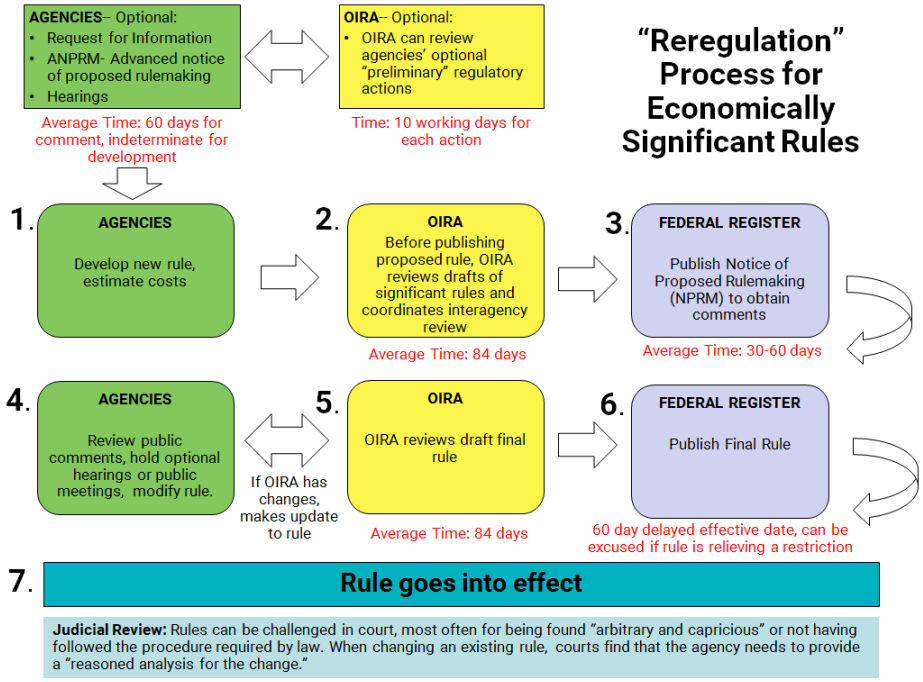
First, legislation could pass through budget reconciliation. While this limits legislative initiatives, in practice it has been used to move some meaningful initiatives, like ACA and the TCJA. In the case of the latter, it even enabled a deficit expansion because it was preceded by a budget resolution that permitted such an increase.

Second, the Senate could get rid of the filibuster through a simple majority vote. A number of Democratic presidential candidates, including sitting Senators, have voiced support for this.

In either case, we argue a simple majority would still deliver a legislative agenda less ambitious than the current slate of residential candidates is promising due to the need to design bills that satisfy the wings of the controlling party.

3) White House control can set a regulatory tone and foreign policy tone, but fundamental impacts are less reliable

The president names all political appointees to the executive branch, including relevant posts such as the FCC commissioners, the assistant attorney general for the Antitrust Division of the Justice Department, banking regulators, and Federal Reserve Board of Governors. The Senate must confirm many of these appointments. These appointees may be able to use existing laws and regulations to take a stronger approach than current appointees. However, their ability to change existing regulations is limited by the demands of the regulatory system and where the current changes are within the system. If a Trump administration change is not completed in time, a Democratic appointee could more easily work to overturn the change. In the occasion of a Blue Wave, Democrats could use the Congressional Review Act to overturn rules submitted to Congress within 90 session days of the new Congress (meaning Trump administration regulations need to be completed by summer 2020 to avoid that possibility). Every regulation should be considered individually as they are all in different stages of the process. [For more information, see The 'Reregulation' Playbook, 8/2/17.]



Source: Morgan Stanley Research, Congressional Research Service, Office of the Federal Register Notes: Executive Order 12866 requires covered agencies to assess costs and benefits for "economically significant" rules at the proposed and final rule stage. Economically significant rules "have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety." Independent regulatory agencies are not subject to the OIRA cost-benefit analysis [Congressional Research Service, 3/17/2017]. OIRA has 90 calendar days to review proposed and final rules, but there is no penalty if OIRA fails to meet the deadline. The average length of reviews of economically significant rules was 84 days in 2015, 106 days in 2014 and 120 days in 2013 [Congressional Research Service, 10/4/2016].

On foreign policy, the story is similar. Consider:

- **Trade Policy:** Unless Congress changes the law, the president has the authority under multiple provisions of trade law to take action on trade policy. The president can influence key issues such as US-China trade tensions, potential auto tariffs, and the state of the WTO. The administration can also push for Congress to pass the USMCA and potentially TPP (See Trade Policy: Beyond The Hypothetical, 1/22/2018).

- **National Security:** While Congress has oversight over foreign policy and can pass specific laws to direct the executive branch to take action (e.g., sanction laws), the president is the driver when it comes to foreign policy. Issues include the Iran deal, Russia sanctions, North Korea, and the Paris Climate Agreement.

'Plausible Policy Paths' by Scenario

We combined the above guidelines and checked our conclusions against the findings of a model built by Skopos Labs (see A Note on Methodology on how we applied their model) to the attributes of legislation that impact the likelihood of enactment.

Exhibit 16: Potential Legislation and Executive Action Under Stylized Scenarios

	Divided Government		Unified Government	
	Thin Red Line (RRD)	Blue Tide (DRD)	Red Redux (RRR)	Blue Wave (DDD)
Legislation We're Watching:	• Bipartisan Rx Drug Pricing • Raise Tobacco Sales to 21 • Modest Infrastructure Add to Highway Bill	• Bipartisan Rx Drug Pricing • Raise Tobacco Sales to 21 • Modest Infrastructure Add to Highway Bill	• Tax 2.0: Extending Indiv. Tax Cuts • Tax 2.0: Deduct Start Up Costs • Tax 2.0: Repeal R&D Tax Cliff • Raise Tobacco Sales to 21	• Prescription Drug Pricing Bill • Health Care reform short of Medicare for All • Infrastructure Bill • Tax Changes as Pay-fors for Spending Programs • Stop Corporate Inversions • Stock Buyback Bill • Raise Minimum Wage • Raise Tobacco Sales to 21
Potential Executive Action	• Continued Trade Tension Globally • Push for Immigration Funding, Potentially Tied to Shutdowns	• Challenge China Through Other Means Besides Tariffs • Regulatory Push for Tech Regulation; Net Neutrality; Environmental Issues; Financial Regulation	• Continued Trade Tension Globally • Push for Immigration Funding, Potentially Tied to Shutdowns	• Challenge China Through Other Means Besides Tariffs • Regulatory Push for Tech Regulation; Net Neutrality; Environmental Issues; Financial Regulation

Source: Morgan Stanley Research

Would a recession change our policy path expectations?

It likely would, particularly within divided government scenarios. By our count, 5 out of the last 7 economic downturns elicited a fiscal stimulus response from Congress. While we do think the politics of a fiscal response will be harder this time given potential lawmaker perception of higher US debt levels (see The Downside of Fiscal Stimulus, April 17, 2018), a recession probably increases the prospects for one relative to our current expectations of legislative gridlock. Simply put, economic downturns tend to scramble political calculations as members of Congress feel urgency to act from their constituents. Hence, we'd see a variety of fiscally expansionary plans, including infrastructure and targeted tax cuts, as more likely should the US enter a recession.

Strategy: Three Takeaways

Michael Zezas, Serena Tang, & Andrew Sheets

We argue that investor expectations are at odds with a market priced for a status quo policy outcome. Hence, election-driven market volatility is to be expected, and we think it is important for investors to have fundamental outcomes to anchor to in order to react properly to them. In our view, this starts with understanding that 1) unified outcomes, and hence larger polling moves, are likely required to drive effective change; 2) those outcomes are skewed toward fiscal expansion; and 3) the sector impacts, and therefore investment expression, differ based on which party controls the unified government.

1) Reactive > Proactive in dealing with election risk to markets

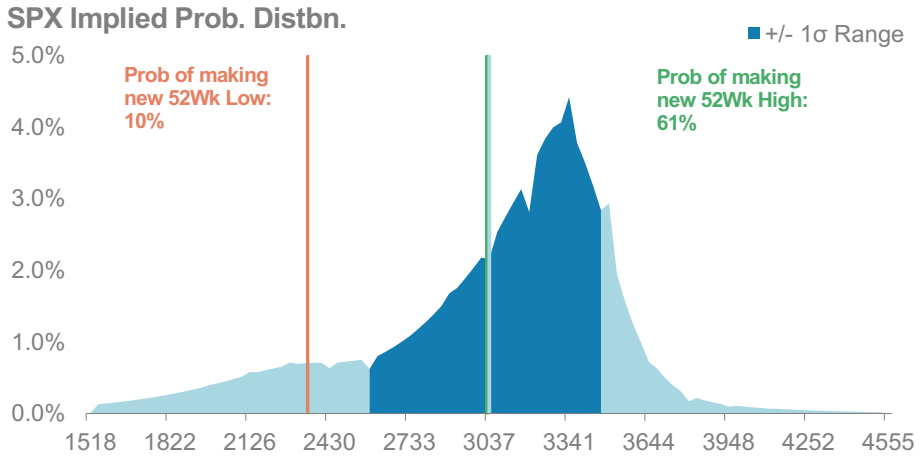
Campaigns can move markets, but a 'plausible policy path' view is needed to react appropriately

Investors expect the outcome could drive policy in meaningfully different ways, but markets are not pricing in meaningful policy changes. Hence, it is reasonable to think that swings in the race for the White House could move markets. For example, the results of the Morgan Stanley 2020 Election Outlook Survey, based on responses from 645 investors worldwide, show us which policy areas investors are most concerned about, and where investors expect the biggest divergence of policy and market outcomes between a Republican and a Democrat White House. Of note:

- Survey respondents are generally most concerned about trade policy, fiscal policy, and taxes, and least concerned about immigration and energy/climate policy (Exhibit 75).
- Higher net share of survey respondents see equities rallying in the first three months of a Trump second term, while more respondents on net associate a Democrat presidency with equities declining (Exhibit 81).
- More survey respondents on net expect equities across nearly all sectors to benefit significantly/moderately benefit during the first three months of a second Trump term compared to in the first three months of a Democratic presidency (Exhibit 82).
- Sectors where the highest share of respondents expect divergent outcomes between a Republican and a Democratic presidency include Financials, Energy, and Technology (Exhibit 82).
- Overwhelming share of survey respondents believe a Democrat candidate will be more likely to implement policies around 1) increased financial regulations, 2) de-escalation of China tariffs, and 3) prescription of drug reforms (Exhibit 80).
- Survey respondents associate a Republican candidate with a higher likelihood of pursuing fiscal stimulus.(Exhibit 80).

Yet pricing in options markets suggest meaningful policy changes are not accounted for. Consider the SPX options markets. They demonstrate a high confidence fin the market breaching all-time highs over the next 12 months, but considerably lower probability of a 10%+ drawdown. This skew is at odds with the perception from our survey that a Democratic presidential victory could put pressure on equities.

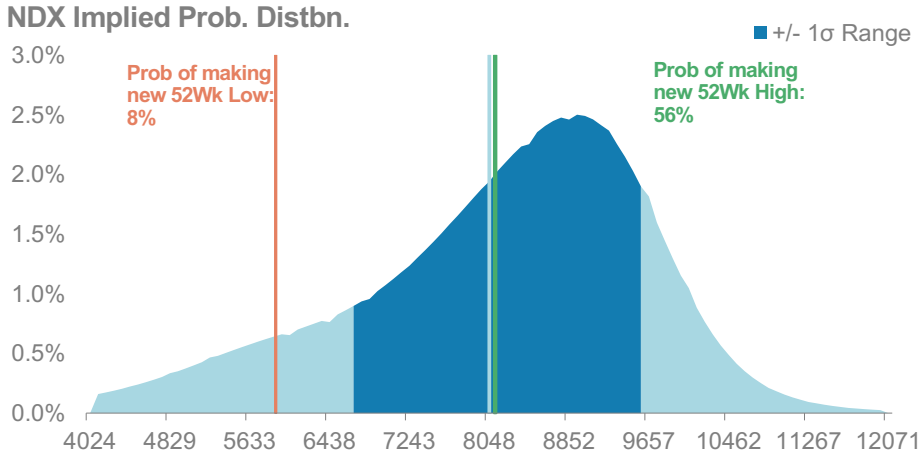
Exhibit 17: Option markets more confident of SPX making new highs over next 12M than 5% down



Source: Bloomberg, Morgan Stanley Research

A similar story can be seen in option markets for technology stocks...

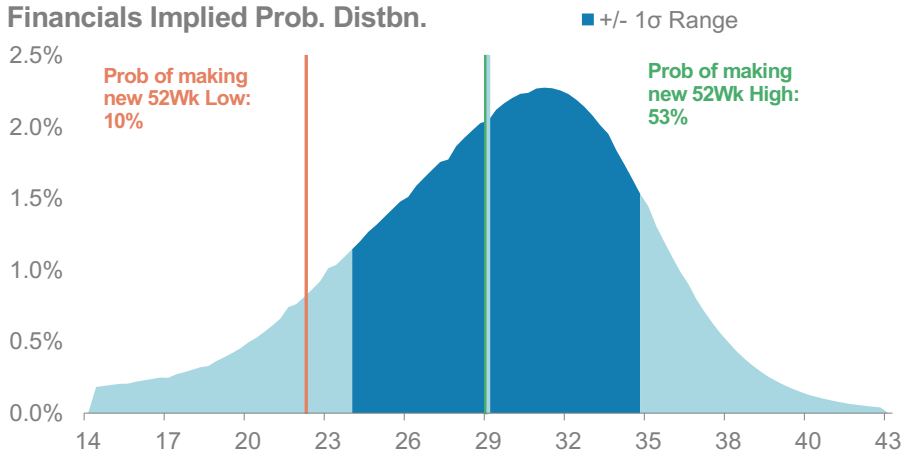
Exhibit 18: Option markets not pricing in extreme downside scenarios for NASDAQ despite concerns about divergent policy outcomes under different electoral scenarios



Source: Bloomberg, Morgan Stanley Research

...and in financials.

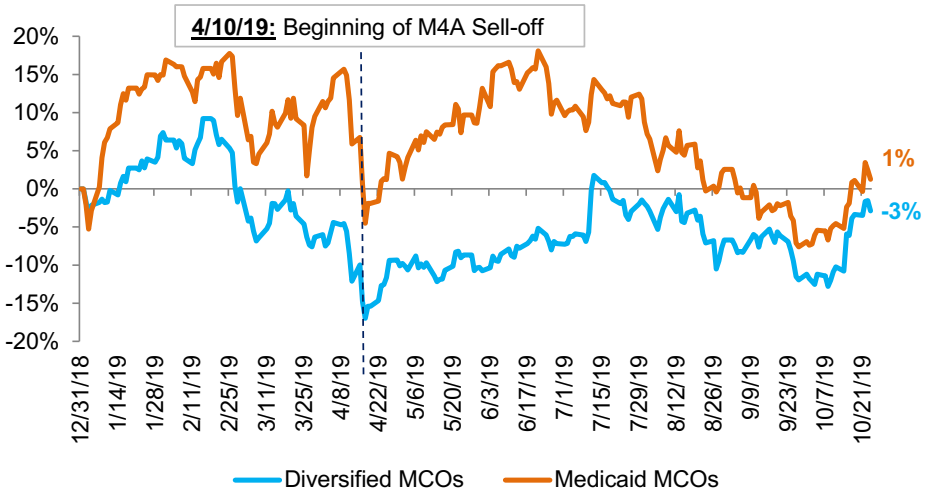
Exhibit 19: Similar story in option markets for financials - meaningful policy changes not in the price



Source: Bloomberg, Morgan Stanley Research

One need only to look at the experience of healthcare equities earlier this spring for an example of how policy risk shifts can influence markets. Managed care stocks were down 16.1% over the six trading days between April 9 and April 17, compared to the S&P 500 up 0.8% over the same timeframe, after Senator Bernie Sanders introduced his Medicare-for-All proposal in the Senate on April 10. From peak-to-trough, the MCOs as a group derated 5.3 turns from a high of 1.5 turn premium to the S&P in late January to a 3.8 turn discount in mid-April. The group recovered somewhat after former Vice President Joe Biden announced he would join the race for Democratic nomination on April 25.

Exhibit 20: MCOs YTD Stock Performance Affected Early on by Sanders' Position

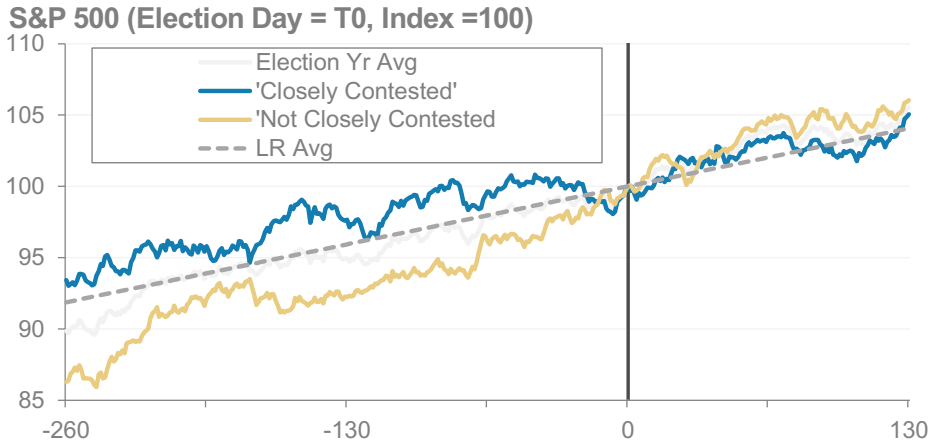


Source: Company data, Morgan Stanley Research Estimates, Thomson Reuters. Note: Diversified MCOs index includes ANTM, CI, CVS, HUM, UNH. Medicaid MCOs includes CNC, MOH, WCG.

Furthermore, recent history tells us that close elections tend to see more range-bound equity markets than ones where the outcome was more certain. Consider the 1996 presidential race, in which Bill Clinton's polling margin over Bob Dole was never less than high single-digits[2]; S&P 500 rallied by 22% 12 months going into the election. In contrast, the 2016 race was quite uncertain. Although anecdotally many treated a Trump victory as improbable, the polls and polling-based probability models said

otherwise, with his polling deficit typically in low single digits; US stocks saw only 3% gains 12 months going into that election. On average, excluding the 2008 episode, elections that aren't close see equities rally by about 16% the year before voting; elections that are close only see about 7% gains, weighted down partly by uncertainties.

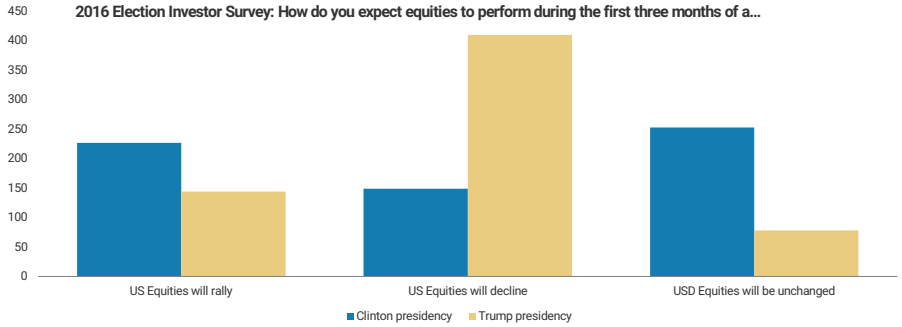
Exhibit 21: Equities tend to be more range bound going into closely contested elections and tend to rally more when there's more uncertainty



Source: Bloomberg, Morgan Stanley Research ; Note, based on presidential episodes since 1960, with exception 2008, where market performance was an outlier. "Closely contested" defined as where resulting popular vote margin is below average; "Not closely contested" defined as where resulting popular vote margin is above average.

However, we'd caution investors not to play for moves based on perception. Rather, we think it a better strategy to consider the total government outcome of the election, the policy path it drives, and whether it is "in the price" in order to react appropriately to election-driven market volatility. While it would be reasonable to deduce from our survey that moves toward a Democratic victory could initially weigh on risk markets, we wouldn't have confidence in the durability of such a reaction. The 2016 election serves as a cautionary tale here. In our same survey that year, respondents overwhelmingly identified a Trump victory with an equity market sell-off.

Exhibit 22: Our 2016 Investor Survey Showed Investors Thought a Trump Victory Would Lead to an Equity Sell-Off, Which It Did, but Only for a Few Hours



Source: Morgan Stanley Research

And on election night, that's what they got in the futures market...for a few hours. The subsequent risk asset rally is history. In our view, investors realized that a unified Republican government was a path to tax-cut stimulus.

2) Macro impacts are more about unified vs. divided than Republican vs. Democrat

We argued earlier that divided government outcomes tend toward legislative gridlock. And though divided governments could still influence the outlook through regulatory reinterpretations and resulting impacts to business sentiment, they are unlikely to deliver transformative policy in a macro sense. **Hence, divided government is unlikely to deliver policy that counteracts the current late-cycle economic narrative.**

A more surprising observation might be that we see some symmetry in the direction of the macro impact in both unified government scenarios. Both tend toward fiscal expansion, fueled in part by messaging driven implicitly by ideas such as the Laffer Curve and MMT. Hence, unified vs. divided appears to be the key variable for some macro markets, like US Treasuries and the US dollar.

'Red Redux' skews policy toward supply-side expansion

Applying our prior standard that transformative policy likely requires satisfying moderates, we argue that to the extent Republicans are able to legislate their policy priorities (far from certain), it skews more toward revenue reduction than spending reduction. On the former, tax cuts appear to be one area of near universal agreement among Republicans. The same does not appear true of the latter. Although Republicans generally support the concept of entitlement spending cuts, in recent administrations when they've had the opportunity to pursue them they have typically not succeeded (i.e., the failed ACA repeal attempt).

One might push back and argue that Republicans may feel constrained by further expanding the deficit given their hawkish fiscal rhetoric. We take the other side of this argument. In recent administrations, when Republicans have held unified power, they've generally pursued deficit-expanding tax cuts (i.e., the Bush tax cuts and the Tax Cuts and Jobs Act [TCJA]). Republicans would likely not phrase it that way, but instead use the Laffer Curve theory to argue tax cuts will be self-financing over time. We think whether this ends up being true is besides the point, which is that the acceptance of Laffer Curve logic enables Republicans to pursue policies that are near-term fiscally expansive.

So what could a potential stimulus look like? It would probably be less potent than the TCJA in that it would be a proactive extension of tax cuts. Hence, it would not increase deficits in the near term, but instead would likely create the expectation of future stimulus vs. the baseline.

Exhibit 23: Estimated costs of extending policy within the 10-year budget window

Corporate Provisions	Policy Expiration	Estimated Cost/Benefit
Immediate expensing of research and experimentation costs, rather than amortization over 5 years	End of 2021	($240B)
Deduction for business net interest expense at 30% of EBITDA, rather than 30% of EBIT	End of 2021	($150B)
Extension of full expensing for short-life business investments	End of 2022	($250B)
Three international-related provisions (GILTI, FDII, & BEAT) stay at current levels	End of 2025	($140B)
	Total	**($780B)**
Individual Provisions	**Policy Expiration**	**Estimated Cost/Benefit**
Reduced individual income tax rates	End of 2025	($1840B)
Increase in the standard deduction, elimination of the personal exemption, and doubling of the child tax credit	End of 2025	($200B)
Limit on SALT and mortgage interest deductions	End of 2025	$1210B
Reduction in AMT	End of 2025	($950B)
20% pass-through deduction	End of 2025	($410B)
Reduction in the estate tax	End of 2025	($80B)
	Total	**($2,270B)**

Source: Tax Foundation, Joint Committee on Taxation, Morgan Stanley Research estimates

'Blue Wave' skews policy toward demand-side expansion

Applying the same logic on policy moderation — to the extent Democrats are able to legislate their initiatives — we see their relatively popular spending ideas having a better chance of gaining sufficient Congressional votes than the totality of tax increases required to make them deficit neutral. Indeed, polls have found that voters favor taxing the wealthy and increasing domestic spending [Fox News Poll, 1/24/19; Morning Consult, 2/27/19].

Substantial increases in corporate, income, and potentially new wealth taxes could make these ambitions deficit neutral, but we struggle to see what combination of sufficient tax increases can get affirmative votes from Democrats in moderate geographies, which is likely necessary in a "Blue Wave" outcome given the unlikelihood of control beyond a simple majority.

Exhibit 24: Making Programs Deficit-Neutral Would Require a Variety of Tax Increases

Proposed Pay-fors	Healthcare		Childcare		Higher Education		
	Medicare for All	Medicare for America	Baby Bonds	Child Care Program	Student Loan Forgiveness	College for All	Higher Ed Expansion
6.2% Employer Tax	✓						
2.2% Individual Premium	✓						
Increase Income Tax for High Earners	✓						
Increase Capital Gains	✓		✓				✓
5% Surtax on AGI (Including Capital Gains) Above $500k		✓					
Futher Limit Tax Deductions for High Earners	✓						
Increase Estate Tax	✓		✓				
Roll back TCJA		✓					
Increase Medicare Payroll Tax		✓					
Increase Net Investment Income Tax		✓					
Excise Tax on Tobacco, Alcohol, and Sugary Drinks		✓					
Financial Transactions Tax						✓	
Wealth Tax				✓	✓		
Buffett Rule							✓

Source: Morgan Stanley Research. Medicare for All: CFRB.org analysis of Sanders Proposal. Medicare for America: Delauro.house.gov; Baby Bonds, Booker Proposal: NYT; Child Care Proposal and Student Loan Forgiveness: Warren Campaign. College for All, Sanders plan, Time; Higher Ed Expansion, Klobuchar Campaign.

Yet, we also wouldn't expect a lack of politically viable pay-fors to impede the Democrats' agenda, much as it did not the Republicans' in 2017 around tax reform, where the TCJA was scored as adding $1.5 trillion to the deficit over a 10-year period [Joint Committee on Taxation, 12/18/17].

Both Parties' Fiscal Orthodoxy Increasingly Permits Deficits

While Democrats and Republicans both claim the mantle of fiscal responsibility, we see increasing signs that in practice this may not be true going forward, at least from the perspective of economic forecasting. One contributing factor, in our view, is the increasing tolerance, whether pragmatic or genuine, of heterodox macroeconomic ideas. These ideas can make policy makers more comfortable making votes in favor of bills that are not fully paid for.

For the Republicans, it is the Laffer Curve. This is the idea that tax rates above a certain level impede economic activity and, hence, cutting rates can actually lead to higher tax revenue by boosting the economy. This assumes that policy makers can know if tax rates are above this threshold ex-ante, but this is likely only something that can be observed ex-post. Elected Republicans tend to use this idea to defend recent tax cuts as fiscally sound, including tax cuts enacted during the Bush and Trump administrations. From a market economist's standpoint, though, the fact that revenue cuts, measured on a static basis, increase deficits is the operational takeaway, as they tend to increase near-term growth expectations.

Democrats don't have the same recent examples as Republicans, but they do have a rising heterodox challenge: Modern Monetary Theory (MMT). In short, MMT posits that solvency is not a constraint for governments who borrow in their own fiat currency. Hence, under MMT, deficits are only a problem insomuch as they stoke too much growth and inflation, and therefore ambitious spending programs aren't intrinsically bad fiscal policy. More orthodox economists associated with Democratic policy making have pushed back that a major flaw with this approach is its reliance on a democratically elected body to control fiscal policy the way an apolitical central bank controls monetary policy. Yet many of those same economists concede that current deficit levels can be pushed farther, and therefore there's space to spend more on social initiatives. [Foreign Affairs, 1/27/19]

Exhibit 25: Our Views: 2020 Election Macro Impacts

Scenarios	Key Macro Impacts +	Key Macro Impacts –
Blue Wave **D President** **D Senate** **D House**	US GDP USD	US Treasuries
Red Redux **R President** **R Senate** **R House**	US GDP USD	US Treasuries EM

Source: Morgan Stanley Research

3) Sector impacts vary in degree and magnitude by scenario

While many of the legislation proposals that investors have expressed concerns about seem unlikely across our scenarios, more likely but less ambitious initiatives would still have a meaningful impact to fundamentals. That's in part due to regulatory changes that can be initiated by a president. While those changes typically take years to implement, we think it is fair to recognize the potential impact of such moves.

While our table below focuses on select fundamental exposures, sector analysts in the sections that follow also focus on how scenarios can influence investor sentiment in the near term. Hence, in some cases the view of potential near-term market influences may be different from the view on the potential policy impact of a scenario. Healthcare is a good example of this, where concerns around Medicare-for-All could pressure insurer stocks even though we view that policy as unlikely even in a Democratic Sweep.

Exhibit 26: Key Fundamental Exposures by Plausible Post-Election Policy Path

	Scenarios	Potential Pressure +	Potential Pressure –
Divided Government	**Blue Tide** **D President** **R Senate** **D House**	Energy (Non-US Oil & Gas, Renewables)	Energy (US-Focused Oil & Gas) Large Cap Banks Consumer Finance IT Hardware US Internet Telecom Pharma
Divided Government	**Thin Red Line** **R President** **R Senate** **D House**	Large Cap Banks Consumer finance Telecom US Energy Asset Managers	
Unified Government	**Blue Wave** **D President** **D Senate** **D House**	Large MCOs Transportation Energy (Non-US Oil & Gas, Renewables)	Pharma Large Cap Banks Consumer Finance IT Hardware US Internet Telecom Energy (US-Focused Oil & Gas) Asset Managers
Unified Government	**Red Redux** **R President** **R Senate** **R House**	Telecom Financials US Energy Asset Managers	

Source: Morgan Stanley Research

What's the Impact of Impeachment?

In our view, the impeachment process is important to markets insomuch as it could change the US policy trajectory. Since we see little scope for major policy enactment before 2021 (see Pop & Gridlock, 1/8/19), the impeachment impact is therefore a function of how it affects the outcome of the 2020 election and, accordingly, the post-election policy paths we've outlined in this report.

First, we should acknowledge that we don't think investors will get much

satisfaction in playing the initial reaction to new impeachment information. The survey we detail in this report notes investors are far more concerned about risk assets with Democrats in control, suggesting risk markets may initially come under pressure on impeachment news. Yet, that could easily be short lived. Our survey in 2016 suggested a similar reactionary sell-off would happen if Trump won the election. Such a sell-off did happen and was sharp, but over in a matter of hours. Hence, we argue investors should react to such news flow by looking to express themes around the medium-term fundamental sector impacts we outline in this note.

For example, if the House impeaches President Trump, but it is clear that the Republican-controlled Senate does not have the votes to remove him from office, this wouldn't give investors new information about the potential outcome of the 2020 election. Elected officials, being rationally self-interested, have likely reacted to polls, public or not, showing that Democrats increasingly support impeachment, but Republican support for President Trump hasn't meaningfully wavered. This is more or less what polls show today. Hence, beyond the potential for some knee-jerk reactions and volatility in markets, there are likely few reliable fundamentally investable themes.

If, instead, the House impeaches President Trump and the Republican-controlled Senate appears headed toward a vote to remove him from office, then we think that likely would reflect a reading of public opinion in which Republican voters' approval of Trump has slipped substantially. Note this information would likely be available well before a vote. Hence, in that scenario one could reasonably infer that, at least for the moment, the chances of a Democratic victory in 2020 had risen meaningfully, putting key sector positives and negatives into motion.

Macro Impact: US Economics

Ellen Zentner & Robert Rosener

Key Takeaways

- Divided government outcomes are unlikely to meaningfully change our US economic outlook.
- Unified Republican or Democratic outcomes could boost our expectations by creating the possibility of fiscal expansion.
- While our survey suggests concern with the economic impact of a Democratic win, it could deliver "demand-side" stimulus.
- Economic policy uncertainty matters. Researchers have found that particularly in tight elections policy uncertainty can dampen investment and employment.

We think the probability of achieving **meaningful fiscal stimulus in 2021 is greatest in a scenario in which there is a sweep** — regardless whether the outcome is Republican or Democrat. In a unified outcome scenario, then, the type of stimulus delivered depends on which party prevails, and we would expect that a Democratic sweep in 2020 could deliver the greatest impulse to the economy. (Note: We focus on the impacts of policy choices in the medium term, not the longer-term potential growth impacts of policy choices). Why? It comes down to policy design, and the associated multiplier effects of that policy. **Offsetting factors we think investors should take into account include the path of regulation, as well as heightened economic policy uncertainty.** We explore these topics further.

Taxes: Supply-side vs demand-side matters

In a unified party scenario, Republicans are likely to focus on supply-side fiscal expansion, which tends to come in the form of tax cuts delivered across the board to both households and the corporate sector — the design of the Tax Cuts and Jobs Act (TCJA) of 2017 being the most recent example. Both the design of the TCJA and the timing of its delivery led us to assume a low multiplier effect of just 0.4 as the cuts were not weighted toward lower income groups and much of the tax benefit to corporations went toward increased M&A activity, share buybacks, and dividend increases, which worked to boost equity valuations and return income to higher-income savers.

Regardless of the election outcome, there are various provisions of the TCJA that we think need to be extended in order to avoid a sharp contraction in government support; for example, on the corporate side immediate expensing of R&D and the deduction for business net interest expense at 30% of EBITDA rather than 30% of EBIT both expire in 2021. In 2022, full expensing for short-life business investments expires, and in 2025

three international-related provisions expire (see US Public Policy: Corporate Taxes Are Going Up, March 27, 2019). Congress is very likely to extend these measures — they were written to expire in 2021 to comply with the budget rules when Congress passed the TCJA, but with the intent to address at a later date. These extensions, however, would only avoid a fiscal contraction starting in 2021 as opposed to providing incremental new stimulus.

Democratic policies tilt toward demand-side stimulus that, in net, create and shift money toward the lower end of the income chain, in which the marginal propensity to consume tends to be higher. These policies carry some of the largest multipliers. For example, a CBO study of President Obama's American Recovery and Reinvestment Act (ARRA) suggested a multiplier range of 0.10 to 2.5, with the largest multipliers assigned to transfer payments to individuals and tax cuts for middle-to-lower income households (Exhibit 27). Other policies such as the expansion of childcare tax credits and expansion of the unearned income tax credit also carry higher multipliers.

Exhibit 27: Estimated Output Multipliers For Major Provisions of the ARRA of 2009

Type of Activity	Estimated Output Multipliers	
	Low Estimate	High Estimate
Purchases of Goods & Services by the Federal Government	0.5	2.5
Transfer Payments to State & Local Governments for Infrastructure	0.4	2.2
Transfer Payments to State & Local Governments for Other Purposes	0.4	1.8
Transfer Payments to Individuals	0.4	2.1
Onetime Payments to Retirees	0.2	1.0
Two-Year Tax Cuts for Lower- and Middle-Income People	0.3	1.5
One-Year Tax Cut for Higher-Income People	0.1	0.6
Extension of First-Time Homebuyer Credit	0.2	0.8

Source: Congressional Budget Office, Morgan Stanley Research

Infrastructure

Our election outcome scenarios argue that an infrastructure spending plan is more likely to take place in a unified Democratic outcome than a Republican one. Why? As we argued above, we believe Republicans are reticent to increase federal spending — as opposed to reducing federal revenue — without a pay-for, and there's no consensus yet in the party about a tax that could finance the endeavor. Hence, infrastructure is more likely to be part of a "demand-side" fiscal strategy and historically have packed a greater economic punch.

While multipliers related to government spending can be quite small, they can vary greatly depending on the type of policy. In Rebuilding America: Infrastructure: Laying an Investment Foundation (April 9, 2018), we highlighted that infrastructure comes with a much higher multiplier between 1.4 and 3.0. In general, most estimates of the output multiplier for infrastructure investment are significantly higher compared with other fiscal interventions (see, as an example, Leduce and Wilson (2012))[3]

In 2012, economists at the San Francisco Federal Reserve Bank studied the effects of federal highway grants since 1990 on gross state product (GSP) and concluded that infrastructure spending carried on average a "relatively large" multiplier of 2.0 — that is,

every dollar spent on infrastructure increases a state's GSP by two dollars.[4]

Both short- and medium-run effects were positive — a boost to aggregate demand in the short run that isn't immediately met with an adjustment in prices, and medium-run effects that reflect a supply-side response increasing the economy's productive capacity (primarily a reflection of better roads). Indeed, a multiplier of 2.0 suggests the dynamic effects of infrastructure spending are quite large. The authors note that in downturns the multiplier can be even larger, such as in 2009 during a severe downturn when they estimated the multiplier to have been as much as "roughly four times" normal.

Ultimately, multiplier effects are inherently uncertain and only observable long after policy implementation. The net impact of any fiscal expansion policies will be determined by the Fed's response, the market reaction and the evolution of financial conditions, and where the tax cuts are targeted (e.g., lower- versus higher-income households).

Wouldn't increased regulation blunt these effects? Not necessarily

It seems clear that there have been benefits to economic growth from a softening in regulation under the current administration. But quantifying the impact is difficult because there is no counter-factual comparison to be made. Indeed, increased regulation under a Democratic sweep is an unknown factor within an analysis that aims to estimate what the net economic impact of a Democratic or Republican sweep could ultimately be.

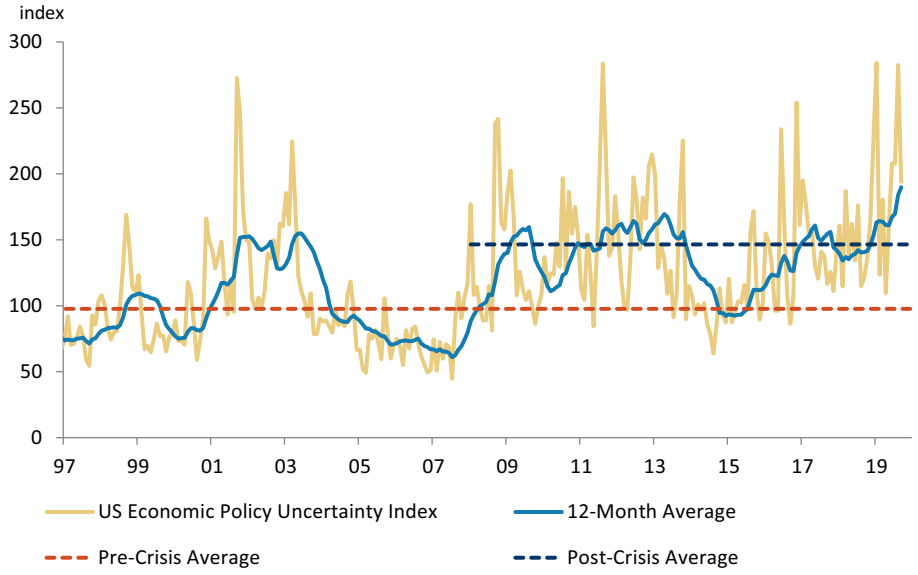
Policies that raise or lower healthcare costs, or alter the cost of living, also could come with relatively large multiplier effects. In these cases, lower income groups in the US shoulder a disproportionate share of healthcare and rental costs in relation to disposable income. These groups are particularly vulnerable today, and are the source of rising delinquencies as we have recently noted in How Strong Is the US Consumer Really? October 13, 2019.

Economic policy uncertainty

In 2012, Scott Baker and Nicholas Bloom of Stanford University and Steven Davis of the University of Chicago developed an index that tracks economic policy uncertainty.[5] The index consists of three measures that quantify 1) newspaper coverage of policy-related economic uncertainty, 2) the number of federal tax code provisions set to expire in future years, and 3) disagreement among economic forecasters as a proxy for uncertainty around monetary policy and government purchases at the federal level.

As shown in Exhibit 28, economic policy uncertainty receded sharply in September, but a rolling 12-month average suggests that **uncertainty has increased sharply since 2018** and is running much higher than levels sustained from 2015 to 2017, and when compared with the post-crisis average. When applying changes in the index within a macroeconomic model of the US economy, Baker, Bloom, and Davis found that heightened policy uncertainty "raises stock price volatility and reduces investment and employment in policy-sensitive sectors like defense, healthcare, and infrastructure construction. At the macro level, policy uncertainty [foreshadows] declines in investment, output, and employment…."

Exhibit 28: Economic Policy Uncertainty Has Persisted at Much Higher Levels



Source: Baker, Bloom and Davis, Morgan Stanley Research

Because the index incorporates the dispersion of economists forecasts, it will naturally rise as the business cycle ages; we can observe in Exhibit 28 that policy uncertainty bottomed alongside the end of household deleveraging in 2014. The persistence of uncertain outcomes around trade amid an undercurrent of slower global growth in a late-cycle economy has no doubt contributed to a wide dispersion of expectations. **Uncertainty over economic policy, particularly if we see a close presidential race, is likely to continue to weigh on business and household decisions in 2020.**

Macro Impact: US Rates

Matthew Hornbach & Guneet Dhingra

Key Takeaways

- **United we rise, divided we fall.** US rates markets (including breakeven inflation rates) are most likely to rise *after* the election of a united government — Red Redux (RRR) and Blue Wave (DDD); they are most likely to remain range-bound or fall *after* the election of a divided government — Thin Red Line (RRD) and Blue Tide (DRD). Rates may move in different directions, however, *before* the election.

- **Fiscal policy, regulatory policy, and trade policy all matter to varying degrees.** Fiscal policy should have the largest direct impact on US rates markets. But regulatory policy and trade policy should also exert influence on corporate sentiment - which can affect the economy, monetary policy, and rates markets. Again, how markets respond is likely to come from both perception of these policies *before* the election and the reality of these policies *after* the election.

- **Expectations for policy matter more for US rates markets than the effects of policy implementation.** US rates markets are forward looking. Investors make decisions — which move markets — based on their expectations and, ultimately, whether reality follows those expectations. Expectations for higher fiscal deficits cause investor expectations for higher supply and stronger economic activity to form. These expectations, and the decisions made on their backs, send rates higher *before* supply and economic activity actually increase.

- **Expectations for the path that policies take, i.e., the order in which they are pursued, matter as much as the policies themselves.** If we've learned anything from the past three years, it's that the path for government policy matters. If investors expect an administration to pursue fiscally expansionary policies first, interest rates and breakeven inflation rates will go higher first. If investors expect an administration to pursue policies likely to compromise economic activity first, interest rates and breakeven inflation rates will fall first.

Four outcomes, many possible interest rate paths

The four scenarios outlined in this note are best separated along "united" and "divided" lines. We place each outcome into a bucket depending on the outcome of the presidency, the Senate, and the House of Representatives. United outcomes, a Red Redux (RRR) and Blue Wave (DDD), have either Republicans or Democrats "sweeping" the presidency, the House of Representatives, and the Senate. Divided outcomes, a Thin Red Line (RRD) and Blue Tide (DRD), have the same outcomes for Congress — a

Republican majority in the Senate and a Democratic majority in the House — but different outcomes for the presidency.

We think US rates markets (including breakeven inflation rates) are most likely to rise *after* the election of a united government and most likely to remain range-bound or fall *after* the election of a divided government. At the same time, markets may respond differently *before* the election, even if the outcome of the election meets expectations, as formed over time by polls. Indeed, each of the four possible outcomes come with expectations for different combinations of fiscal, regulatory, and trade policies (and each with a different ordering). This makes such an up-down assessment of interest rates simplistic at best, unhelpful at worst.

We think a more helpful approach is to suggest how investor expectations — and thus investment decisions — may evolve over time, given each outcome. In no particular order, and based off the potential legislation and executive action described in Exhibit 16:

1. **Red Redux (RRR):** The policy path will matter for rates markets. Do Republicans immediately embark on Tax 2.0 (rates biased higher)? Or does the administration first focus on trade policy with China, Europe, or other trading partners (rates biased lower)? Before the election, we would expect rates to drift higher if polls point toward this outcome, as uncertainty among CEOs, small businesses, and consumers declines and optimism increases. After the election, the path of rates will depend on which policies take priority.

2. **Blue Wave (DDD):** Again, the policy path will matter for rates markets. Do Democrats first reduce tariffs on China and approach China using other methods instead (rates biased higher)? Do they pursue infrastructure or healthcare reform without fully funding the expense (rates biased higher)? Or do they pursue a regulator push including financial regulation (rates biased lower)? Before the election, we would expect rates to move sideways, as CEO confidence may decline followed by economic activity. After the election, however, rates could move higher, given the possibility of higher fiscal deficits.

3. **Thin Red Line (RRD):** The status quo is unlikely to see rates markets move dramatically either before the election or after it. Still, we expect concerns about trade policy to linger - preventing rates from moving higher after such an outcome — while the certainty of status quo politics could prevent rates from moving dramatically lower. On net, continued gridlock in Washington coupled with the risk of increasing trade tensions should weigh on yields to an extent.

4. **Blue Tide (DRD):** Before the election, the prospect of a Democrat winning the White House may put downward pressure on rates markets, depending on which candidate wins the nomination, the policies they promote, and how their politics evolve into the general election. After the election, we think rates will remain range bound or move slightly lower, depending on the priorities the Administration gives to trade policy (rates biased higher) versus regulatory reform (rates biased lower).

Quantifying the fiscal impact on rates

Expectations for changes in fiscal policy can effect expectations for changes in Treasury supply. And changes in those expectations can impact the direction of interest rates - both those usually controlled by the Fed directly and those usually not. Here we

discuss the fiscal impact on longer-term interest rates, or those the Fed does not control directly, in most cases.

In our view, the rates market is a forward-looking discounting machine. It prices in supply as investor expectations form for it. As investors adjust expectations, their investment behavior changes such that, by the time the supply actually arrives, investors are prepared to take it down. Of course, this holds only as long as the size of the eventual supply meets previously those formed expectations.

This forward-looking aspect of investor behavior makes analyzing the effect of Treasury supply on yields difficult. Indeed, the deficit in 2019 was much larger than usual, but Treasury yields have fallen dramatically so far this year (see our analysis of the Tax Cuts and Jobs Act impact on yields). Unfortunately, we do not have data that captures expectations for Treasury supply. We only have data on actual supply.

Academic research that addresses the effect of Treasury supply on Treasury yields — a topic with wide appeal — is scarce and usually inadequate, given the data limitations described above. A paper titled, "New Evidence of the Interest Rate Effects of Budget Deficits and Debt" (Laubach 2003) describes a valiant effort. Laubach tries to capture the effect of changing expectations by using a projection for 5y ahead deficits from the Congressional Budget Office (CBO). Unfortunately, the CBO updates its deficit projections sporadically, and often well after market participants have updated theirs.

Laubach concludes that **5y forward longer-term yields (think: 10y yields in 5 years time) rise "about 25 basis points per percentage point increase in the projected deficit/GDP ratio."** At the same time, Laubach notes that the results are not robust over time. For example, after 1999, yields went down with higher projected deficit/GDP. The inconsistency in Laubach's results likely comes from how markets incorporated expectations for fiscal stimulus, and how stimulus may have been counter-cyclical, as opposed to pro-cyclical, historically.

Nevertheless, we think Laubach's estimate (25bp per 1pp increase in deficit/GDP) is a good starting point when estimating the impact of pro-cyclical fiscal stimulus, or fiscal drag, on yields. Regarding the 2020 election, we don't know how much fiscal deficits will expand in either a Red Redux or Blue Wave outcome, with much less visibility coming with the Blue Wave.

While we believe the Red Redux outcome could see the early extension of expiring tax provisions (see Exhibit 16) and that could add a hefty sum to budget deficits relative to the CBO baseline (see Exhibit 23), our economists suggest that Congress has been expected to extend these measures, which were written to expire in 2021. And if they do, it will simply avoid a fiscal contraction relative to expectations instead of creating a fiscal expansion relative to expectations (see Macro Impact: US Economics).

The sentiment effect pre- and post-election

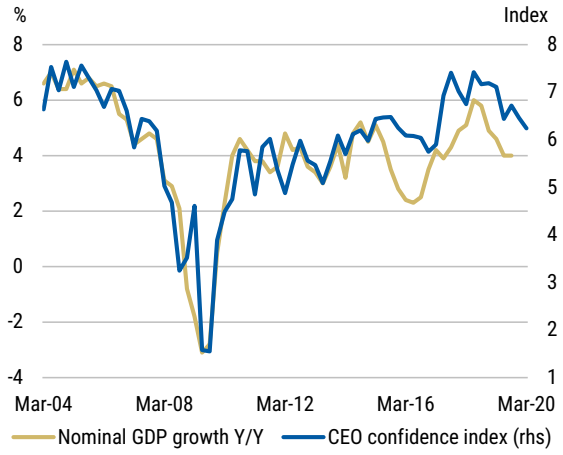
Uncertainty about election outcomes, policy priorities, and policy paths will remain entrenched up until the election itself. This uncertainty will be common to businesses, consumers, and investors alike. While investors may come under the influence of political polls throughout the year, **we suggest investors avoid trading on perceived outcomes, but rather trade on the economic performance that may result from**

perceived outcomes (which can effect sentiment).

Investors should remember that governmental policy paths can be influenced just as much by political ideology as by the state of the economy. For example, while potential executive action could result in a regulatory push under the Blue Tide and Blue Wave scenarios (see Exhibit 16), Democrats may forgo such action, for a period, if the economy is mired in a recession. As such, the state of the economy may have as much, if not more, impact on how rates markets behave as the perceived outcomes ahead of the election.

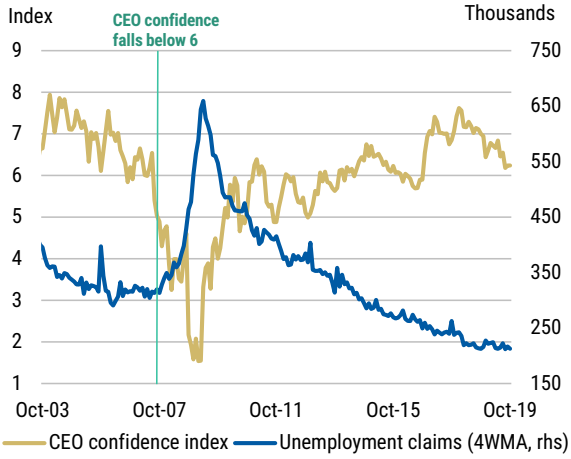
How can economic performance depend on perceived outcomes? If investors perceive the Blue Wave or Blue Tide outcomes negatively, as our survey suggests (see Executive Summary - Five Key Takeaways), chief executive officers (CEOs) may perceive those outcomes negatively as well. If perception leads to a reality in which confidence declines, economic activity may decline as well. Exhibit 29 suggests that the level of CEO confidence affects the pace of real economic growth. And when CEO confidence falls too much, layoffs begin to increase (see Exhibit 30).

Exhibit 29: CEO confidence leads US nominal GDP growth by two quarters



Source: Morgan Stanley Research, BEA, Chief Executive Magazine

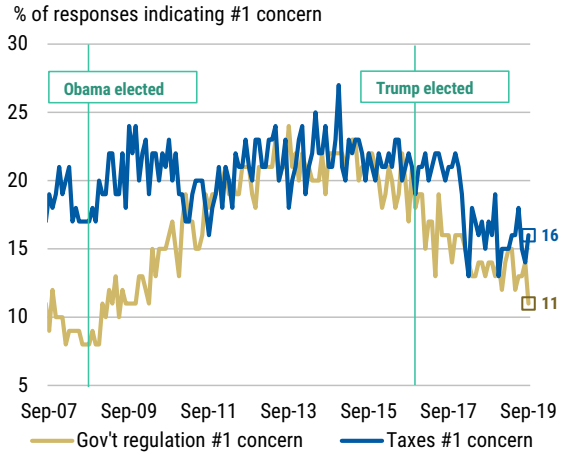
Exhibit 30: Unemployment claims vs. CEO confidence index



Source: Morgan Stanley Research, BEA, Chief Executive Magazine
Note: scatterplot uses data from March 2004 through September 2019

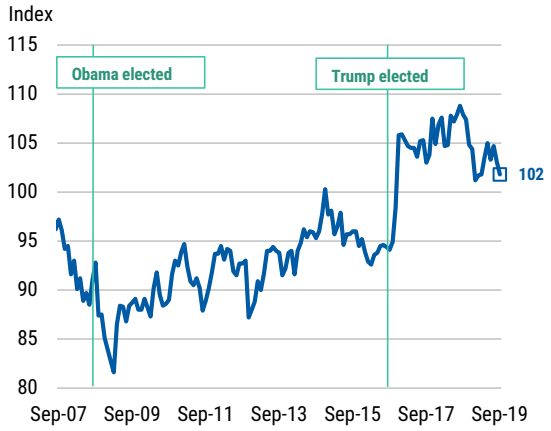
Similarly, elections can also impact small business confidence and concerns — which may drive decisions about investment in labor and capital either before or after the election itself. Exhibit 31 shows how small businesses became much more concerned about government regulations and taxes after the 2008 election, and less concerned after the 2016 election. And Exhibit 32 shows how overall optimism amongst small businesses moved into and after the 2008 and 2016 elections.

Exhibit 31: NFIB survey: #1 concern for small businesses – government regulation and taxes



Source: Morgan Stanley Research, NFIB

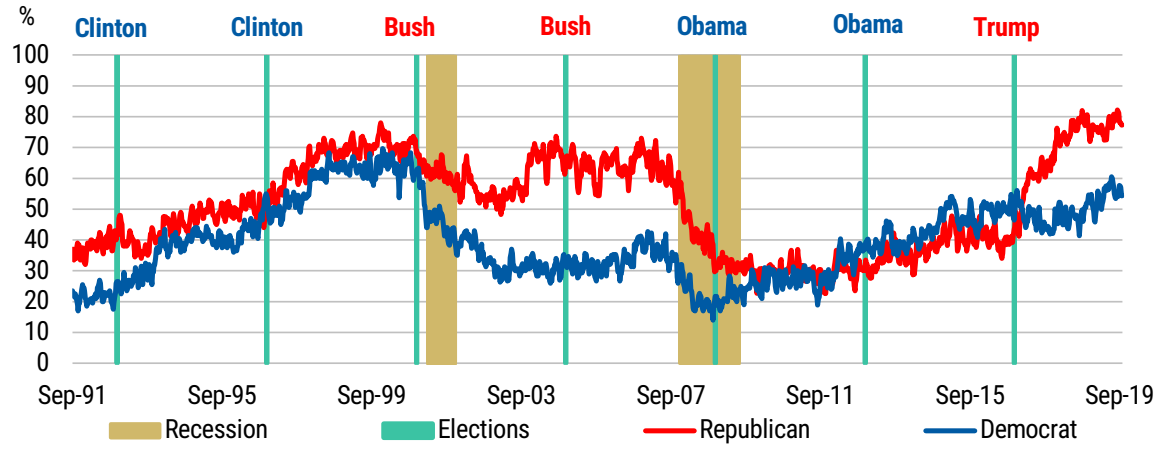
Exhibit 32: NFIB survey: small business optimism



Source: Morgan Stanley Research, NFIB

Elections impact more than just CEOs and small businesses confidence. They also impact consumers and, in the US, the consumer is a very important driver of the economy. Exhibit 33 shows how comfort among Democrats fell much more quickly after the 2000 election of Republican George Bush than comfort among Republicans fell. Similarly, comfort among Republicans increased much more than Democrats after Donald Trump was elected.

Exhibit 33: Bloomberg US Weekly Consumer Comfort Index: Republicans vs. Democrats



Source: Morgan Stanley Research, Bloomberg

If perceived outcomes of the election impact consumer comfort, and that impacts spending behavior, investors will see it show up in the economic data — upon which investment decisions should be made.

Election tips for the TIPS market

Among our discussed election scenarios, sweep scenarios, i.e., a Blue Wave or a Red Redux could affect the inflation markets significantly, at least initially. Sweep scenarios, at least as they may be perceived, carry a meaningful chance of fiscal stimulus. Depending on the type of fiscal stimulus, policies could prompt a meaningful change to

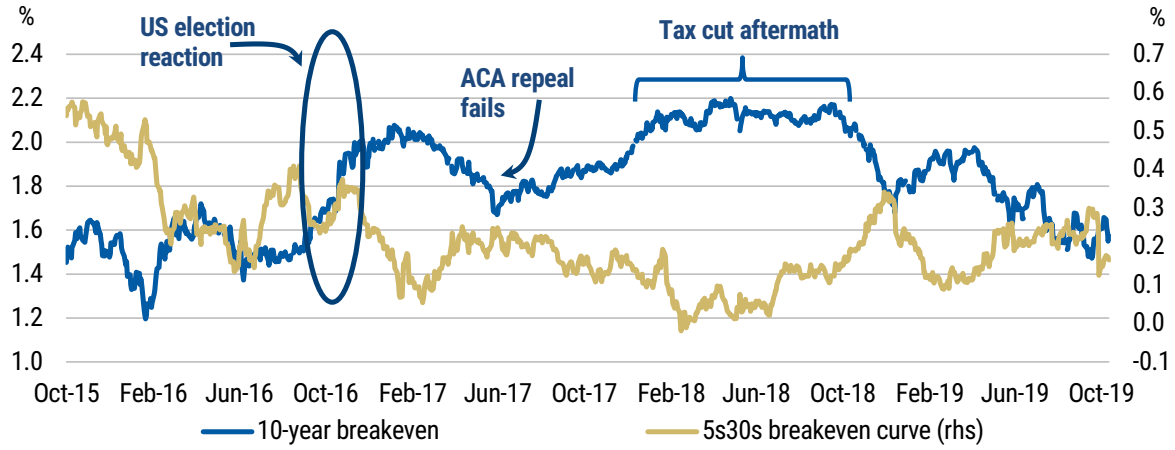
the inflation trajectory. If that new trajectory is sustained, inflation expectations may be affected as well. At the same time, there are valuable lessons for the TIPS market based on the experience of the 2016 election, which resulted in a Republican Party sweep.

1. **A knee-jerk reaction to a sweep should lead to breakeven widening initially.** We think the inflation markets will outperform nominals, widening breakevens in a knee-jerk reaction if either Republicans or Democrats sweep the 2020 election. Such a scenario is more likely to lead to fiscal stimulus, whether via infrastructure or social spending programs, albeit details of these plans will matter for the magnitude of the reaction. Similar to growth multipliers, one can think of inflation multipliers for various fiscal spending plans.

2. **How long will the breakeven widening last?** The 2016 elections provided a template for how breakevens trade before and after fiscal stimulus. While breakevens widened immediately after the elections and moved around the prospects of legislation passing in 2017, they eventually topped out right after the impact of the 2018 tax cuts started to fade in realized CPI (in mid 2018). Part of the reason that breakevens were unable to sustain their widening was the emergence of trade tensions, which cast immediate doubt on the sustainably of higher inflation. We think markets may react with lesser widening in another sweep scenario than in 2016 to adjust for the lack of sustenance of higher inflation from fiscal stimulus in 2018.

3. **The breakeven curve might steepen, but the move may prove fleeting.** Right after the 2016 election, the 5s30s breakeven curve steepened even as breakevens widened (see Exhibit 34) — a relatively rare occurrence for breakeven markets where typically the 5-year point moves more than the 30-year point. The message immediately after the 2016 election was that expectations of fiscal measures would lead to high inflation, not just in the near term, but also long term, helping the 5s30s breakeven curve steepen. We think breakeven curve steepening is less likely as a response to 2020 elections, given that the steepening did not persist for any significant period of time in 2016.

Exhibit 34: 5s30s breakeven curve and 5-year breakevens during the last five years



Source: Bloomberg, Morgan Stanley Research

Macro Impact: US Equities

Michael Wilson, Adam Virgadamo, Andrew Pauker, & Michelle Weaver

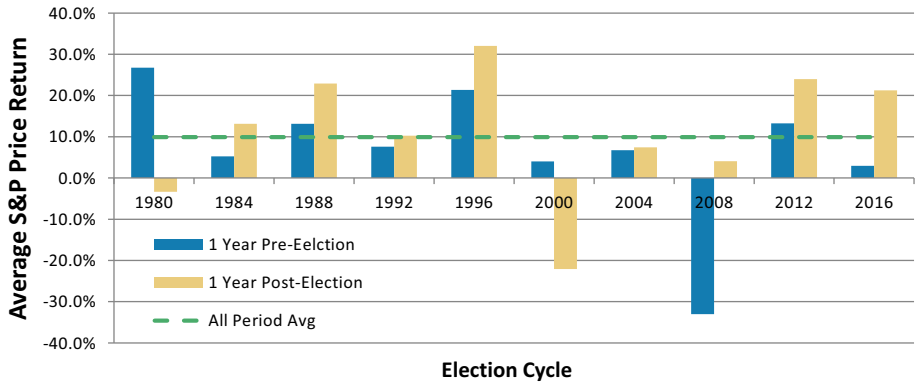
Key Takeaways

- **Unified outcomes could help at the index level, but not reliably so.** The outlook for trade policy and fiscal policy are likely to matter most for fundamentals, while corporate confidence and risk appetite may be affected by growing concerns of an aggressive regulatory agenda. Given this mix of variables, a unified government outcome could deliver meaningful policy change, but the impact to the overall direction of the index is less reliable this far out. This syncs with what history tells us: Election events are not necessarily meaningful drivers of equity performance.

- **Focus for now on sector impacts:** At a sector level, we would expect the most meaningful potential implications for Healthcare, Tech, Financials, and Energy. In each case, the common thread is legislation or regulatory change that reshapes the status quo and challenges current operating models, with Democratic proposals generally those that are likely to affect the most change.

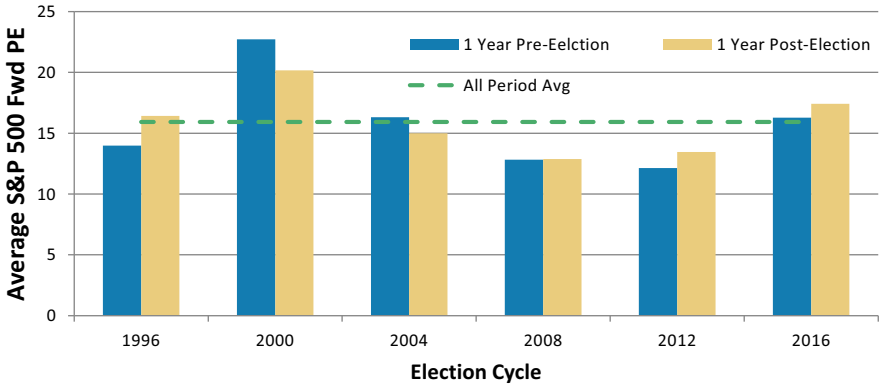
Rate of change on underlying fundamentals is ultimately the principal driver of equity valuations and therefore prices, so election years do not necessarily mean a fundamentally different market environment. In Exhibit 35 - Exhibit 37 we show how price returns, average market PEs, and the average VIX level looked one year pre and post the last few US presidential elections. In general,there is not a clear difference before and after elections. For the periods shown below, returns do appear to be marginally better, on average, in post-election periods, but we note that, given the volatility in equity markets, there is no statistically significant difference between pre and post-election returns or between those returns and average one year returns over the multi-decade period shown. Average PE multiples and the average level of the VIX look even more indistinguishable from their longer term averages. It's also clear from the 2000 and 2008 elections that the market was dominated by economic and other fundamental drivers completely unrelated to politics which aligns with our general view over time — fundamentals, namely growth and interest rates matter the most for stocks especially if there are important business cycle dynamics at play — i.e., recession risks.

Exhibit 35: S&P 500 Returns Have Not Been Consistently Better or Worse Than Average Pre/Post Elections



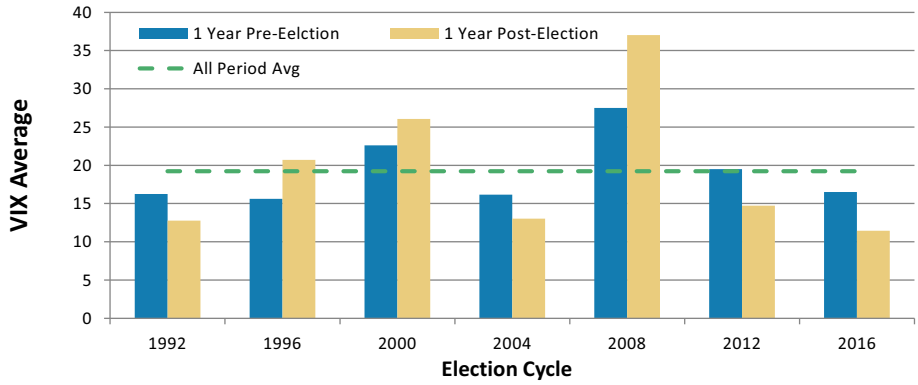
Source: Bloomberg, Morgan Stanley Research.

Exhibit 36: S&P 500 Multiple Has Not Been Consistently Better or Worse Than Average Pre/Post Elections



Source: Bloomberg, Morgan Stanley Research.

Exhibit 37: Average VIX Level Has Not Been Consistently Better or Worse Than Average Pre/Post Elections



Source: Bloomberg, Morgan Stanley Research.

The above reflects the reality that sweeping change of the kind that would affect the broader economy is often difficult to achieve, though in any one election there is always the possibility of policies that could have a broader impact. For the upcoming election, we think 1) trade policy, 2) fiscal policy (infrastructure bill, tax changes), and 3) uncertainty have the greatest potential to affect the broader market outlook.

- **On Trade:** We have been of the view that trade policy has *not* been the primary

driver of the slowdown in corporate profits and the economy over the past year, but rather an addition headwind to an already slowing economy. Whether or not it has been the primary driver of ailing corporate profits, trade tensions have had an impact on market sentiment and risk appetite and we expect this will continue. In contrast to many of the other policy considerations we discuss, the outcome here is more directly dependent on the outcome of the presidential and congressional election alone. We think the market will expect a modestly more conciliatory tone on trade with a Democratic White House win, but we note that there is a lot of time for the dynamics of this issue to evolve in different directions over the next year. For example, a deal under the current administration's leadership that Democratic candidates felt failed to address key structural issues could lead to a Democratic win being seen as modestly more hawkish on trade. The bottom line is that expectations can and will evolve based on progress on trade (or lack thereof) and associated shifts in political stances on the issue.

- **On Fiscal Policy:** Proposals from both sides may result in fiscal expansion, but likely require a RRR or DDD sweep to maximize their chance of passage. On the Republican side, fiscal stimulus would be most likely to arrive via extension of sun-setting provisions in the TCJA and further adjustments to tax rates. Though the degree of stimulus would be less than that following the 2016 election, lower taxes, or at least no risk of higher taxes, along with relative certainty on this front going forward could help restore corporate confidence and willingness to resume investment spend. With a Democratic sweep, the picture may be a bit more nuanced. Democratic policies may similarly result in fiscal stimulus and deficit expansion while also redistributing money away from wealthier tax payers and US corporations. While the deficit spending and redistribution toward cohorts with a higher propensity to spend marginal dollars of income may provide a boost to aggregate spending and demand, the effects on business investment, corporate confidence and employment could plausibly provide an offset to this dynamic. Based on the results of our investor poll we believe most investors think the equity market would price in the degradation in corporate confidence first and would view any pickup in aggregate demand as something to be proven. The hit to corporate confidence initially would also likely increase the odds of a layoff cycle — i.e., recession, in the near term. The pick up in consumer spending velocity however might increase the rate of cyclical recovery on the other side of the trough.

- **On Uncertainty:** Election cycles naturally bring uncertainty around policy but, as we show above, this has not necessarily translated into poorer equity returns, lower multiples or higher volatility over the past few cycles. Nevertheless, to the extent the market begins to discount a regulatory or legislative agenda that threatens the fundamentals of major sectors or perhaps limits the outlook for business investment, higher uncertainty could weigh on investor sentiment and risk appetite, and this risk is likely elevated in an environment with already weakening fundamentals.

Elections can have more meaningful consequences at the sector level and in 2020, we're focused on Healthcare, Technology, Financials, and Energy. We provide some high level thoughts here, but for an in depth look at what is at stake across each of these sectors, we defer to our sector analysts in the body of this publication. As a general comment though, we note that our investor survey shows that for 9 out of 11 GICS sectors, investors expect a Republican administration to be the more favorable outcome, likely due to legislative agendas that do not raise the possibility of industry change

and/or a lighter regulatory burden.

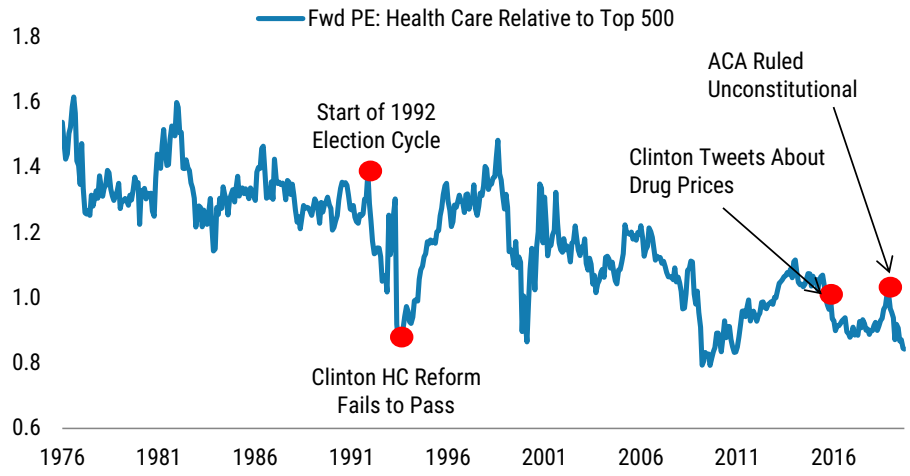
- **Healthcare:** Despite a relatively low possibility for truly transformative change from a DDD scenario, the possibility is likely to weigh on the sector's relative multiple. Exhibit 38 illustrates that this is not a new phenomenon. In 1993, the sector's relative forward P/E ratio dropped 37% when the Clinton administration's healthcare reform package was on the table and surged 70% once the package failed to pass. In 2015, the sector's multiple fell by 12% after Hillary Clinton tweeted about drug pricing. This pressure on multiples in the space continued through the 2016 election, but abated as the defeat of Republican attempts to repeal the ACA became more apparent. Recent political concerns have driven the relative multiple to the lowest level since 2011 and in the — bottom 5th percentile vs. the last 43 years. We do not think recent underperformance of Healthcare is a reflection of the market thinking Dems have a better shot of winning next so much as its recognition of the fact that there is strong bipartisan support on both sides of the aisle to find a solution to the ever rising cost of healthcare, including drug pricing in particular. No matter who wins, healthcare profitability could be under attack from a political and legislative standpoint, with different degrees of severity depending upon election outcomes.

- **Technology:** We expect political rhetoric and scrutiny of large tech firms to continue through the election cycle as top polling Democratic candidates call for enhanced oversight and the breakup of large tech firms while the current Republican administration pursues anti-trust investigations. Ultimately, the scope of potential outcomes in either case is quite broad and difficult for us to project with confidence. The overhang of increased political scrutiny and the prospect of higher costs (through higher taxes or increased regulation for example) may remain an overhang, and the impacts will likely vary by firm, but based on talking points to date it seems that Democratic proposals may be perceived to have the largest potential impact. While the market will likely assume, at least initially, that the breakup of larger tech firms would lower total market cap, we think there is a case to be made that in the long term, the breakup may actually be value accretive as the market rewards greater transparency on core businesses with higher multiples. Similar to Healthcare, we also think there is growing bipartisan support for some form of breakup or regulation of the large tech giants who have seemingly monopoly power and control of individuals' data. The main issues of debate will be around privacy and the ability of these large companies to control public opinion on important topics, not the least of which is the election next year. The bottom line is that many of these large tech companies are trading at discounts to their historical absolute and relative valuations because the market understands these risks. As a result we expect these discounts to remain in place but not necessarily get much worse.

- **Financials/Energy:** We group these two together as the market reactions to various election outcomes and channels of potential impact are likely the same. We think a Republican led White House (whether or not the Congress is split) ultimately serves to remove the risk of a higher regulatory burden that could curtail some business activity. Thus, a Republican presidential win is likely to be perceived as a fundamental positive in that it removes a risk more than an absolute tailwind in its own right. A Democratic White House (whether or not the Congress is split) would likely be perceived as increasing regulatory risk and could act as an overhang on the multiple as the market wrestles with the size of the potential curtailment to

earnings growth and/or ROEs.

Exhibit 38: The Possibility of Legislative Reform Has Affected Healthcare's Multiple Before



Source: FactSet, Morgan Stanley Research as of October 25, 2019.

Macro Impact: G10 FX

David Adams

Key Takeaways

- **Fiscal expansion: A USD support?** A unified government in either scenario, generating more expansionary fiscal policy, could lead to a 2018-style situation wherein a wider fiscal deficit, coupled with tighter monetary policy to check an inflationary impulse, generates USD strength. Divided government, keeping the fiscal impulse constant, is likely modestly USD negative as investors price out fiscal risks.
- **Will there be a change in US FX policy?** Will a new administration change the current "strong dollar" policy? Is FX intervention more likely to weaken the USD? Will Congress pass legislation to check USD strength?
- **Trade:** Will a new administration and Congress amplify or check the global increase in protectionism? A reduction in global trade tensions and uncertainty would be USD negative as it improves rest-of-world growth and investment prospects.

Fiscal expansion: 2018 redux? Pro-cyclical fiscal expansion – either due to tax cuts, spending increases, or both – may end up being USD positive if accompanied by a monetary tightening from the Fed concerned about the potential inflationary impact. The magnitude of the move though is driven both by the deficit expansion itself as well as the impact on the growth potential of the economy.

Rising public sector capital demand finds funding from three sources: domestic savers, foreign savers, or the banking system. The combination of loose fiscal policy and tight monetary policy tends to be USD positive, attracting capital from the rest of the world, particularly if growth abroad is relatively slow and net savings are abundant. Thus, if we see a "2018 redux", wherein fiscal expansion is matched by a Fed tightening policy to prevent an inflationary impulse, then USD likely gains. Deficit-financing for infrastructure may be particularly USD bullish if it raises the potential growth rate, increasing the attractiveness of US investments – though markets may counterbalance this if accompanied by increased policy uncertainty. On the other hand, limited fiscal changes coupled with improving growth abroad is likely to be USD negative.

A change for US FX policy? The broad strength in the USD coupled with declining global manufacturing have raised political discussions of the USD's value and its potentially pernicious impact on the tradable goods sector. Efforts to weaken the USD either by legislation or through executive action may have an non-negligible USD impact, but it might be accompanied by a tightening in financial conditions. We provide more detail on this topic in our FX Intervention Playbook.

Trade policy and globalization: The future administration and legislature's policies on trade and globalization are key for USD. A reduction in global trade tensions and uncertainty as to the global trading arrangement would be USD negative by enhancing rest-of-world growth prospects. However, continued (or even further escalation) in trade tensions would render economies less sensitive to trade tensions like the US relatively more attractive.

Macro Impact: EMFX

Andres Jaime

The macro impact on EMFX will likely be an amplified reflection of the USD direction. The effect of uncertainty on global growth and productivity, fiscal policy dictating part of the USD direction along with the possibility of a meaningful change in economic policy are only a few potential drivers of the asset class. However, we think that the focus for EM will be on the potential size and composition of any additional fiscal stimulus along with any potential change in the trade rhetoric.

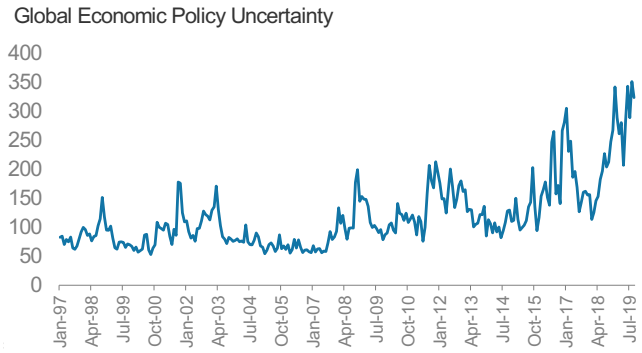
On the trade front, not surprisingly, any escalatory measure should keep EM under pressure. Not only do tariffs have a direct impact on USD, but it is a well-known fact that elevated uncertainty has a negative effect on growth and can have a longer-lasting effect by damping productivity (Exhibit 39). Any policy that decreases uncertainty in a credible way should have positive and non-linear effects on EM.

Further fiscal stimulus should exert pressure on EM in two different ways. First, it would further decouple the economic cycles (US versus RoW) by prompting the Fed to shift its rhetoric – towards a more restrictive one – and strengthening USD across the board. This should end up tightening financial conditions in EM and impacting global growth (ex-US) negatively. Second, it would crowd out EM flows and tighten USD funding, constraining financial conditions further. It is important to note that size and composition will likely depend on the electoral outcomes, making the impact of the different scenarios heterogeneous.

While policy U-turn remains unlikely as both Republicans and Democrats support a somewhat hawkish rhetoric on trade, a meaningful change in the strong dollar policy and/or pro-growth policies could be positive for EM. While there is always discussion about the implications of falling US equity markets and its implications for EMFX, a softer USD caused by markets pricing the end of the cycle – absent systemic risks that dry up USD funding – should be positive for the asset class.

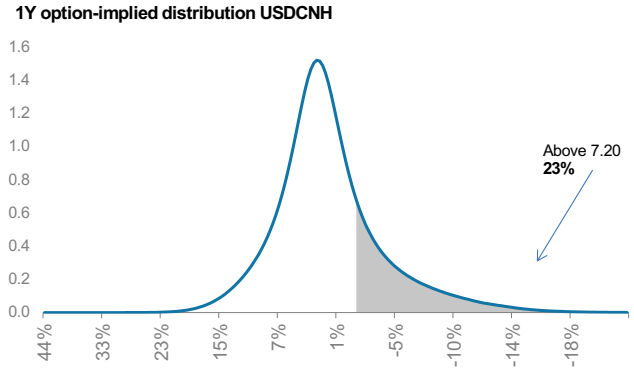
The number of policy combinations is certainly large and difficult to assess. However, policies that provide certainty on the direction of policy along with those than promote a weaker USD are necessary elements for the asset class to see a meaningful rally.

Exhibit 39: Policy certainty is key for global growth to pick up



Source: www.PolicyUncertainty.com, Baker,Bloom and Davis (2016)

Exhibit 40: USD stability is key for EM to perform well – markets pricing in only a ~25% probability of USDCNH going above max highs



Source: Bloomberg, Morgan Stanley Research

Macro Impact: US Housing and Agency RMBS

Jay Bacow & James Egan

Key Takeaways

- **Housing Finance Reform – who needs legislation anyway?** Housing finance reform in some fashion is likely to be a point of discussion no matter what the results of next year's election. Housing finance reform can be both administrative or legislative. As the odds of legislative reform are quite low, we focus on the administrative reforms recently proposed by the current administration, which would be more likely with a Republican in the White House.

- **GSE Reform – what will happen with Fannie Mae and Freddie Mac?** Within the broader context of housing finance reform, GSE reform is one of the most important topics, if not the most important. While the federal government no longer guarantees 90% of mortgage originations as it did in the years immediately following the recession, it still finances approximately 70%. A majority of this comes through Fannie Mae and Freddie Mac. A Republican sweep could accelerate the exit of the GSEs from conservatorship.

- **QM Patch Expiration – how qualified is your mortgage, really?** The current administration has already expressed its desire for the patch to expire in January 2021. While the ultimate consequences of such a decision would depend upon any changes that might be made to the Qualified Mortgage definition, letting the patch expire without re-defining QM would lead to tightening credit standards and a more expensive housing market.

Housing finance reform has been a topic of much discussion but little action in the years since the recession. Various proposals over the years have included changes that have required legislation and others that could be enacted administratively. As we stated in our recent summary of the Housing Reform Plans from the Departments of the Treasury and HUD, we believe that 2020 election outcomes, both presidential and congressional, will have a significant bearing on legislative reform to the US housing market. As our Public Policy strategists outline, unified government of one party or the other is needed to pass major legislation.

That being said, administrative proposals can still be substantial. For instance, the recent proposals from the current administration recommend restricting GSE securitization of certain loans including cash-out refinancings, investor loans, vacation loans, and jumbo loans. Restricting the securitization of these loans would obviously reduce issuance in the agency space, along with likely some flattening of the s curves for those type of loans. Most of this would be positive for the basis, though we would need specific details about what is included to quantify this.

Other administrative proposals would not have as great an impact. For instance,

recapitalizing the GSEs while the Treasury retains its commitment to support the GSEs through PSPAs. There is some risk that if they are taken out of conservatorship and recapitalized that some investors may decide that there is more implicit credit risk in the securities and buy G2/UMBS, but this is difficult to forecast.

Another development we are following closely is the fate of the QM-Patch, which is set to expire on January 10, 2021. Both the Consumer Financial Protection Bureau and the current administration have advocated for its expiration on that date, or potentially after a short extension. According to the CFPB's own estimates, a full 31% of the closed-end, first lien mortgages purchased or guaranteed by the GSEs in 2018 exceeded the 43% DTI ratio and thus were originated under the QM patch. This represents 16% of all mortgages originated in 2018. In our view, expiration in a vacuum would lead to tighter and potentially more expensive mortgage credit conditions, impacting housing demand and also putting downward pressure on home prices. That being said, both the CFPB and the Treasury's proposals discuss a potential re-defining of the Qualified Mortgage definition. Given the myriad potential avenues for revision, it is difficult for us to comment on what QM patch expiration with revision would look like for credit availability, mortgage markets, and the US housing market more broadly (please see our recent report for more details).

A change in administration could cause a re-litigation of the False Claims Act (FCA). HUD, FHA, and the DOJ have recently agreed to a memorandum of understanding regarding the FCA. The memorandum generally outlines that the FCA should be used more judiciously and that HUD will give its opinion whether a case should be brought under the FCA. HUD Secretary Ben Carson cited the need for "depository lenders to come back" as a primary motivation for the memorandum. We have discussed potential changes to the FCA previously. If Republicans maintain control over the government, these concerns would be assuaged, which could lead to an increase in FHA issuance from large money-center banks. However, in the short term, we do not believe that there will be a significant increase in large money-center bank participation in the FHA space, as a potential change in administration in 2020 could present lenders with renewed litigation risk.

The proposals discussed above have all been introduced by a Republican administration and would therefore be more likely to be enacted in our Red Redux or Thin Red Line scenarios. Democratic members of Congress have been outspoken in their opposition to a number of these proposals. As such, the results of this election stand to have a meaningful impact on housing finance.

Macro Impact: Munis

Michael Zezas & Mark Schmidt

Key Takeaways

- **Unified government outcomes have c**onsequences for muni investors. A Republican unified government could pressure the high-yield market (through legislative actions on Tobacco) and the healthcare market (by making another attempt at ACA repeal). A Democratic unified government presents similar Tobacco challenges, as well as to NFP hospital sentiment. Additionally, a fiscal expansion could bear steepen the yield curve leading to an outflow cycle, though this would likely unlock value in the basis given a bias toward higher tax rates.

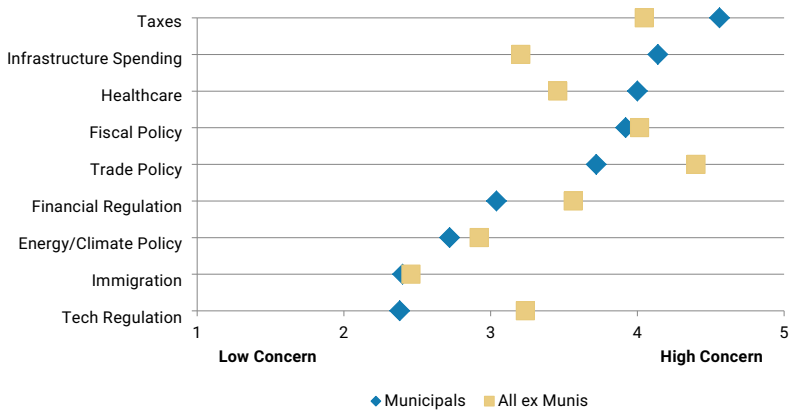
- **Tax Reform - one step forward or two steps back?** Many provisions from the Tax Cuts and Jobs Act are set to expire in 2025. A Democratic surge could put tax increases on the table that would enhance the value of the municipal exemption. A Republican sweep could make permanent lower marginal rates, or even look to further curtail the municipal tax exemption as a way to pay for additional tax cuts.

- **Healthcare Reform - single payer or ACA 2.0?** Healthcare expansion proposals, broadly speaking, aim to increase coverage through government insurance. More government insurance, broadly speaking, would likely lower hospital margins in the near term. Meanwhile, proposals to repeal the Affordable Care Act may increase hospital bad debt expense.

- **Student loans and higher ed – forgive or forget?** Student loan forgiveness is a double-edged sword for higher education credit. On one hand, it should make it easier for young people to finance additional higher education. On the other hand, making student loan debt dischargeable in bankruptcy could reduce the availability of private student loans used to finance profitable graduate programs. We are currently underweight higher education, as high student loan balances may make higher education demand cyclical - not countercyclical as in prior recessions.

- **Infrastructure spending - more than a nothingburger?** Expensive infrastructure proposals are likely in theory, but unlikely in practice. However, we remain on the lookout for a less expensive infrastructure bill that encourages growth in municipal bond issuance - like a return of BABs or tax-exempt advance refunding bonds.

Exhibit 41: Survey Says: Muni Investors are More Concerned About Taxes, Infrastructure Spending, and Healthcare than Other Investors



Source: Morgan Stanley Research

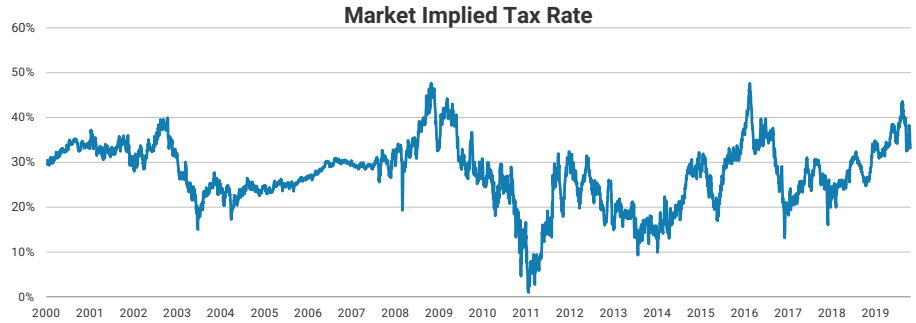
Exhibit 42: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD		Additional Tobacco regulation		MSA Tobacco
Divided Government	DRD		Additional Tobacco regulation		MSA Tobacco
Unified Government	RRR	Extension of expiring tax cuts Tobacco 21 Legislation	Lack of response to a possible court repeal of ACA		Muni duration Healthcare MSA Tobacco
Unified Government	DDD	Tobacco 21 Legislation Potential higher tax rates Possible student loan relief	Talk of single payer	Higher Ed Muni basis (medium term)	Muni duration Healthcare MSA Tobacco Muni basis (short term)

Source: Morgan Stanley Research

What could enhance the intrinsic value of munis? We measure investors' confidence in the tax exemption by following a basket of credit and maturity-matched spreads between corporates and tax-exempt munis. Although noisy, this market-implied tax rate can help gauge the tax bracket of the marginal muni buyer. Today's market implied tax rate of about 33% suggests relatively little investor concern about future tax changes. In fact, it suggests confidence that tax rates are staying where they are. Relatively wide spreads between munis and corporates also leave room for only modest further outperformance.

Exhibit 43: Market implied tax rate of 33% close to where it was a year before the 2016 election



Source: Morgan Stanley Research, MMD, FTSE-Russell (Yield Book)

What could enhance munis' intrinsic value, given that the tax exemption already appears in the price? An expectation of major tax hikes could help. As it is, however, transformative policy changes are unlikely. A "sweep" of the White House and both chambers of Congress is not the base case. And even if there were a Democratic sweep, our policy strategists' review of the candidates' platforms shows that major tax hikes are not a top priority for all candidates. Nor do we see other legislation as high enough a probability to change our view on the broad market.

On a sector level, MSA tobacco, healthcare, and muni duration strike us as most exposed to potential policy changes. We think healthcare stands to trade at a wider spread in unified government outcomes, albeit for different reasons. In an RRR outcome, there could be a renewed push to repeal the ACA. Or there could be no momentum to replace the ACA if it is overturned by the courts. In a DDD outcome, talk of a single-payer plan could reduce demand for hospital bonds, even though such a plan is unlikely.

Sector Impact: Healthcare

Healthcare Services & Tech

Ricky Goldwasser & Moses Mutoko

Key things we're watching:

- Polling numbers of key Democratic candidates in support of Medicare for All.
- Ongoing Fifth Circuit hearing on Affordable Care Act (ACA) constitutionality.

Government involvement in healthcare is the key debate for Managed Care Organization (MCO) stocks as we head into the election year. The president continues to advocate for repealing and replacing the Affordable Care Act (ACA), and also recently signed an executive order calling "Medicare for All" proposals harmful to seniors. On the other hand, most Democratic candidates support a range of substantive changes to the current healthcare insurance landscape, from public options to expand Medicare (Medicare at 50 / Medicare X) to universal coverage through the government (Medicare for All). See Exhibit 37 and our report Managed Care: Healthcare Policy and Medicare Advantage; Who is Best Positioned? Consequently, we expect trading in the MCO stocks to be affected by Democratic debates, polls, and candidates' positioning until we gain clarity on who the Democratic nominee will be — and, later, on which party eventually wins the 2020 elections.

Exhibit 44: Overview of Current Policy Proposals

	ACA Repeal	Medicare at 50	Medicare X	Medicare for America	Medicare for All
Read Through to Managed Care	ACA exchanges are eliminated. Medicaid expansion is reversed. HIF goes away.	Uninsured individuals ages 50-65 can buy into Medicare.	Uninsured individuals of all ages can buy into Medicare.	Uninsured individuals of all ages are enrolled into Medicare. ACA exchanges and Medicaid are eliminated. HIF goes away.	Universal coverage replacing all private insurers.

Source: Kaiser, Morgan Stanley Research

Exhibit 45: Democratic Candidates Vary in Their Preferred Healthcare Policy Changes

Policy Proposal	Authority	Biden	Warren	Sanders	Buttigieg	Harris	Yang	O'Rourke	Klobuchar	Booker	Castro	Gabbard
Medicare for All (Abolishing private insurance)	Legislative		✓	✓								
ACA Improvements with Public Option	Legislative	✓			✓				✓			
Medicare buy-in at 50	Legislative	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Medicare for America (Path to universal coverage with private insurance)	Legislative					✓	✓	✓		✓	✓	✓

Source: Morgan Stanley Research

Transformative policy change — ACA repeal, Medicare X, Medicare at 50, Medicare for America, Medicare for All — would likely take place only under a unified government (one party controlling the executive branch and both houses of Congress), a low likelihood event according to current polling. While a few sitting Democratic senators have signed on to the existing Medicare for All plan in the Senate, other senators indicate that they see a continued role for private insurance, or at least a long transition time that involves private insurance. For private insurers, Medicare for All would be a clear negative, secular risk. Most other policy proposals, however, include some sort of Medicare expansion (Medicare at 50, Medicare X, and Medicare for America), which would likely be favorable for MCOs with large Medicare Advantage market share (Humana, 18% share; UnitedHealth, 26%; and CVS, 10%) see Exhibit 2. On the other hand, under a unified Republican government, we think exchanges would likely come under pressure in an ACA repeal effort, which would potentially represent headwinds for Centene, Molina, and, to a smaller extent, Anthem. Nonetheless, if one party is able to secure unified government, that does not necessarily mean that healthcare reform would happen, as evidenced by recent data from the research firm Skopos Labs (see Exhibit 38). Recent history is a good example of this: Even with united government and a newly elected president, Republicans were unable to repeal the ACA.

Exhibit 46: Policies We're Watching

	Scenario	Legislative Impact	Regulatory/ Executive Impact	Exposure: Positive	Exposure: Negative
Divided Government	RRD	Unchanged	Executive action remains sole policy variable		
Divided Government	DRD	Unchanged	Executive action remains sole policy variable		
Unified Government	RRR	Minimal chance of ACA repeal	Some headline risk on status of the Affordable Care Act		CNC, MOH, ANTM
Unified Government	DDD (Pro-ACA)	Minimal chance of Medicare expansion	Expect efforts to strengthen ACA	CNC, MOH, ANTM (1)	
Unified Government	DDD (Pro-Medicare)	Minimal chance of Medicare expansion	Expect efforts to expand Medicare	HUM, UNH, CVS (2)	All MCO stocks

(1) Positive if rhetoric supports Medicare expansion without elimination of private insurers.
(2) Negative if rhetoric supports Medicare for All with elimination of private insurers.

Source: Morgan Stanley Research

Sorting through the noise, investors should keep in mind most current policy proposals favor Medicare expansion while retaining private insurers; Medicare for All would pose the biggest potential threat to MCOs' earnings. While candidates supporting Medicare for All advocate for elimination of private insurers, other popular policy proposals — Medicare at 50, Medicare X, and Medicare for America — would likely be favorable for the earnings of MCOs with large Medicare Advantage (MA) market share (Exhibit 2). We think Humana would be likely to see the most benefit as it doesn't have commercial exposure that could experience some attrition under all potential scenarios, followed by UnitedHealth, and CVS/Aetna. Regardless of the election outcome, government share of medical spend is likely to grow, in our opinion, favoring companies with both Medicare Advantage and Medicaid exposure.

Exhibit 47: MCOs Earnings Exposure to Health Policy Proposals (Based in MS 2020 Estimates)

		ACA Repeal	Medicare at 50	Medicare X	Medicare for America	Medicare For All*
Molina	MOH	-33.8%	-4.3%	-7.1%	-24.1%	-100.0%
Centene / WCG	CNC	-14.0%	-2.2%	-4.1%	-10.8%	-98.0%
Anthem	ANTM	-3.9%	-1.2%	-1.7%	5.4%	-98.0%
Cigna	CI	0.2%	-0.3%	-0.3%	1.1%	-51.0%
CVS	CVS	5.5%	0.1%	1.4%	9.3%	-44.0%
UnitedHealthcare	UNH	1.1%	0.5%	3.4%	14.9%	-57.0%
Humana	HUM	6.9%	3.5%	18.2%	31.4%	-98.0%

*All health insurance earnings are eliminated

MCOs stand to benefit from increase in Medicare enrollment under current policy proposals; analysis based on current MA market share.

Source: Kaiser, Company Data, Morgan Stanley Research estimates
*Note: Analysis assumes that a significant proportion of displaced ACA exchange members switch to Medicare or Medicaid plans with the same MCO (mostly impacts CNC and MOH). Some members might switch to MA plans with more dominant players such as HUM and UNH. Also assumes that Medicare-for-All will eliminate Private Health Insurance as we know it.

But for time being stock volatility is here to stay. We got a taste of the volatility over the past seven months. Managed care stocks were down 16.1% over the 6 trading days between 4/9 and 4/17, compared to the S&P 500 up 0.8% over the same time frame, after Medicare-for-all proposal was introduced in the Senate on 4/10 (see Exhibit 20). From peak-to-trough, MCOs as a group de-rated 5.3 turns versus the S&P500 from a high of 1.5 turn premium to the S&P in late January to a 3.8 turn discount in mid-April. Currently on an NTM basis, the group trades at 14.5x, which is a similar 3.8 turn discount to the S&P which is at 18.3x. Uncertainty about i) who the Democratic nominee would be, ii) if the nominee pursues a policy outside the framework of the Affordable Care Act (ACA), and iii) who eventually wins the 2020 elections will likely continue to weigh on MCO stocks. We expect the group to be impacted by Democratic debates, polls, and candidate's positioning statements. See Exhibit 69 –for key political catalysts to watch.

Pharmaceuticals

David Risinger & Charlie Yang

Key things we're watching:

- Congressional action on the Senate's Prescription Drug Pricing Reduction Act of 2019 and The House's Lower Drug Cost Now Act of 2019.
- Winner of Democratic presidential nomination; we are interested in the nominee's stance on pharmaceuticals.
- Evolution of expectations for a potential Democratic sweep in November 2020.

Washington action is an overhang for pharma. We think investors will continue to be wary of political newsflow and already view 2020 as a year of uncertainty due to the November elections. We think stock price pressure is possible if a Democrat is elected president who is an advocate of drug price controls. A divided legislature would be a perception positive for Pharma, and a Democratic sweep would be a perception negative. Risks to industry include House proposed legislation plus potential removal of non-interference clause from Part D which currently precludes the government from negotiating directly on drug prices. Most exposed companies include MRK, LLY, PFE, and BMY. **Keep in mind that although Senate needs only a 51-vote majority to pass legislation, ending a filibuster effectively requires 60 votes.** Since a filibuster requires 60 votes to be overcome, basically all controversial bills now require 60 votes. The only exceptions are reconciliation, which applies only to budget-related bills, and presidential nominees, including to the Supreme Court.

Senate Finance Committee legislation (Prescription Drug Price Reduction Act of 2019) designed to lower out-of-pocket costs for seniors but cost pharma. It is currently unclear if the legislation will move forward, and recent news reports indicate that Senate Majority Leader Mitch McConnell may not even bring it up for a vote; additionally, Senator Chuck Grassley, chairman of the Finance Committee, told reporters on Sept. 25 that the legislation "will probably get pushed to early next year." We see the provision of the bill that would prevent drug prices from rising faster than inflation

under Medicare as an essential component for the Part D reform to work, and there may be potential unintended consequences.

Lower Drug Costs Now Act of 2019 (H.R. 3) is unlikely to pass a Republican-controlled Senate. Both the House Energy & Commerce Committee hearing on Sept. 25 and Ways and Means Committee hearing on Oct. 17 struck a partisan tone, with Democrats largely supportive of the bill and Republicans expressing dissatisfaction with its content and process. Hence, action on Democratic proposals to significantly change US drug pricing seems unlikely unless Democrats sweep in the Nov. elections. In particular, Sen. McConnell said price controls would damage the healthcare system, "[a]nd of course we're not going to be calling up a bill like that." Moreover, recent news reported that the Oct 21. report of the nonpartisan Congressional Research Service indicated that H.R. 3 could be found unconstitutional, potentially violating the Fifth and Eighth Amendments, as well as Congress' taxing power under the Constitution. On Oct. 11, the Congressional Budget Office (CBO) released a preliminary analysis of the bill's effect on Medicare Part D and reported an estimated $345B savings in 2023-29, including $42B from reduction in services. CBO's baseline projection for Part D spend of $1,072B would translate to ~28% in saving compared to the status quo.

Drug importation bills are immaterial in our view. A Democrat-led drug importation bill was defeated by a narrow 52-46 vote on Jan. 11, 2017, with 12 Republican senators supporting the legislation. Critics see drug importation as unsafe since FDA cannot ensure drug safety and legitimacy. In addition, the actual savings from drug importation would be insignificant based on the CBO's projected $1B to $1.5B in saving annually. Finally, the Canadian government has indicated that it could outlaw exporting of drugs in order to protect its drug supply and pricing.

Legislation to allow Medicare to negotiate drug prices. In 2018 Democratic Representatives Elijah Cummings and Peter Welch presented President Trump with a bill designed to allow Medicare to negotiate drug prices directly with drug makers, with the president expressing a desire to work in a bipartisan way. The White House and Speaker of the House Nancy Pelosi's office have discussed allowing direct Medicare price negotiation for a limited number of expensive drugs, such as drugs with no therapeutic alternatives, and a bill sponsored by Rep. Lloyd Doggett (D-Texas) remains active. While historically the CBO has suggested direct negotiation would not save money, the concept could be revisited in the future.

Exhibit 48: Policies We're Watching

	Scenario	Presidential Candidate	Potential Legislative Impact	Regulatory/ Executive Impact	Exposure: Positive	Exposure: Negative
Divided Government	RRD	Not relevant	Unchanged	Neutral		
Divided Government	DRD	Less Severe Drug Pricing Agenda	Unchanged	Neutral		
Divided Government	DRD	More Severe Drug Pricing Agenda	Unchanged	**Partial Downside**		MRK, LLY, PFE, BMY
Unified Government	RRR	Not relevant	Prescription Drug Pricing Reduction Act of 2019, but with no price cap	**Upside:** *Part D donut hole elimination *Lower costs for seniors benefits public perception **Downside:** *Companies would need to cover 20% of drug costs once patients' total out of pocket cost reaches $3,100 *Medicaid rebate cap raised from 100% to 125%	MRK, LLY, PFE, BMY	
Unified Government	DDD	Less Severe Drug Pricing Agenda	TBD	**Partial Downside:** *Upside could include lower costs for seniors and greater access to medicines. Downside could include pharma bearing greater costs, net pricing pressure, and elimination of pharma tax break for advertisement spending		MRK, LLY, PFE, BMY
Unified Government	DDD	More Severe Drug Pricing Agenda	Lower Drug Costs Now Act of 2019	**Downside:** *Allow Medicare to negotiate drug prices on the top 25 to 250 drugs with highest cost to Medicare with price no more than 1.2x of the weighted avg. price of six ex-US countries *Penalty fee that equates to 75% of the gross sales of the drug to manuf who refuses to participate *Medicare Part B & D inflation rebates		MRK, LLY, PFE, BMY

Source: Morgan Stanley Research

MedTech

David Lewis & Marissa Bych

Key things we're watching:

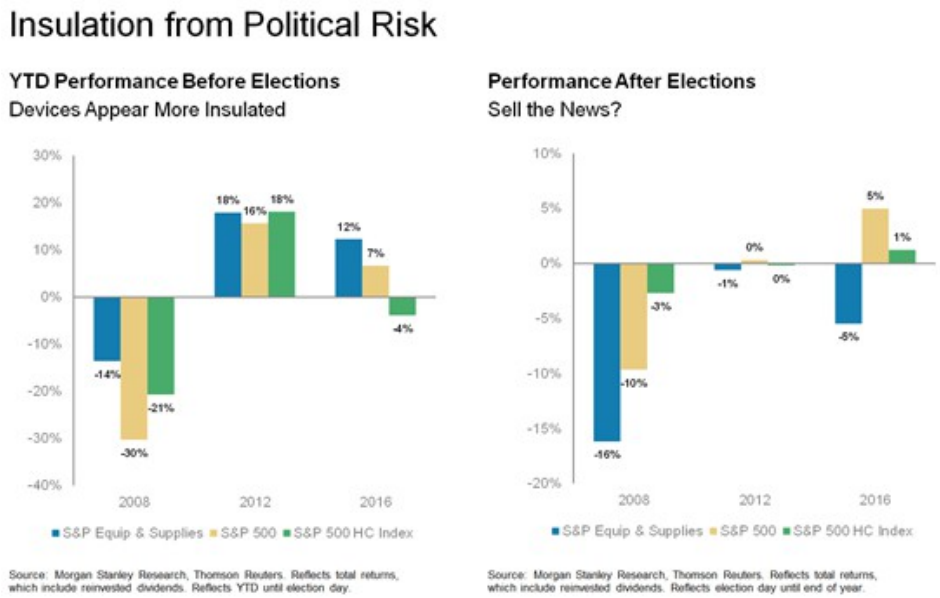
- The impact of incremental coverage and pricing proposals on the broader Healthcare sector, as we expect Medical Devices to be a derivative beneficiary of intra-sector flows (e.g., from Pharma, Biotech) potentially stemming from concerns around expanded coverage or heightened drug pricing scrutiny.
- Into 2020, (pre-Presidential Election) we also look for a 1-year extension to the Medical Device Tax moratorium (to be assessed again by future Congresses), as we discussed in further depth here.

Relative to broader healthcare, Medical Device positioning is favorable in the face of regulation. As discussed in our 2019 Medical Device Outlook and Medtech 2020 series, Medical Devices remain largely insulated to regulatory and pricing risk versus the broader sector. Despite the industry's current valuation premium, relative device positioning today may be the most favorable it has been in decades as the group has long learned to adapt to low-single-digit pricing pressure. In other words, while price controls present a relatively new concern for the pharmaceutical and biotech industries, pricing controls have been a headwind to medtech for years due to hospitals' active role in determining device payment. Moreover, fundamentals remain strong across devices, as companies continue expanding into higher-growth markets (both in terms of product

end markets and newer geographies), the capital environment remains healthy, MCO utilization pressures have eased, and acuity is improving, all of which keep us at an Attractive industry view.

Markets seem to understand this dynamic. Historical precedent suggests device outperformance leading up to election day. As shown in Exhibit 49, devices have outperformed both the healthcare sector and the broader S&P 500 leading up to the past three US presidential elections (from January 1 through election day). Following election day, we note flows have shifted as investors typically "sell the news" and move back toward pharma, biotech, hospital, and MCO verticals collectively. If price concerns stemming from Medicare for All, Medicare for America, Medicare X, and incremental coverage proposals become an increasing point of focus during the 2020 campaign season, we would expect device companies to outperform.

Exhibit 49: Medtech Relative Outperformance in US Election Years



Source: Morgan Stanley Research

Sector Impact: Financials

Large Cap Banks and Consumer Finance

Betsy Graseck & Manny Nimarko

Key things we're watching:

- ***Consumer Loan Pricing:*** There are several proposals to cap interest rates on credit cards or to eliminate OCC preemption and enable the states to determine interest rates caps on all non-mortgage loans. While these are likely to be met with legal challenges and concerns about limiting credit availability, we are concerned about headline risk, especially if proposals proliferate.

- ***Break Up the Banks Debate:*** Even if there is no legislation, does this idea gain ground with a broader political constituency? Could it drive support to limit the type of investments that a bank fund with deposits? Examples would be limiting to loans, removing trading assets or FX.

- ***Tax Reform:*** Higher taxes, coupled with larger government, could drive stagflation, slowing economic growth and raising credit losses.

- ***Regulators and New Stress Test Rules:*** An new incoming administration would likely change out the heads of the FOMC, FDIC, OCC, CFPB. However, this would take several years as current chairs and vice chairs have terms ending 2-12 years after the 2020 election. The Federal Reserve has the most longevity, important as cross-regulatory rules require their participation. Of course, regulators may decide to step down on their own, potentially accelerating regulatory changes. Most important, we expect to see new Stress Test rules soon; if they are not proposed, debated, and finalized by midsummer 2020 — that is, finalized more than 60 working congressional days before the new Congress begins in January — then a new unified Congress and administration could overturn any new regulation.

Exhibit 50: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	Unchanged	Unchanged	Large Cap Banks and Consumer Finance, particularly GS, C, JPM, BAC, WFC, SYF, COF, DFS, ALLY, SC, AXP	
Divided Government	DRD	Unchanged	Stable		Potential headline risk depending on Democratic candidate. Affects Large Cap Banks and Consumer Finance, particularly GS, C, JPM, BAC, WFC, SYF, COF, DFS, ALLY, SC, AXP
Unified Government	RRR	Positive	Unchanged	Large Cap Banks and Consumer Finance, particularly GS, C, JPM, BAC, WFC, SYF, COF, DFS, ALLY, SC, AXP	
Unified Government	DDD	Potential Negative	Potential Negative		Potential headline risk depending on Democratic candidate. Affects Large Cap Banks and Consumer Finance, particularly GS, C, JPM, BAC, WFC, SYF, COF, DFS, ALLY, SC, AXP

Source: Morgan Stanley Research

Key Proposals:

S.2243: Payments Modernization Act of 2019

S.1389: Loan Shark Prevention Act

S.881: 21st Century Glass-Steagall Act of 2017

H.R.7006: Too Big to Fail, Too Big to Exist Act

S.1005: Empowering States' Rights to Protect Consumers Act of 2019

It is important to highlight that large cap banks face headline risks when Democrats are polling higher. However, in our view, any of these proposals above would require a Democratic sweep of the House, Senate, and White House in order to become law.

Consumer Finance Risk: Potentially the largest impact to the industry. Lower interest rates on loans would drive down revenues, potentially leading to layoffs; as well as increase risk aversion, lowering credit availability to riskiest consumers.

There are currently three proposals to reduce the consumer cost of borrowing. The most potentially impactful is the Empowering States' Rights to Protect Consumers Act, which would enable states to determine the maximum interest rate applicable across all non-mortgage consumer loans. This could potentially remove banks' ability to utilize the OCC preemption, which has enabled singular national pricing on consumer loan products for the past many decades. This could lower interest rates as it gives individual states the ability to determine interest rate caps on individual consumer loan products. The ruling could also raise costs as banks would need to manage their loan product offerings for each of the 50 states, a more expensive proposition than the one-size-fits-all system currently in place. The proposal would likely face significant legal pushback given the many court cases that have been heard on preemption. Separately, Senator Bernie Sanders and Representative Alexandria Ocasio-Cortez have proposed a 15% credit

card interest rate cap in their Loan Shark Prevention Act. Currently, credit card interest rates range from 4.9% to 27%. A cap of 15% would lower bank revenues. Their response would likely be to get more efficient, reducing employees, as well as to restrict credit to riskier customers. Last, Sen. Sanders and Rep. Ocasio-Cortez have also outlined a postal banking initiative, which we assume will be funded by the federal government. A postal bank funded by the US Government, an non-profit seeking, uneconomic competitor, could have the potential to undercut bank prices across a wide range of products. Affected companies: SYF, COF, DFS, ALLY, C, JPM, BAC, AXP, GS.

Breaking Up Banks/Reinstating Glass-Steagall: We See as Unlikely, but It Could Raise Cost of Running Trading Operations.

There are two primary proposals to shrink the size of the largest financial institutions. Senator Bernie Sanders also wants to cap the size of the largest financial institutions so that their total exposure is no larger than 3% of GDP, currently $584B. On its face, this would require most of the largest banks under our coverage, as well as a handful of other large Financials companies to split up or shrink. Separately, there is a bill originally proposed by Senators Elizabeth Warren, Maria Cantwell, and Angus King, along with the late Sen. John McCain, titled the 21st Century Glass Steagall Act of 2017. The bill, as written, essentially would allow banks only to take in deposits, make loans, and enable payments. They would have to exit any ownership of insurance, securities, or swap activities. The difficulty we see with this is that even small, private banks, strong local political supporters, engage in swaps to manage interest rate risk. As a result, we see many implementation questions around how to execute such a policy. Additionally, given the risk to GDP if banks currently responsible for more than 34% of the nation's loans were required to break up or shrink, we expect that these proposals/bills would have a hard time making it through Congress, even if both the House and Senate enjoy Democratic majorities. More likely, in a Democratic sweep, are increased restrictions around how deposits can be used, in our view. It is possible that regulators, over time if they are replaced by leaders nominated by a Democrat, reinstate stricter rules around how deposits can be used — limiting it to just loans, for instance, and not activities like trading books or FX. This would increase the cost of doing business for any trading or derivative activities that are funded with deposits. Affected companies: JPM, BAC, WFC, GS.

Tax Reform: The combination of higher taxes and bigger government could increase the probabilities of stagflation, a tough environment for banks.

Most of the Democratic candidates for president are in favor of reversing the Trump-era tax cuts. Higher corporate taxes, coupled with increased government spending on Medicare for All, free college tuition, or even a federal student loan "jubilee," could drive down GDP and drive up inflation. A potential stagflation environment would be tough for banks as growth slowed and credit quality deteriorated. Separately, Senators Bernie Sanders and Kamala Harris have outlined transaction taxes for stock, bond, and derivative trades that would be negative for banks. Senator Warren has proposed a 7% additional tax on all corporate profits above $100 million as a simplified way of ensuring that large corporations pay their fair share of taxes. Senator Sanders has also proposed an increased corporate tax rate based on the CEO-to-median worker pay ratio for companies with annual revenues above $100 million. The increase in corporate taxes under the proposed Sanders plan ranges from an additional 0.5% to 5%, depending on

the ratio (e.g., JPM's tax rate would have increased by 3% last year based on Jamie Dimon's pay). Affected companies: all large cap banks and consumer finance.

Asset Managers and Brokers

Michael Cyprys & Peter Kaloostian

Key things we're watching:

- **Private equity overhaul:** There is a proposal that would overhaul and limit certain business practices of private equity firms and require them to have more skin in the game.
- **Tax policy changes:** Higher and/new taxes could impact magnitude of flows into asset management products and have an impact on asset allocation strategies and demand for various asset management products.
- **More stringent fiduciary rule,** perhaps similar to the version that the Department of Labor enacted in 2017 but was subsequently vacated by the Fifth Circuit Court of Appeals in 2018, which stating that the rule reflected regulatory overreach.
- Winner of Democratic presidential nomination.
- Evolution of expectations for a potential Democratic sweep in November 2020.

Exhibit 51: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	Unchanged	Unchanged	APO, ARES, BX, CG, HLNE, KKR	
	DRD				
Unified Government	RRR	Unchanged	Unchanged	APO, ARES, BX, CG, HLNE, KKR	
	DDD	Funds liable for debts of portfolio companies, increased carried interest taxation, removal of Interest deductability, leverage limitation, portfolio dividend limitation			APO, ARES, BX, CG, HLNE, KKR

Source: Morgan Stanley Research

Key Proposal: Private Equity Overhaul

As probabilities of a Democrat winning the White House shift, we expect alternative asset manager stocks to be volatile as proposed regulations that call for an overhaul of private equity pose varying degrees of risk to the business model. While stocks are vulnerable to swings in indicators into election season, we caution that 1) several aspects of the proposal would have limited or modest impact on PE returns and Alt mgr earnings, and 2) implementation of the more adverse elements of the proposal would represent a meaningful change to the overall capital markets, which we see as a lower likelihood scenario and would require a unified Democratic control of government (White House, Senate, and House). It's important to recall that the largest driver of PE returns is operational improvements that grow EBITDA, rather than financial engineering.

Near term we continue to see fundamental catalysts for the group over the next 3-12 months with fundraising cycle that will grow sticky mgmt fees at BX, accelerating at KKR and ARES, and continued asset gathering at APO. We also see performance fee monetization catalysts.

What's been publicly confirmed on potential private equity regulation? To date, only Senator Elizabeth Warren has published a proposal that would overhaul and limit certain business practices of private equity firms. However, we would expect that, until the Democratic nominee is settled, sentiment around the sector could swing with generic Democratic prospects in the election.

Analysis of Senator Elizabeth Warren's proposal that would overhaul and limit certain business practices of private equity firms:

- **Limited to no impact to PE returns and Alt mgr earnings, in our view:**
  - **i) Closing the carried interest loophole** would subject PE professionals to a higher tax rate on carried interest received — currently taxed at favorable long-term capital gains tax rates. Importantly, this would not impact Alt mgrs earnings or tax treatment of dividends paid by the firms. Employees would pay higher taxes on their carried interest, and we would not expect firms to increase compensation to help soften the employee tax bill. As a result, we would expect no impact to public shareholders. Recall, the Alts recently converted to C-corporations (from a partnership structure) that pay corporate tax rates, meaning distributions to shareholders will be taxed as qualified dividends like any other company.
  - **ii) Eliminating monitoring fees** wouldn't have much impact on IRRs and earnings of the Alt mgrs as industry practice evolved over the past decade to largely rebate monitoring fees to LP investors as a way to offset mgmt fees, and not all firms charge monitoring fees.
  - **iii) Providing investors with greater information** about the performance and effects of private equity would not affect client interest and fundraising as LP clients already receive significant amount of disclosure and information.
- **Modest impact to PE returns and Alt mgr earnings, in our view:**
  - **i) Removing deductibility of interest** won't turn a good deal into a bad deal; as long as the low interest rate environment continues, we don't see a meaningful impact to IRRs.
  - **ii) Limiting the ability of lenders to provide leverage on LBOs** could lead to lower purchase prices on deals, certain deals may not get done, and other deals may see limited

to modest impact on returns depending on where the leverage limitation is set. For a number of years, leverage was essentially capped at 6x debt/ebitda but that's drifted higher toward 7x in recent years.

- **iii) Limiting the ability to take a dividend from a portfolio company** could pressure returns by delaying the time frame to receive a cash return on an investment, but the ultimate impact depends on how such a provision is structured and the time frame.

- **Potentially more impactful to PE returns and Alt mgr earnings… but less likely, in our view:**

  - **i) Holding private equity funds responsible for the debts and pension obligations of portfolio companies** could meaningfully increase risk of loss on deals in the bear case beyond a fund's capital contribution. That could significantly hurt fund returns. However, the probability of such a provision passing and becoming law may potentially be low given the significant change it represents to the way corporate law and capital markets operate today in which owners are not personally liable for a company's debts or liabilities, and enactment of this legislation would require Democratic control of Congress and the White House, we think.

Sector Impact: Business Services

Toni Kaplan and Greg Parrish

Key things we're watching:

- Credit rating agency reform
- Lower consumer interest rates
- National credit registry
- Fossil fuel restrictions
- Minimum wage increase
- Financial regulation
- Government provided child care
- Free college tuition

Exhibit 52: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	Unchanged	Unchanged		
Divided Government	DRD	Neutral	● Increase financial regulation ● Stricter fossil fuel regulation		FDS, MSCI INFO, VRSK
Unified Government	RRR	Unchanged	Unchanged		
Unified Government	DDD	● Carbon Tax ● National credit registry ● Credit rating agency reform ● Lower consumer interest rates ● Minimum wage increase ● Government provided childcare ● Free college tuition ● Increased education spending	● Increase financial regulation ● Stricter fossil fuel regulation	EFX and TRU (lower consumer int rates), ARMK (more students in universities), BFAM (increased childcare subsidies) and HMHC	INFO, VRSK, FDS, MSCI, MCO, SPGI, EFX and TRU (credit registry), ARMK, CTAS, SERV (min wage increases), BFAM (government run childcare)

Source: Morgan Stanley Research

We would view a Republican administration as positive for many of the companies in our Business Services coverage. President Trump's support of fossil fuels creates a more

positive environment for INFO and VRSK's energy customers, while MSCI, FDS, SPGI, and INFO should benefit from less stringent financial regulations. Both Senator Elizabeth Warren and Senator Bernie Sanders have called for credit rating agency reform in their campaign plans, and have called the 'issuer pays' model into question. Looking at the credit bureaus, there are currently three different proposals that would reduce the cost of consumer borrowing, and are more likely to gain traction in a Democratic administration. Bernie Sanders has also proposed a national credit registry, which would have a large negative implication for the bureaus. Minimum wage increases, which all of the leading Democratic candidates have campaigned on, would likely impact our labor-intensive companies, such as ARMK, SERV, and CTAS. The support for free college tuition from Democratic candidates could lead to higher enrollment at colleges, which would benefit ARMK, where 30% of revenue is derived from education centers.

Credit rating agency reform: Several Democratic candidates have questioned the "issuer pays" model within the credit rating industry, and floated the idea of credit rating agency reform. This could possibly lead to an "investor pays" model or something similar to the Franken Amendment proposal in the original Dodd-Frank bill. The Franken Amendment would have created a ratings oversight board made up of various constituents to randomly assign the rating agency assigned to a debt offering. We believe these issues were already debated and litigated during the financial crisis, so our base case is we would not expect a material change to the current model of the rating agencies.

Lower consumer interest rates: As outlined in the financials section above (Sector Impact: Financials), there are currently three proposals to reduce the cost of consumer borrowing. Two of these proposals — one that would enable states to cap the interest rate applicable on non-mortgage consumer loans and another that would limit the interest rate on credit card balances, would likely result in more limited credit access to riskier customers. This would result in less credit pulls and therefore less revenue to the bureaus. The third proposal, a postal banking initiative, could potentially be a positive for the bureaus if it expands the market for credit for the underbanked population. However, we would expect it to be a nominal impact on the margin, given postal banking would likely only include smaller dollar loans.

National credit registry: Senator Sanders has proposed the creation of a government-managed credit registry, which would eliminate the role of the private credit bureaus. The registry would be managed by the consumer financial protection bureau and would consist of a transparent algorithm to determine consumer creditworthiness. It would also allow consumers to receive credit scores for free and not allow the use of credit checks for rental housing, employment, insurance, and other non-lending categories. Our view is that having three private credit bureaus likely helps to spur innovation (e.g. trended data, use of alternative credit data) and actually expands the market for credit, as it gives lenders increased comfort around underwriting decisions.

Financial regulation: Much of the discussion around tighter financial regulation is not directly aimed at our companies, who provide data, software, and tools in the industry (MSCI, FDS, INFO, SPGI, MCO); however, they are not immune to the impact from a more stringent regulatory environment. Tighter regulation would indirectly impact those companies as the spending environment could become bleaker as belts are tightened and uncertainty around future profit potential rises. Many of the candidates on the Democratic side have called for much stricter financial regulations in their agenda's, such

as expanding Dodd-Frank, revisiting Glass-Steagall, etc. Under this scenario, we would expect investment banks, asset managers, and other financial firms to be put under pressure. We would expect MSCI and FDS to be most impacted, given their primary client base would be affected, with INFO, SPGI, and MCO also being affected.

Fossil fuel restrictions: There are multiple agenda items our energy team is watching that could have a substantial impact on the energy landscape, such as a potential ban on fracking, carbon tax / clean energy standard, and restrictions on energy exports. If the fossil fuel market is negatively impacted, we would expect INFO's Resources segment and VRSK's Energy and Specialized Markets business to be negatively impacted. While both businesses have diversified in recent years into adjacent energy markets, such as power, chemicals, and alternative energy, both are predominately exposed to traditional energy. We think if the regulatory or legislative environment becomes unsupportive of traditional fossil fuels, it would put pressure on the respective segment's growth rates, and potentially force further pivoting into alternative energy data assets.

Minimum wage increase: SERV, CTAS, and ARMK could be negatively affected by an increase to the minimum wage rage. All three are labor intensive business models, and although they do not typically employ at the minimum wage rate, it is close enough to it to have a negative impact.

Government-Provided Child Care: Currently, the government provides childcare assistance primarily through either direct subsidies directed at low income families or tax-based assistance through the Child and Dependent Care Credit. Programs like these make childcare more affordable and are positive drivers for BFAM, which provides full service day care, back-up care, and educational advisory services. However, a growing proliferation of government-funded childcare could result in higher demand for lower cost alternatives and reduced demand for BFAM. Certain states and municipalities offer state-funded prekindergarten at low or no cost to families. BFAM participates in universal pre-k in some jurisdictions, like Georgia and Florida, but does not participate in New York City, for example. BFAM chooses whether or not to participate based on the economics that are offered. Notably, Senator Warren recently introduced a universal child care policy that would require the federal government to work with local providers to create a national network of government funded care centers. If some version of this were to be enacted, we believe it would result in a headwind at for-profit providers like BFAM. However, if childcare reform were more centered around increased government subsidies, as is the case in the UK and the Netherlands, this could actually be a positive for BFAM through higher enrollments.

Free college tuition: All of the three leading Democratic candidates have proposed offering free college tuition in the United States. Former Vice President Joe Biden has proposed free 2-year community college, while both Senators Warren and Sanders have proposed free 4-year college.

Sector Impact: US IT Hardware

Katy Huberty & Elizabeth Elliot

Key things we're watching:

- Polling numbers of key candidates in support of big tech regulation
- Legislation on corporate tax rates and accelerated depreciation
- Trade and tariff legislation
- *Key Takeaway: We believe our IT Hardware companies can mitigate trade headwinds and defend against big tech regulation. Therefore, we expect risks to be around headlines and sentiment, more so than fundamentals and financials.*

Exhibit 53: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	Unchanged	Unchanged		
Divided Government	DRD	Unchanged	(-ve) Increased big tech regulation (-ve) Tighter import regulation		AAPL, HPQ, HPE, DELL, NTAP, PSTG, IBM, STX, CDW, SONO
Unified Government	RRR	Unchanged	Unchanged		
Unified Government	DDD	Potential Negative (-ve) Potential corporate tax increases (-ve) Large tech breakup	(-ve) Increased big tech regulation (-ve) Tighter import regulation		AAPL, HPQ, HPE, DELL, NTAP, PSTG, IBM, STX, CDW, SONO

Source: Morgan Stanley

Apple exposed to headline risk on big tech regulation. Politicians from both parties have voiced criticism of big tech companies, including calling for the breakup of tech giants. Large tech companies have faced increased scrutiny in recent years particularly around data privacy and misinformation. However, CEO Tim Cook's focus on privacy puts Apple at less risk than others, in our view. Some investors, including Warren Buffett, also view Apple as a consumer products company at its core rather than a technology company. We view privacy and misinformation claims as less relevant for Apple, but the SCOTUS ruling in May, which allows antitrust suits against the Apple App

Store, does increase attention on monopoly accusations at Apple. Some argue that the App Store monopolizes the market for iPhone software applications and Apple's 30% take rate from developers causes consumers to overpay. However, we note that developers, not Apple, sets the price and many apps are priced similarly to what consumers would pay if they engaged directly with the developer (example: Netflix, Spotify). What's more, the vast majority of apps are free to consumers and many paid Apps don't pay Apple a fee. For examples, Netflix and Spotify have recently pushed users to sign up and pay on their own platform after downloading the free app on Apple's App Store. Only those app developers that leverage Apple's payments platform and search placement services pay Apple for access to these services. Nevertheless, we do see headlines around big tech regulation and/or breakups as an risk for Apple shares.

Change to corporate tax & accelerated depreciation could help or hurt capex spend with Enterprise Hardware vendors. Demand for on-premise servers and storage in 2018 achieved record levels on the back of cyclical factors including US tax reform. A lower effective tax rate, and freed up foreign cash in some cases, allowed for incremental investments in data center infrastructure. Additionally, the ability to expense 100% of capital purchases in year one (i.e., accelerated depreciation) supported additional spending and increased the attractiveness of capex rather than opex spend. Consequently, we expect any changes in corporate tax and accelerated depreciation could help or hurt capex spend with on-premise data center infrastructure vendors. *Companies most exposed: DELL, HPE, NTAP, PSTG, IBM, CDW.*

Tighter import regulation could hurt our companies that are dependent on Asia-based component suppliers. The IT hardware sector relies on large scale manufacturing outside the US and has significant exposure to Asia-based component suppliers. Therefore, tighter regulation regarding imports could hurt the ability for hardware vendors to acquire components and products, driving higher costs or supply shortages. Alternatively, loosening of trade regulation could alleviate tariffs currently in place on PCs, consumer electronics and enterprise hardware. While many of our companies have mitigated disruption with configured-to-order facilities in other locations or by adjusting delivery logistics, changes in trade regulation can be a headline risk to IT hardware stocks. Apple remains the most exposed to China restrictions as the company leverages China's low-cost labor force in manufacturing consumer electronics with nearly $150B cost of goods sold annually. However, we still see an opportunity to mitigate the financial impact of tariffs given the company pays suppliers in USD and can capitalize on FX changes and pressure suppliers to adjust shipping locations or absorb part of the tariff costs. *Companies most exposed: AAPL, HPQ, DELL, STX, SONO*

Sector Impact: US Internet

Brian Nowak

Key things we're watching:

- Polling numbers of key candidates in support of big tech regulation
- Given new big tech regulation is the primary risk, in our view a Democratic presidential and Senate/House sweep is likely to weigh on sentiment and multiples in the sector

Exhibit 54: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	Unchanged	Unchanged		
Divided Government	DRD	Unchanged	Regulatory Risk		US Internet
Unified Government	RRR	Unchanged	Unchanged		
Unified Government	DDD	Negative	Regulatory Risk		US Internet

Source: Morgan Stanley Research

Political uncertainty, regulatory scrutiny and the risk of adverse legislative change remains an overhang on the group. We expect investors to continue to be wary of political headlines around regulating big tech into the 2020 election season. This, in our view, is already impacting the multiples investors will pay for large cap tech (GOOGL, FB, AMZN) and we expect that to continue.

In our view, a divided legislature would likely be a positive for US Internet. That said, **the more important factors** will likely be gaining a better understanding for **1)** details around actual proposed legislation to potentially change the tech landscape and the probability of it passing into law and **2)** the outcomes/findings of the multiple government-led investigations into big tech (DoJ, FTC, State Attorneys General. etc)

"Gig" economy employee status in focus too: The employment status of "gig" economy workers (whether they are full-time employees requiring full hourly wages and benefits) is also a key focal point for the rideshare and online food delivery industries (Uber, Lyft, GrubHub). This again would require legislative change with a Democratic sweep mostly likely to weigh on sector sentiment and multiple investors will pay for the assets.

Sector Impact: Telecom

Simon Flannery & Alexis Roper

Key things we're watching:

- Net Neutrality/Broadband regulation
- Municipal Broadband Funding
- Antitrust Policy Shift
- Tax Policy Changes

Exhibit 55: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	Unchanged	Unchanged	T, VZ, S, TMUS, CTL, FTR, CBB	
Divided Government	DRD	Neutral	Net Neutrality Anti-Trust Actions		T, VZ, S, TMUS, CTL, FTR, CBB
Unified Government	RRR	Unchanged	Unchanged	T, VZ, S, TMUS, CTL, FTR, CBB	
Unified Government	DDD	Public Broadband Dividend Taxation Policy	Net Neutrality Anti-Trust Actions		T, VZ, S, TMUS, CTL, FTR, CBB

Source: Morgan Stanley Research

For Telecom Services and Communications Infrastructure, we would make the following observations:

The party in the White House matters: Telecom stocks historically do better under Republican administrations than Democratic ones, which broadly reflects the degree of regulation/regulatory risk. Much of the action could happen at the FCC rather than Congress.

Net Neutrality is likely to be revisited by a Democrat-led FCC: Net Neutrality regulations covering the treatment of internet traffic were adopted by the FCC under President Obama in 2015, but were reversed by the current FCC in 2017. The regulation of internet services under Title II (Common Carrier) of the Communications Act rather than Title I (information services) would give the FCC broad regulatory powers. A number of Democrats have expressed concern about the digital divide and broadband prices.

Municipal Broadband networks are possible: Some candidates are proposing funding municipal broadband network buildouts rather than incentivizing private companies to expand rural coverage. This would be more likely in the Blue Wave scenario.

Antitrust in focus: We are seeing more than a dozen state AGs, led by California and New York, challenge the DoJ approval of the Sprint/T-Mobile merger. We could potentially see the DoJ more active in wireless and broadband under Democrat leadership. In such a scenario, further industry consolidation could be more challenging.

Dividend taxation could increase: We could see an increase in dividend tax rates on qualified dividends which are currently taxes at the capital gains tax rate (0, 15 or 20%). A higher tax rate could reduce the attractiveness of dividend paying stocks relative to municipal bonds for example. For example if the dividend tax rate went from 20% to 39.6%, as some candidates propose (for taxpayers earning over $1m), this would cut the after-tax yield by 25%.

Morgan Stanley & Co. LLC ("Morgan Stanley") is acting as financial advisor to Deutsche Telekom AG ("DT") and is providing financing services in relation to T-Mobile USA, Inc. ("T-Mobile") for the proposed acquisition by T-Mobile of Sprint Communications, Inc. ("Sprint") as announced on 29th April 2018. The transaction is subject to approval by T-Mobile and Sprint shareholders and other customary closing conditions. DT and T-Mobile have agreed to pay fees to Morgan Stanley for its financial services that are contingent upon the consummation of the transaction. Please refer to the notes at the end of the report.

Sector Impact: Transportation

Ravi Shanker & Christyne McGarvey

Key things we're watching:

- Infrastructure Legislation
- Highway Bill
- Hair Follicle Testing Regulation Reform
- Autonomous Trucking Regulation / Legislation
- USPS Reform
- Independent Contractor Regulation

Exhibit 56: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	Highway Bill: Positive Autonomous Legislation: Positive USPS Reform Legislation: Negative Employee Classification Legislation: Unchanged	Hair Follicle Testing: Positive Autonomous Regulation: Positive	Highway Bill: KNX, SNDR, WERN, USX, ODFL, SAIA, ARCB, XPO, UPS, FDX Autonomous Legislation: KNX, SNDR, WERN, USX	USPS Reform Legislation: UPS, FDX
Divided Government	DRD	Highway Bill: Positive Autonomous Legislation: Mixed-to-Positive USPS Reform Legislation: Negative Employee Classification Legislation: Negative	Hair Follicle Testing: Positive Autonomous Regulation: Mixed-to-Positive	Highway Bill: KNX, SNDR, WERN, USX, ODFL, SAIA, ARCB, XPO, UPS, FDX Autonomous Legislation: KNX, SNDR, WERN, USX	USPS Reform Legislation: UPS, FDX Employee Classification Legislation: All of Freight Transportation
Unified Government	RRR	Highway Bill: Positive Autonomous Legislation: Positive USPS Reform Legislation: Negative Employee Classification Legislation: Unchanged	Hair Follicle Testing: Positive Autonomous Regulation: Positive	Highway Bill: KNX, SNDR, WERN, USX, ODFL, SAIA, ARCB, XPO, UPS, FDX Autonomous Legislation: KNX, SNDR, WERN, USX	USPS Reform Legislation: UPS, FDX
Unified Government	DDD	Infrastructure Bill: Positive Highway Bill: Positive Autonomous Legislation: Mixed-to-Positive USPS Reform Legislation: Negative Employee Classification Legislation: Negative	Hair Follicle Testing: Positive Autonomous Regulation: Mixed-to-Positive	Infrastructure Bill: SAIA, ARCB, ODFL, UNP, CSX, NSC, KNX, SNDR, WERN, USX Highway Bill: KNX, SNDR, WERN, USX ODFL, SAIA, ARCB, XPO, UPS, FDX Autonomous Legislation: KNX, SNDR, WERN, USX	USPS Reform Legislation: UPS, FDX Employee Classification Legislation: All of Freight Transportation

Source: Morgan Stanley Research

Infrastructure Bill: While the details of what an infrastructure bill might look like are still undetermined, we believe such a bill could get bipartisan support in a variety of

government scenarios. We see two main groups of Freight Transportation beneficiaries from infrastructure spending/investment, should it materialize: 1) Transportation modalities that will benefit from the construction spend and 2)Transportation modalities that will benefit from post-construction infrastructure.

Transportation stands to benefit from a surge of infrastructure construction as it is likely to drive higher freight volumes and revenues within construction material end markets like stone, lumber, steel etc. as well as construction equipment like machinery. LTL, Rails, and TL Trucking would be the primary beneficiaries. LTLs stand to be the biggest beneficiaries given construction-related materials and equipment account for ~30% of LTL industry tonnage. Our favored way to gain LTL exposure would be EW-rated ODFL. With construction-related materials and equipment accounting for ~15% of Rail volumes, US-exposed names like UNP, NSC, CSX stand to benefit the most. TLs could also be beneficiaries as construction-related materials and equipment account for 15-20% of TL revenue — we prefer OW-rated KNX, WERN, SNDR, USX. Additionally, we could also see positive impact at brokers with significant flatbed exposure if there is tightness driven by construction demand (~30% of LSTR's TL loads are flatbed).

For the second group, given most Rail infrastructure is privately owned, we see Road infrastructure as the main beneficiary of the government's spend by helping alleviate two main pinch points to Trucking (1) road congestion and (2) truck maintenance, particularly tires. Highway congestion can be a large operating drag on a carrier's performance. According to ATRI, at a national level in 2016, the trucking industry experienced over 1.2 bn hours of delay on the NHS as a result of traffic congestion. By applying the 2016 national average operational cost per hour (CPH) of $63.66, this is the equivalent of more than $74.5 billion in added industry operational costs. Meanwhile, maintenance accounts for roughly 5% of the cost base for the average truck carrier, but we can look at tires to try to isolate maintenance expense as a result of bad roads. The commercial truck industry consumed 19.2M Replacement Medium / Heavy Truck Tires and 14.3M Retreaded Truck Tires in 2017. At an average price of $381.50 for a new tire and $237.48 for a retread, that is an industry worth $10.7 bn. While we do not have data on what % of tire replacement is driven by road damage vs. regular maintenance, we note that every 10% improvement in tire wear/consumption as a result of better roads will save the industry ~$1 bn. Here we also prefer to gain exposure through the OW-rated TLs.

Highway Bill: The Senate's Environment and Public Works Committee has introduced a $287bn proposal for a five-year reauthorization of the 2015 FAST ACT. The bill seeks to provide additional funding to the INFRA grant programs and the National Highway Freight Program. Environmental impact is also addressed with a $1bn competitive grant program for states and local governments to build hydrogen, natural gas and electric vehicle fueling infrastructure and an additional $3bn to projects that more broadly support lower highway-related carbon emissions including facilitating "the use of vehicles or modes of travel that result in lower transportation emissions per person-mile traveled" which could potentially include trucking. Other efforts include reducing traffic congestion and truck idling time at ports. In a Democratic unified, or divided but majority, government we believe the current allocation for environmental initiatives could be much greater. For example, Democratic candidate Senator Bernie Sanders has carved out a $216bn budget for electric trucks in his "Green New Deal" Policy proposal. However, we note that this would likely be tempered to a lower, though potentially still

significant number, through the legislative process, especially in a divided government. Similarly, in a Republican majority government, we would expect concessions on the environmental initiatives in the final bill such that the final bill may have very limited if not zero grant programs to environmental projects in a unified Republican government. The bill has only been introduced at this point though it is worth noting the committee which delivered the proposal is bipartisan.

We see two potential impacts to Transportation 1) reducing operational headwinds of road congestion and truck maintenance and 2) accelerating the adoption of EV trucks. Similarly to the post-construction infrastructure beneficiaries, we believe TLs and LTLs will see the most benefits from a highway bill given it stands to reduce the operational headwinds of road congestion and truck maintenance. However, we also believe they will see a net benefit from environmental programs that accelerate the adoption of EV trucks. Charging infrastructure remains a key headwind to adoption and the $1bn laid out for that specifically could accelerate commercial usage of EV trucks. The other $3bn has the potential to be, in part, granted to programs that help get more commercial EV trucks on the road in a more direct manner. Government assistance for the adoption of electric trucks could ease the path to market and be a significant tailwind for large public trucking companies as it reduces their operating costs and improves their relative competitiveness vs. other transportation modes. However, government financial assistance could also enable smaller mom-and-pop and midsize trucking companies to get on board, which would limit the industry consolidation/share gain opportunity for large well capitalized TLs/LTLs. However, the range of outcomes on the environmental grants could vary materially depending on which party is in the majority. We believe OW-rated TLs (SNDR, KNX, WERN, USX), LTL players (ODFL, SAIA, ARCB), and those with LTL divisions (XPO, UPS, FDX) are best positioned to benefit, we think.

Hair Follicle Drug Testing Reform Regulation: There are two pieces of enacted legislation that have directed the Department of Health and Human Services to draft guidelines for the use of hair follicle drug testing, the FAST Act of 2015 and the Opioid Crisis Response Act of 2018. Currently, hair follicle testing proposed guidelines have been formally forwarded to the White House Office of Management and Budget for review. Given this directive was signed into law by both a Democratic and Republican administration we view it as equally likely. However, at this point the regulation still needs to be approved by OMB and go through the rulemaking process for both DOT and FMCSA, which could take years.

We believe the main impact of this legislation would be to structurally reduce the number of drivers in the market. According to the Trucking Alliance, their data shows that as many as 9 of 10 illegal drug users are missed when administering a urine test alone and this could be because urine samples can only detect traces of drug use within 2-3 days compared to up to 90 days with hair follicle tests. With the launch of the Drug & Alcohol Clearinghouse in January 2020, a national database of information on DOT controlled substances and alcohol program violations , allowing hair follicle testing to be used even in conjunction with urinalysis could mean that habitual users would be precluded from driving commercially as their violations would be broadly accessible (currently companies who hair test are not allowed to disclose this to government agencies or other companies). Many large, public TLs already use hair follicle testing and are able to offer benefits to drivers that mom & pop shops can not. As such, we believe the supply rationalization we expect from this regulation would come from small "mom

& pop" carriers exiting the market. While public carriers will not be immune to the impact from wage inflation, we believe they would be best positioned to recruit and retain talent while also benefitting from a tighter market driven by a shortage of high-quality drivers.

Exhibit 57: Industry Players Are Expecting a Material Impact to Capacity from the Drug and Alcohol Clearinghouse – the impact of mandated hair follicle testing will be significantly greater

"This rule is scheduled for implementation in early 2020 and may reduce the number of available drivers in an already constrained driver market" – *HTLD, February 2019*

"Our experience going from urine test to hair follicle at the time, certainly would indicate that cleaning that up is going to -- not going to help capacity, that's for certain." – SNDR, September 2019

"And if you were to couple hair follicle with drug and alcohol clearinghouse, I think by comparison, it makes ELD look like a speed bump in the road." – *WERN, April 2019*

"When compliance becomes mandatory, it could result in a decrease in driver availability" – USAK, February 2019

"...the only real negative for capacity but good for society in safety is the national drug database that could be coming at us here in 2020, which gets after the habitual drug use. And then you saw the other item, some approval to get after hair follicle testing, which we believe is superior in its ability to identify and weed out the habitual drug users. So those are the probably two that's going to put the additional crimping on capacity going forward, but probably for a very good reason." - SNDR, November 2018

"I think the one thing that I would really point to is the -- probably the most impactful is going to be the Drug and Alcohol Clearinghouse... And my personal opinion, if it goes into effect like it's been laid out, it could potentially be more impactful than ELDs." *USX, March 2019*

"If hair follicle was included, I think there's data out there that says, on average, the failure rate for your standard urinalysis is 1% to 1.5%. And I think there's a pool of carriers that provided some data, I forget if it was to the ATA or who it was, but the failure rate is higher, maybe 9%. So if that data went into the Drug and Alcohol Clearinghouse, clearly, it would have a more significant impact on capacity." – JBHT, September 2019

"Implementation and future compliance with the Clearinghouse may result in a reduction of the pool of qualified commercial motor vehicle drivers." – *SAIA, February 2019*

"ELD 2018 and National Drug and Alcohol Clearing House 2019 will impact labor and constrain capacity" - *TLSS respondent, June 2019*

Source: Morgan Stanley Research

Autonomous Trucking Regulation / Legislation: We see potential for both legislative and regulatory changes in the world of autonomous trucking as efforts in both endeavors have stepped up in the past few years. We see the TL space, particularly KNX, SNDR, WERN, and USX, as potential beneficiaries.

Attempts by Congress to enact legislation on autonomous driving, including the AV START Act in 2018 and SELF DRIVE Act in 2017, have thus far failed to get over the finish line. However, earlier this summer the Senate Commerce Committee and the House Energy and Commerce Committee were reported to be reaching out to auto OEMs and other stakeholders seeking input on autonomous vehicles. The main goal of the legislative attempts thus far have been to create a national framework, and to preempt state laws, for the regulation of autonomous vehicles. Currently the DOT has issued policy guidelines in "AV 3.0" which aims to encourage regulatory consistency amongst municipalities but ultimately there are still conflicting local and state laws which create confusion and impede scaled adoption. We believe a clear, universal, framework, which may include carve-outs from current safety rules to operate without things like steering wheels, brakes and human drivers, as indicated by earlier efforts, would likely accelerate the adoption of autonomous vehicles. While AV legislation has received some bipartisan support, the most recent attempt was stalled due to Democrat concerns about safety (including cybersecurity, data transparency, and mandatory arbitration clauses, amongst others) and some have voiced other concerns about the labor impact. Indeed, Democratic candidate Andrew Yang has carved out an entire policy dedicated to easing "the transition to self-driving vehicles," which seeks to "protect Americans who work in the trucking industry" and features a proposal to tax profits from autonomous trucks "to provide severance packages for the drivers whose jobs are replaced." As such, we believe legislation is both more likely to be passed and more

likely to be "pro-autonomous" trucking in a Republican majority government.

Though no major autonomous legislation has managed to pass, over the past few years a variety of regulatory agencies have made efforts to provide guidelines for autonomous vehicles and there have been a number of important steps that leads us to believe that the pace of regulatory intervention likely accelerates from here. Such developments include the FMCSA declaring they will "no longer assume that a commercial motor vehicle driver is always a human or that a human is necessarily present on board when in operation", the Government Accountability Office (GAO) directing the DOL (Dept. of Labor) and DOT (Dept. of Transportation) to work together to prepare for the employment impacts of autonomous trucking, the FMCSA adding the language "on duty, not driving" to Hours of Service regulations, and the DOT's issuance of their "AV 3.0" policy guidance which included ex-passenger vehicles (i.e., trucks) for the first time. Currently, the NHTSA recently closed the public comment period after seeking input on "Automated Driving Systems Technologies" with the explicit purpose of removing "unnecessary regulatory barriers to the safe introduction of automated driving systems (ADS) vehicles in the United States." In particular they note the three following barriers to certification for Automated Driving System-Dedicated Vehicles (ADS-DVs) that lack the traditional manual controls: (1) The standard requires a manual control; (2) the standard specifies how the agency will use manual controls in the regulatory description of how it will test for compliance; or (3) the definition or use of particular terms (e.g., “driver”) become so unclear that clarification is necessary before certification and compliance verification testing is possible. Resolution of these barriers could open up additional technologies to be used and validated. Beyond this most recent development, we believe more regulatory agencies will increasingly take steps to make current guidelines more accommodative of autonomous technology, though this also seems more likely in a Republican majority.

While it is still early days to know exactly what policy might look like, we believe it is more likely than not that further autonomous legislation and regulation will be designed to accelerate the pace of adoption of autonomous trucks in commercial use rather than slow it down. Given our view that the truck driver shortage and associated wage increases could constrain freight capacity and materially increase freight costs (which would be passed through to the consumer) over the coming decade, we believe that regulation will need to be supportive of intelligent trucking. In our view, a more accommodative regulatory environment for autonomous trucks could be a significant tailwind to TL companies, particularly KNX, SNDR, WERN, and USX. We estimate that autonomous technologies could collectively drive as much as a 50% reduction in trucking operating costs in the next 10 years. We continue to believe intelligent trucks could hit the road as early as next year, particularly if the regulatory environment continues on this path.

Exhibit 58: Autonomous Implementation Timeline

Phase	1	2	3	4	5
	ADAS	YOU ARE HERE Platooning	Autonomous Platoons	Autonomous + Electric Platoons	Fully Autonomous + EV
Autonomous Level	1/2	3	4	4	5
Timing of Implementation	Immediate	2018	2020	2020	2025 - 2030
Implementation Cost	$150-500 per truck	$500-1000 up front	$10,000 per truck	$30,000 per truck	$20,000 per truck (net of cab cost reductions)
Benefits	• 30-50% Insurance Savings	• 5-15% fuel efficiency improvement	• 30-50% overall op. cost reduction • 2x productivity • Industry consolidation	• 60-70% overall op. cost reduction • 2x productivity • Industry consolidation	• 80% op. cost reduction • 2x productivity • Industry consolidation • Savings are easier to achieve
Payback Period	~2 months	~1 month	~3 months	~5 months	~4 months

Source: Source: Morgan Stanley Research Estimates; Note: Please see Debate 1 in Trucking & Logistics: An Intelligent Revolution is Coming report for calculations and assumptions on intelligent truck technology; Payback period calculation is based on after-tax cost savings using WERN financials.

Independent Contractor Classification: With the rise of the "gig economy" employee classification has moved to the forefront of the conversation among Democratic Party candidates. By way of background, California recently passed and Governor Gavin Newsom signed into law Assembly Bill 5 — informally referred to as "AB 5." The bill seeks to codify into law a recent California Supreme court decision (Dynamex Operations West v. Superior Court), which imposes stricter limits for employee classification, requiring a 3-part test: 1) Is the worker free from the control and direction of the hirer in connection with the performance of the work, both under the contract for the performance of such work and in fact? 2) Does the worker perform work that is outside the usual course of the hiring entity's business? 3) Is the worker customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity? While not the primary target of the legislation, we believe the legislation could have a meaningful impact on TL, LTL, Parcel and Intermodal operations, who regularly classify some employees as independent contractors. As such, if a similar legislation were enacted federally, Transportation companies would likely have to significantly reconfigure their current operating models to comply – likely driving costs higher and squeezing margins. Democratic candidates Bernie Sanders, Elizabeth Warren, Cory Booker, Pete Buttigieg, Beto O'Rourke, and Kamala Harris have all backed California's AB 5 legislation. For instance, Senator Warren penned an OpEd in August supporting the California legislation as a "start" (see here). Senator Sanders has called for national legislation to "bar these employers (like Lyft and Uber from continuing to misclassify their employees" (see here). Former Vice President Joe Biden has not expressed a position on the legislation to our knowledge.

USPS Reform: There is no question that the USPS is a financially unviable entity as it stands and the good/bad news is that this needs to be comprehensively addressed imminently to prevent a crisis. With every passing day, the deteriorating financial condition of the USPS raises the pressure on Congress to pass USPS Reform Legislation — though this has been the case for a while. The last Congress saw two bills introduced (the House's HR.756 and the Senate's S.2629), both of which had the most bipartisan support we have seen for a long time — indeed, the Senate bill was even "fast-tracked" at one point — though neither managed to cross the finish line. We believe the ultimate USPS reform could find common ground between those two bills and the takeaways from the recent Presidential Task Force report, though we believe avoiding particularly controversial Task Force recommendations (like maintaining the pension/healthcare obligations, though restructured, which are the biggest drag on USPS financials today,

rather than a taxpayer-funded bailout and the proposed elimination of collective bargaining and wage reforms) could increase the likelihood of passing. However, if the US does have a more financially healthy Postal Service, Parcel names (UPS / FDX) stand to be negatively impacted, as it becomes a better competitor in their core business.

Sector Impact: Energy & Utilities

North American Energy

Devin McDermott, Drew Venker, Connor Lynagh & Benny Wong

Key things we're watching:

- A potential ban on "hydraulic fracturing"
- More stringent regulations on emissions, including methane
- A Clean Energy Standard or Carbon Tax
- Changes to policies on leasing and permitting federal land for oil & gas
- Restrictions on energy exports
- Limits on new infrastructure (pipelines) or flaring (direct burning of natural gas)

Exhibit 59: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRR	Minimal legislative changes	No meaningful changes to energy policy or oil & gas regulations. Continuation of current federal lands leasing policy.	US Energy Sector	Midstream, US-focused E&P, Oil Services, Refining
	DRD	Minimal legislative changes	Increased regulatory oversight of emissions, including methane. More extensive environmental review of proposed pipelines & energy infrastructure. Potential changes to federal lands leasing policy.	Non-US Oil & Gas, including Canada, and some global Oil Services	
Unified Government	RRR	Minimal legislative changes	Continued roll-back or weakening of existing regulation. No changes to federal leasing policy.	US Energy Sector	
	DDD	Meaningful probability of a carbon tax and/or a clean energy standard; increased risk of new restrictions on fracking and energy exports; potential anti-OPEC legislation	Stringent regulation of emissions. More extensive environmental review of proposed pipelines & energy infrastructure. Likely changes to federal lands leasing and permitting policy and/or oil & gas royalty rates.	Non-US oil & gas, including Canada, and some global Oil Services. Carbon tax in isolation could be positive for US natural gas	Midstream, US-focused E&P, Oil Services, Refining

Source: Morgan Stanley Research

We believe an outright 'frac ban' is very unlikely, but a potentially shifting regulatory

environment is worth monitoring. Throughout the ongoing Democratic primary campaign, one thing is clear: Proactive environmental policy to address issues such as climate change is a key focus of most candidates. At the forefront of this is either a clean energy standard or carbon tax as a strategy to reduce emissions. However, some candidates have also proposed a ban on hydraulic fracturing — the technology responsible for turning the US into the word's largest oil producer, and from a natural gas importer into a major exporter.

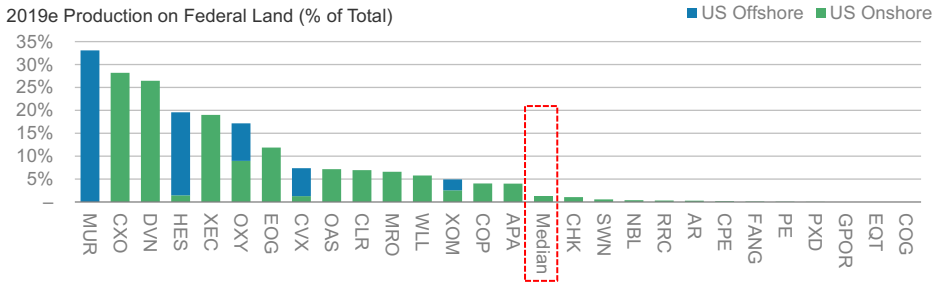
Could a president ban fracking? We think an outright "ban" on fracking is unlikely and would be challenging to implement, for many reasons. However, perhaps any Democratic president who followed the current administration would mean a more stringent regulatory backdrop for the US oil & gas industry — a shift that we think would come with both positives (potentially higher commodity prices) and negatives (such as increased costs and/or lower growth) for the exposed stocks. Based on our conversations with various legal and regulatory experts over the past few weeks, many feasible options exist to constrain oil and gas activity, including a slowdown in federal leasing and permitting, increased impediments to new oil and gas infrastructure, and stricter methane emissions or flaring limits.

Policy toward oil & gas production on federal lands could be the most likely to change. The president has the power to restrict federal leasing, permitting, and infrastructure development. Currently, ~3 MMb/d of oil and ~4.5 Bcf/d of gas production comes from federal lands, representing 25% and 4%, respectively, of the US total. Since existing permits provide 1-2 years of drilling runway, any policy changes would be unlikely to have an immediate impact on production.

Potential impacts on oil & gas prices:

- **Oil:** All else equal, we think policy changes that slow US supply growth would be bullish for both WTI and Brent prices. However, this would also create room for OPEC to raise production and reclaim some market share, which may offset some of the positive price impact of lower US output over time.
- **Gas:** While more stringent regulations on oil & gas activity could put upward pressure on US natural gas prices, we expect prices to remain below $3/MMbtu under most scenarios.

Exhibit 60: In the event of new restrictions on federal land oil & gas activity, existing production is not at risk, in our view.

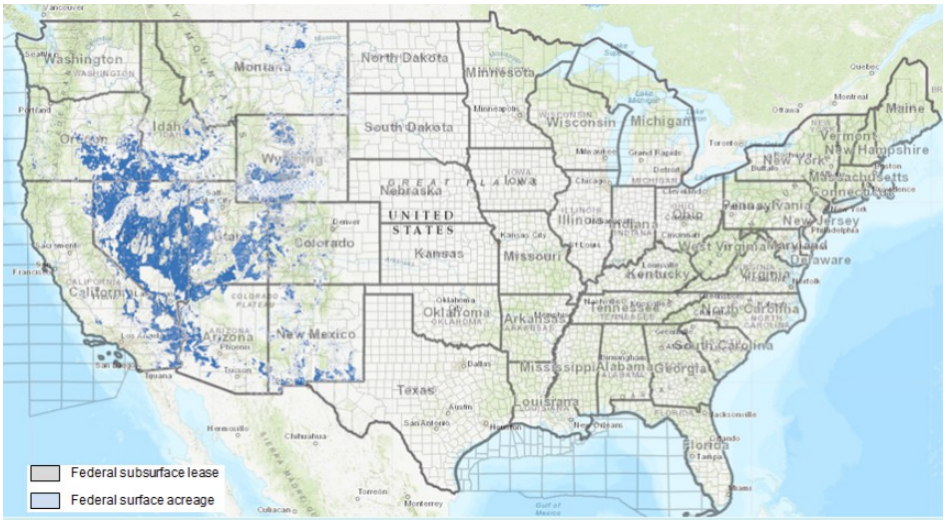


Source: Rystad Energy; Morgan Stanley Research estimates

Geographically, we believe fracking restrictions on federal lands would be most impactful for oil & gas operations in New Mexico. The Permian is the largest oil

producing region in the US, and it is core to the growth plans for many E&Ps. Part of the Permian sits in southeast New Mexico, a region where companies including **DVN, CXO, and EOG** that also high levels of federal land. However, the remainder of the Permian is largely non-federal, and many exposed companies would likely shift investment to other parts of the basin. Onshore federal acreage is also concentrated in the Powder River Basin and a subset of Alaska, the latter being heavily reliant on oil and gas production for state revenue. However, only select companies have meaningful development plans in the Powder River Basin (**CHK, DVN, EOG**), and in our coverage, **COP** is the only company exposed to Alaska. Offshore US oil and gas development is all federal, though a long runway of already permitted drilling may limit risk for the exposed companies (**MUR, HES, OXY, CVX, XOM**).

Exhibit 61: Federal acreage overlap with US shale basins is concentrated in the NM portion of the Permian and in the Powder River Basin in Wyoming. Gulf of Mexico acreage is nearly all federal.



Source: Enervus
Note: BLM acreage shown constitutes surface acreage in blue and subsurface leases in gray, but may not include all Federal subsurface leases.

How might more stringent regulations, such as restrictions on federal lands drilling activity, impact the North American Energy sector?

- **US Exploration & Production and Integrated Oil:** We believe large-cap producers with more diversified global footprints are best positioned going into the upcoming period of election uncertainty, including OW-rated **CVX, HES, NBL,** and **COP** (although COP has federal lands exposure in Alaska). Conversely, **DVN, CXO,** and **EOG** have the most value exposed to federal land in our coverage.

- **Oilfield Services:** The median stock in our coverage earns >50% of its revenues in the US. Most exposed: most small cap services & equipment companies; among large caps, **HAL** is most exposed.

- **Refining & Marketing:** We believe a policy that limits US oil and gas supply would reduce the cost advantage US refiners have over global peers. Most exposed are companies with greater weighting toward inland operations such as **DK, HFC,** and **MPC.**

- **Canadian Oil & Gas:** Limiting US oil and gas production would increase the country's reliance on imports. Canadian supply, which already makes up the

majority of US imports, would directly benefit from strengthened pricing. We highlight **MEG, CVE,** and **CNQ** as companies that could benefit most from higher oil prices. On the natural gas side, **CNQ** and **ECA** could benefit most from stronger prices. We note that development of Keystone XL would likely be at risk under a new administration that seeks to limit oil & gas activity, although we estimate that very little of the potential from the pipeline is being priced into the stocks today.

Power & Utilities; Clean Energy

Stephen Byrd & Laura Sanchez

Key things we're watching:

- S.1128: American Opportunity Carbon Fee Act of 2019
- H.R. 6463: Market Choice Act
- H.R. 763: Energy Innovation and Carbon Dividend Act
- H.R. 4058: Stemming Warming and Augmenting Pay Act
- S.2284: Climate Action Rebate Act
- H.R.3966: Raise Wages, Cut Carbon Act
- S.2289: Renewable Energy Extension Act
- S. 1974: Renewable Electricity Standard Act
- S.1142: Energy Storage Tax Incentive and Deployment Act of 2019

Exhibit 62: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	• Minimal legislative changes; low probability of carbon regulation, extension of renewable tax credits, and national renewable energy standard	• Potential for continued tariffs on solar panels manufactured outside the US • Supportive federal policy towards natural gas pipelines, but local/state challenges persist • Modest regulation of fossil power plants	• US solar manufacturers (FSLR, SPWR) benefit from tariffs on non-US manufacturers • SRE, given the company's multiple LNG export growth options • Fossil-heavy merchants (NRG, VST) continue to generate strong cash flow	• US wind demand likely to experience a temporary dip in 2022 as tax credits phase out, negatively impacting wind demand – most relevant for NEE, TPIC
Divided Government	DRD		• Potential for more stringent regulation of coal-fired power plants, driven primarily by the EPA; EPA-driven carbon regulation subject to extensive legal challenge • Potential for more extensive federal environmental review of proposed natural gas pipelines, fracking activity	• Fossil-light merchant power generators (EXC, PEG) benefit from the higher costs borne by fossil fuel power plants • Acceleration in coal plant closures would benefit renewable developers (NEE, RUN)	• Utilities with pending natural gas pipeline projects (D, DUK,ED, SJI) • Fossil-heavy merchant power generators (NRG, VST) • Utilities with LNG export potential (SRE)
Unified Government	RRR	• Enhanced support for domestic energy production • Low probability of carbon regulation, extension of renewable tax credits, and national renewable energy standard	• Potential for continued tariffs on solar panels manufactured outside the US • Supportive federal policy towards natural gas pipelines, but local/state challenges persist • Modest regulation of fossil power plants	• US solar manufacturers (FSLR, SPWR) benefit from tariffs on non-US manufacturers • SRE, given the company's multiple LNG export growth options • Fossil-heavy merchants (NRG, VST) continue to generate strong cash flow	• US wind demand likely to experience a temporary dip in 2022 as tax credits phase out, negatively impacting wind demand – most relevant for NEE, TPIC
Unified Government	DDD	• Meaningful probability of carbon regulation, federal renewables standard, extension of tax credits for solar and wind, and inclusion of energy storage in tax credits • Potential for crude oil export restrictions	• Potential for more stringent regulation of coal-fired power plants, driven primarily by the EPA • Potential for more extensive federal environmental review of proposed natural gas pipelines, fracking activity • Potential for review of allowed ROEs for natural gas pipelines	• Fossil-light merchant power generators (EXC, PEG) • Renewable equipment manufacturers (TPIC, FSLR, SPWR) benefit from increased US demand • Acceleration in coal plant closures would benefit renewable developers (NEE, RUN)	• Utilities with pending natural gas pipeline projects (D, DUK,ED, SJI) • Fossil-heavy merchant power generators (NRG, VST) negatively impacted by carbon costs, more rapid renewables growth • Utilities with LNG export potential (SRE)

Source: Morgan Stanley Research

Carbon Tax – Mixed impact in the sector, with large nuclear merchant operators (EXC) benefiting at the expense of fossil-fuel heavy companies (VST and NRG).

There are six bills (two introduced in the Senate and four in the House) that aim to impose a fee/tax/price on carbon dioxide emissions. Fees range from $15 to $52 per ton of carbon dioxide equivalent emitted through the combustion of fossil fuels such as coal and natural gas. The ultimate impact of a carbon tax on companies within our coverage depends on (1) whether a utility is regulated or diversified and (2) its generation fleet. For utilities that have merchant operations (diversified utilities) and IPPs (Independent Power Producers), a carbon tax can have significant impacts on their financials and on the economic viability of their power plants.

Merchants & IPPs: We view EXC as the main beneficiary of a carbon tax given its large merchant nuclear fleet of 20GWs, which represents 61% of its total merchant capacity. For reference, applying a $10/MWh increase in power prices to EXC's non-carbon emitting generation in 2020 drives a $1.6bn (or 20%) increase in the company's 2020 margins — non-carbon emitting power plants, such as those of EXC, benefit from higher margins given that a tax on carbon drives market clearing prices to increase, as the variable costs of running fossil fuel plants increase. On the contrary, companies with power fleets that are predominantly coal- and gas-fired, such as VST (93% of its capacity is coal- or gas-fired) and NRG (77%), would see their fossil-fuel plants at risk of becoming uneconomic.

Regulated Utilities: Regulated utilities aren't impacted by a carbon tax in principle as these higher costs would be simply passed on to customers. That said, increased electricity rates could create political and regulatory pressure on the utilities to retire expensive plants. While the fuel cost savings achieved from retiring a fossil-fuel plant and replacing it with renewable energy resources can be large enough to offset the costs of retiring early a power plant (accelerated depreciation is also a cost that is passed on to customers), depending on the state and the regulatory environment, utilities could potentially face the risk of ending with a stranded asset on their books (an asset on which they cannot recover their investment). Ultimately, the impact depends on the companies' portfolio mix and jurisdiction.

Extension of Solar Investment Tax Credits — Potentially harmful in the short to medium term for developers (NEE) and OEMs (FSLR) but positive longer term.

Developers of renewable energy projects such as NEE have expressed concerns with the extension of tax credits (particularly relate to the PTC) as this would hurt development by pushing demand into the future, which in our view applies to solar investments as well. We believe an extension of the ITC could provide more stability in the demand and development of solar systems longer-term; nonetheless, in the near to medium term (1-3yrs) an extension has the potential to adversely impact developers and OEMs such as FSLR. Further, our preliminary analysis suggests that solar will remain competitive even beyond 2023, when the ITC is set to expire, given further declines in solar capital costs.

Renewable Energy Standard — Potentially negative for utilities in states with unfavorable renewable energy conditions, such as PPL, SO, and ETR.

This bill amends PURPA to establish a federal renewable electricity standard by setting an annual percentage increase of electricity generated from renewable energy resources. We see annual increases of between 1.5-2.5% through 2035 as fairly modest and believe that many states will surpass these levels. Nonetheless, for states like AL, AR, KY, LA, MS, and TN — which currently generate close to 0% of their electricity with renewable energy resources — a federal standard could potentially put pressure in electricity rates. Similar to the effect of a carbon tax on regulated utilities, while customers would see savings from lower fuel costs as fossil-fuel plants are replaced with renewable energy resources, the costs associated with the early retirement of fossil fuel plants could offset these fuel-related savings, putting pressure on electricity rates. Depending on the regulatory environment, utilities could potentially face the risk of ending with a stranded asset on their books.

Energy Storage Tax Incentive — Too early to tell.

This bill expands tax credits to investments in energy storage technologies including battery storage. Similar to the trend seen in wind and solar adoption over the past decade, we believe tax credits would have a significant impact in the development, and ultimately the commerciality, of storage technologies. While the regulatory construct of this technology is in the works, there is a possibility that regulated utilities in deregulated markets could rate base investments in storage technologies while bidding this resource into capacity markets, representing an upside for the utilities. As markets operate today however, this would suppress market clearing prices, negatively impacting companies with large fossil fuel fleets (VST and NRG). FERC is currently determining

how to price subsidized resources in unregulated markets.

Sector Impact: Machinery

Courtney Yakavonis

Key things we're watching:

- Infrastructure Legislation
- Trade Policy & China Relations
- A potential ban on "hydraulic fracturing" & limits on new pipelines
- Farm Economics
- On & Off Highway Truck Emissions Regulation

Exhibit 63: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	Infrastructure Legislation: Low Probability	Truck Emissions Regulation: Low Probability; Fracking/Pipeline Regulation: Low Probability; Farm Subsidies: High Probability Environmental Incentives: Low Probability Trade Policy: Eases	Trade: DE, AGCO, CNHI, TEX, OSK, CMI, CAT	
Divided Government	DRD	Infrastructure Legislation: Low Probability	Truck Emissions Regulation: High Probability; Fracking/Pipeline Regulation: High Probability; Farm Subsidies: Low Probability Environmental Incentives: High Probability Trade Policy: Eases	Farm Subsidies/Incentives: DE, AGCO, CNHI; Trade: DE, AGCO, CNHI, TEX, OSK, CMI, CAT	Truck Emissions: PCAR, CMI, ALSN Fracking/Pipeline: CAT, URI, CMI, ALSN;
Unified Government	RRR	Infrastructure Legislation: Low Probability	Emissions Regulation: Lowest Probability; Fracking/Pipeline Regulation: Lowest Probability; Farm Subsidies: High Probability; Environmental Incentives: Low Probability; Trade Policy: Eases	Trade: DE, AGCO, CNHI, TEX, OSK, CMI, CAT	
Unified Government	DDD	Infrastructure Legislation: High Probability	Truck Emissions Regulation: High Probability; Fracking/Pipeline Regulation: High Probability; Farm Subsidies: Low Probability Environmental Incentives: High Probability Trade Policy: Eases	Infrastructure: CAT, DE, URI; Farm Subsidies/Incentives: DE, AGCO, CNHI; Trade: DE, AGCO, CNHI, TEX, OSK, CMI, CAT	Truck Emissions: PCAR, CMI, ALSN Fracking/Pipeline: CAT, URI, CMI, ALSN;

Source: Morgan Stanley Research

Infrastructure: Construction equipment OEMs and construction rental stand the most to benefit from increased rhetoric on infrastructure spending leading up to the election. Though a bill could get bipartisan support in a variety of government scenarios, our policy team views an infrastructure spending plan as more likely to take place in a unified Democratic outcome than a Republican one since Republicans are reticent to

increase Federal spending without a consensus on how to finance it. An infrastructure bill would significantly impact the Machinery complex, primarily through 1) a direct lift to construction equipment demand which would flow through to construction equipment OEMs, national rental chains, and off-highway equipment at Truck OEMS and 2) an indirect lift to truck demand via the associated broader economic stimulus and GDP impact from the multiplier effect. We see a greater potential for an uplift to the construction complex vs. truck, and see the most upside to CAT, URI and DE which we estimate to have 5-15% exposure to US infrastructure and 20-40% exposure to US Non-Resi construction. **Most impacted: URI, CAT, DE.**

Trade Policy & China Relations: Ag OEMs (DE, AGCO, CNHI) have been most impacted by Trade Policy from a top-line perspective due to the negative impact of China's 25% tariff on soybeans on ag commodity prices, farmer economics, and sentiment. Machinery companies impacted by Section 232 and 301 tariffs have already fully incorporated the cost impacts in their guidance (which have been <1% on average), but could see a cost tailwind if removed (as well as potential pricing pressure from the reversal). Though the White House has suggested that China has committed to purchasing $40-50B worth of agricultural products per year as part of Phase I of the trade deal, little detail has emerged on the pace of those purchases or what specifically they will be (grains or protein). Our equity strategists believe the market will expect a modestly more conciliatory tone on trade with a Democratic White House win, but that there is a lot of time for the dynamics of this issue to evolve, for better or for worse, over the next year. For example, a deal under the current administration's leadership that Democratic candidates felt failed to address key structural issues could lead to a Democratic win being seen as modestly more hawkish on trade. As a result, expectations will evolve based on progress on trade (or lack thereof) and associated shifts in political stances on the issue. **Most impacted: DE, AGCO, CNHI, TEX, OSK, CMI, CAT.**

Fracking Ban/Pipeline Limits: Our energy team views an outright "ban" on fracking as unlikely and challenging to implement, for many reasons. However, any Democratic president would likely mean a more stringent regulatory backdrop for the US Oil & Gas industry, including the possibility of a slowdown in federal leasing and permitting, increased impediments to new oil and gas infrastructure, and stricter methane emissions or flaring limits. Within our coverage, CAT, CMI, and ALSN have the most exposure (5-10%) to upstream oil as key suppliers of engines and transmissions to oil services companies. URI also has ~4% exposure to upstream oil and gas (~12% total exposure). **Most impacted: CAT, CMI, URI, ALSN.**

Farm Economics: Given that farm income is one of the best predictor of ag equipment spend, proposals to protect farm income would benefit all Ag OEMS. Some candidates have proposed removing farmer subsidies and instead guaranteeing farmers a price for their commodity at the cost of their production if they cannot sell it in the private market, which could impact large-scale vs smaller farms. DE tends to over-index to large scale farms vs. AGCO, which tends to have a higher presence among the hobby farmer. Several candidates have also proposed preventing agribusiness consolidation as a means of ensuring competitive pricing for seeds and fertilize as well as additional regulation regarding waste, especially fertilizer use and runoff. Incentives towards more climate friendly practices could increase adoption of precision ag technologies like DE's See & Spray technology (which is not yet commercially available) — as well as benefit pricing and mix at OEMs. **Most impacted: DE, AGCO, CNHI.**

On & Off Highway Truck Emissions Regulation: Decarbonization regulation impacts all OEMs who manufacture engines - across Construction, Ag, and Truck and increasingly opens the door for disruption in previously consolidated markets. CMI has historically benefited from more stringent emissions regulation, since it sells aftertreatment components that reduce emissions, but zero-emissions regulation would not offer the same tailwind (since the aftertreatment systems reduce, but do not eliminate, emissions from diesel engines). Increasing zero emissions regulation poses an existential threat to most OEMs diesel businesses, but charging infrastructure, performance, and high total cost of ownership remain key headwinds to Electric Truck adoption both on and off highway. Government assistance via subsidies for zero emissions trucks & investment in electric and hydrogen fuel cell infrastructure could spur adoption of Electric/Hydrogen fuel cell trucks, but the range of outcomes on the environmental grants could vary materially depending on which party is in the majority. Democratic candidate Bernie Sanders has carved out a $216bn budget for electric trucks in his "Green New Deal" Policy proposal. Additional carbon emissions regulation likely require increased R&D investment by OEMs and also raise cost of engines & aftermarket treatment. Electric trucks also tend to cause less wear on the powertrain and require fewer aftermarket parts. Aftermarket is generally the higher margin, recurring business for OEMs - especially vs. OE, which is highly cyclical, so EV adoption has the potential to eliminate some stable revenue streams. While many of the companies in our coverage are investing in electric and alternative propulsion solutions (CMI's acquisition of Hydrogenics, CNHI's investment in Nikola, ALSN's acquistion of E-axle), the net impact of a shift away from diesel technologies is still highly disruptive and poses a threat to existing business models. **Most impacted: CMI, PCAR, CAT, DE, CNHI.**

Morgan Stanley is acting as financial advisor to CNH Industrial N.V. ("CNH") in connection with its plan to separate its 'On-Highway' and 'Off-Highway' businesses into two listed entities, as announced on September 3, 2019. The transaction is subject to approval at an Extraordinary General Meeting of shareholders and other customary closing conditions. This report and the information provided herein is not intended to (i) provide voting advice, (ii) serve as an endorsement of the proposed transaction, or (iii) result in the procurement, withholding or revocation of a proxy or any other action by a security holder. Please refer to the notes at the end of this report.

Sector Impact: Consumer Staples

Dara Mohsenian & Sydney Adams

Key things we're watching:

- Cannabis Legalization/Regulation
- US-China Trade Tensions
- Tax Policy Changes
- Minimum Wage Increases
- Climate Change Action

Exhibit 64: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	Unchanged	Unchanged	CPG	CPG (if trade tensions continue)
Divided Government	DRD	Potential negative on tax policy changes	Potential of lessened trade tensions Potential positive on cannabis acceptance	CPG (esp. on trade) STZ, TAP (on cannabis)	CPG (on taxes)
Unified Government	RRR	Potential positive on further tax changes	Unchanged	CPG (on taxes)	CPG (if trade tensions continue)
Unified Government	DDD	Potential negative on: tax policy changes, minimum wage increase, and climate change action	Potential heightened focus on climate change Potential of lessened trade tensions Potential positive on cannabis acceptance	CPG (on trade) STZ, TAP (on cannabis)	CPG (higher input costs, taxes)

Source:

Cannabis Legalization/Regulation — Our quantitative policy model suggests that federal legalization of cannabis is unlikely; however, we believe that the powers of the executive branch and state legislatures could make substantial changes to the status of cannabis in the US.

With a number of consumer companies having made substantial cannabis investments, the most notable in our coverage being STZ and TAP, the question of federal action on

cannabis has become one of the key investor debates in our space. Two bills have recently been introduced in the Senate, both with the primary aim of decriminalizing and descheduling cannabis: S.1552, the Marijuana Freedom and Opportunity Act, sponsored by Senator Chuck Schumer and introduced in late May, and S.2227, the MORE Act of 2019, sponsored by a number of senators including Senators Booker, Harris, and Warren, introduced in late July. Although we're aware of only one Democratic candidate who is against federal legalization of cannabis (former Vice President Biden), our policy model suggests there is "minimal" chance of either of these bills passing, regardless of the outcome of the 2020 election.

Despite the minimal chance of legislative action on a federal level, Senator Sanders has said that he would legalize cannabis by way of executive order, which leads us to believe that a Democratic president could take action on cannabis (although perhaps short of full legalization) without needing to seek congressional approval; this could be positive for STZ and TAP. Furthermore, while the end goal for companies like Canopy is full federal legalization, state legalization would also be a positive result, and therefore believe the outcome of state elections is important to consider as the upcoming federal election.

US-China Trade Tensions — Tariffs enacted by the US and China have become a pressing issue for CPG companies. While trade negotiations with China would be outside the scope of legislation, we highlight this issue because its outcomes are highly dependent on the presidential election.

President Trump introduced tariffs on goods originating in China in light of the administration's viewpoint on some of Beijing's trade practices, including around issues of the trade deficit and alleged theft of intellectual property; China then set its own tariffs and other trade barriers on US goods. Although it appears that the US and China have reached a tentative agreement for the beginnings of a trade deal, the unresolved issues could linger on past phase one.

News reports in recent months have suggested that China may wait until the 2020 election before committing to a trade deal. However, we do not believe that a Democratic president would necessarily drive a return to the previous status quo of trade with China. While we note that the 2020 election could mark the first phase of cooperation between the US and China, we note that Democratic candidates have also been critical of China's trade practices, with Senators Warren and Sanders suggesting that their administrations would also look at tariffs as a possible solution. Furthermore, many Democratic candidates have said that they would insist on trade policies that would uphold labor standards and fair wages and tackle issues like climate change, which would perhaps lead to further tension with China.

Tax Policy Changes — With a rollback of Trump-era tax cuts, higher corporate taxes would create a more challenging environment for US consumer companies.

Reversing the corporate tax cuts enacted by the Trump administration has become a shared policy goal among Democratic candidates. While the corporate tax increases vary by candidate (with Senator Warren proposing a 7% additional tax on corporate profits over $100M and Senator Sanders proposing an increased corporate tax rate based on the ratio of CEO pay vs. median worker pay for companies with annual revenue greater than $100M, for example), the party appears unified in its desire to raise corporate tax

rates. As discussed in the earlier tax policy section, Topic Focus: Tax Policy, House Republicans would be unlikely to support further tax cuts.

Wage Increases — In the case of a $15 minimum wage, as supported by many leading Democratic candidates and current members of Congress, our companies would face increased expenses over time.

The Raise the Wage Act (S.150), sponsored by Senator Sanders and endorsed by Senator Warren, would raise the federal minimum wage to $15/hour over several years, which would raise expenses across corporations in the US in the form of higher wages and potentially higher input costs as suppliers try to offset higher expenses. Former Vice President Biden has also said that he supports a $15 minimum wage. While President Trump has said that he would consider a $15 minimum wage, he has not formally endorsed a specific plan to accomplish this, and has suggested that salary growth over the course of his presidency could constitute a proxy for a higher minimum wage. We believe that $15 minimum wage legislation would be most likely in the event that Democrats controlled the presidency and Congress, supported by our policy model.

We also note that while it would drive higher costs for our companies, it would also likely drive greater demand with an increase in consumer income.

Climate Change Action — Climate change is a key issue for Democrats, and given the role CPG companies play in the production of single-use plastic, we anticipate that companies in our coverage will face increasing scrutiny and regulation over time if Democrats control either Congress or the presidency.

Climate change is a unifying issue among Democrats, and the leading candidates (Biden, Warren, and Sanders) have all announced their support of the Green New Deal, a non-binding congressional resolution that would establish a framework for addressing climate change through the creation of new laws and enforcement of existing ones. Given it is non-binding, nothing in the resolution would become law if it were to pass. However, the Green New Deal offers an outline of what could potentially become law in the future if Democrats controlled both the executive and legislative branches, and any plan to reduce commercial greenhouse gas emissions would require the cooperation of CPG companies, as plastic contributes to greenhouse gas emissions from the time it is produced to when it becomes waste.

Furthermore, all Democratic candidates for president have pledged to rejoin the Paris Climate Agreement. By 2050, plastic will be responsible for up to 13% of the total "carbon budget" allowed by the agreement, according to a report from the Center for International Environmental Law, which could lead to international action on single-use plastics. While many of our companies have committed to sustainability targets, we believe that Democratic control of Congress or the presidency could lead to increased regulatory pressure to move up these timelines or raise the targets themselves.

Sector Impact: Tobacco

Pamela Kaufman & Christine Yang

Key things we're watching:

- Tobacco 21
- FDA e-cig flavor guidance
- E-cig applications (PMTA) and decisions
- Ending New Nicotine Dependencies (ENND) Act
- The Reversing the Youth Tobacco Epidemic Act of 2019

Exhibit 65: Policies We're Watching

				Exposure	
	Scenario	Legislative Impact	Regulatory/ Executive Impact	Positive	Negative
Divided Government	RRD	Potential Negative	Potentially Negative		MO, BAT, IMB
Divided Government	DRD	Potential Negative	Potentially Negative		MO, BAT, IMB
Unified Government	RRR	Potential Negative: Unfavorable due to likely adoption of Tobacco 21	Potentially Negative		MO, BAT, IMB
Unified Government	DDD	Potential Negative: Unfavorable due to likely adoption of Tobacco 21, potentially harsher e-cig restriction	Potentially Negative		MO, BAT, IMB

Source: Morgan Stanley Research. British American Tobacco (BATS.L) is covered by Richard Taylor, Imperial Brands (IMB.L) is covered by Sanath Sudarsan

We expect 2020 to be an eventful year for tobacco regulation. Multiple regulatory developments could impact the e-cigarette industry, which is facing heightened regulatory scrutiny due to rising youth e-cig use and recent vaping-related health concerns. For example, the FDA's announced in mid-September that it plans to remove non-tobacco e-cig flavors from the market through a guidance policy. Flavors including mint/menthol represent the vast majority of industry sales. In addition, e-cig manufacturers are required to submit pre-market tobacco product applications (PMTAs) to the FDA by May 2020. Products can remain on the market for a year while the FDA reviews the applications, but the FDA may begin to remove products from the market next year. This creates uncertainty for the e-cig category, as it is unclear which products the FDA will approve to stay on the market.

In our view, the heightened focus around e-cig regulation has lessened the likelihood of adverse cigarette regulation stemming from the FDA such as a proposed rule to reduce nicotine to non-addictive levels in cigarettes. However, the FDA's plans to remove e-cig flavors, including mint and menthol, may increase focus on issuing regulation to restrict menthol cigarettes.

Beyond the FDA, we will be watching legislation in the House and Senate, which have introduced a number of bills targeting e-cigs and proposing to raise the minimum age to buy tobacco products to 21. For example, the Ending New Nicotine Dependencies (ENND) Act proposes banning all non-tobacco e-cig flavors, taxing e-cigs at the current tobacco excise tax, and implementing standards to prevent tampering. Additionally, the Reversing the Youth Tobacco Epidemic Act of 2019 would prohibit all non-tobacco products, raise age of tobacco purchases to 21, and regulate e-cigs in the same way as tobacco. Overall, Skopos analysis assigns a low probability to the ENND Act becoming a law.

However, Tobacco 21 legislation appears to have widespread support. Skopos sees a significant chance that Tobacco 21 legislation could go into effect in a unified government and sees a modest probability in a divided government. So far 18 states have adopted Tobacco 21 laws. We estimate consumers between 18 and 20 represent ~5% of the smoker population and 2% of cigarette volumes. In addition, Altria estimates that the 18-20 age demographic represents ~2% of cigar industry volumes, ~4% of smokeless industry volumes, and ~15% of e-vapor industry volumes. Despite the potential headwind to tobacco sales, Altria is supportive of Tobacco 21 as a means of combatting youth tobacco usage. [6]

We could also see more action at the state and local level, which has picked up momentum over the last two years, including San Francisco and Massachusetts e-cig bans, and Michigan/New York e-cig flavor bans. Courts have halted several state e-cig bans, but we expect more state/local legislation.

Topic Focus: Tax Policy

Todd Castagno, CFA, CPA, Snehaja Mogre, & Evan Silverberg, CPA

Key things we're watching:

- Democratic Candidates' Tax Proposals
- Expiration of Provisions from TCJA
- Tax 2.0

As the Tax Cuts & Jobs Act (TCJA) approaches its second full year, the president's signature legislative achievement remains politically contentious. Both parties see tax policy as a wedge issue to drive voter engagement. The Democratic field advocates reversing much, if not all, of the TCJA and raising taxes on high earners and corporates to fund progressive initiatives. President Trump and Republicans are campaigning on the merits of the legislation by linking it to high job rates and the strength of the economy. Recent press indicates that Republicans intend to double-down by proposing additional tax reform proposals heading into campaign season.[7].

Change is likely; why and when?

The sustainability of today's tax code is vulnerable due to the confluence of (1) shifting political powers and (2) the temporary nature of key TCJA provisions. The outcome of the 2020 election will likely dictate the cadence and trajectory of future legislation.

As the TCJA was passed via the reconciliation process, many of the key provisions are temporary and expire or phase out by 2025. We estimate that extending four key provisions on the corporate side would run ~$800 billion over a 10-year budget window, while extending six key provisions on the personal side would cost ~$2.3 trillion (Exhibit 66). The appetite and ability to extend these policies, or let them expire, will be dependent on the outcome of the 2020 election — and likely the 2022 midterms. Given our base case of mixed government outcomes, some level of compromise and *change* is likely.

Election scenarios and potential tax policy outcomes:

- **Blue Tide and Thin Red Line:** We expect the base case of mixed government to result in marginal rates and compromise. Expiring corporate provisions, such as R&D amortization, interest deductibility limits, and bonus depreciation, likely get extended as is until 2025. This potentially sets the stage for grand re-legislation of the TCJA given the 2025 timing of expiring individual provisions.
- **Blue Wave:** This scenario likely yields the greatest rate of change as Democrats would have significant ability to redirect tax policy towards more progressive goals. See candidate proposal discussion below for policy direction.
- **Red Redux:** The Tax Cuts 2.0 scenario offers Republicans the ability to extend and

expand the TCJA, albeit temporarily, as they will likely be limited to a similar reconciliation process and budget constraints.

Absent a Red Redux, tax uncertainty for business and corporates will be high as the rate of potential change is greatest. Economic research shows that tax policy uncertainty has negative carryover implications for business investment.

Exhibit 66: Estimated costs of extending select TCJA policies within the 10-year budget window

Corporate Provisions	Policy Expiration	Estimated Cost/Benefit
Immediate expensing of research and experimentation costs, rather than amortization over 5 years	End of 2021	($240B)
Deduction for Business net interest expense at 30% of EBITDA, rather than 30% of EBIT	End of 2021	($150B)
Extension of full expensing for short-life business investments	End of 2022	($250B)
Three international-related provisions (GILTI, FDII, & BEAT) stay at current levels	End of 2025	($140B)
	Total	**($780B)**
Individual Provisions	**Policy Expiration**	**Estimated Cost/Benefit**
Reduced individual income tax rates	End of 2025	($1840B)
Increase in the standard deduction, elimination of the personal exemption, and doubling of the child tax credit	End of 2025	($200B)
Limit on SALT and mortgage interest deductions	End of 2025	$1210B
Reduction in AMT	End of 2025	($950B)
20% pass-through deduction	End of 2025	($410B)
Reduction in the estate tax	End of 2025	($80B)
	Total	**($2,270B)**

Source: Tax Foundation, Joint Committee on Taxation, Morgan Stanley Research Estimate

What's the Democratic field proposing?

Across the spectrum of Democratic nominees, various tax proposals have been discussed (Exhibit 67 and Exhibit 68). The consensus position is to raise taxes on the wealthy and corporates while reducing taxes or providing credits to the majority of citizens. Candidate proposals also tend to earmark incremental revenues for other reforms, such as healthcare and education. Below we summarize various proposals for leading Democratic nominees:

Exhibit 67: Specific Proposals from Some Major Democratic Candidates

Biden	Warren	Sanders
Reinstate 39.6% marginal tax rate on high income earners. Tax capital gains as ordinary income for high income earners. Raise corporate tax rate to 28%.	Country-by-country minimum tax on foreign earnings of 35%. Corporate profit tax of 7% on each dollar of profits above $100M. Create a wealth tax for households with net worth of $50M or more. Create a 40% exit tax on net worth of $50M or more for any US citizen that renounces their US citizenship. Mark-to-market taxation of capital gains for wealthiest 1% of households. Tax carried interest at ordinary rates. Create a financial transaction tax.	Include a marginal rate of up to 70% on incomes over $10M. Tax capital gains/dividends at ordinary rates for top 1%. Create a financial transaction tax. Establish a progressive estate tax.

Buttigieg	Harris	Klobuchar
Consider a higher marginal tax rate for top income earners. Consider a wealth tax. Consider a more equitable estate tax. Consider a financial transactions tax.	Reverse the TCJA as it pertains to corporations and the top 1%. Create a financial transaction tax. Tax capital gains at ordinary income rates. Tax offshore corporate income at the same rate as domestic corporate income.	Raise corporate tax rate to 25%. Raise capital gains and dividend rates for people in top two income tax brackets. Implement the Buffet Rule through a 30% minimum tax for people with incomes over $1M.

Source: Morgan Stanley Research

Exhibit 68: Democratic Candidates' Tax Proposed/Discussed Tax Policies

	Policy Proposal	Authority	Biden	Warren	Sanders	Buttigieg	Harris	Yang	O'Rourke	Klobuchar	Booker	Castro	Gabbard
Taxes	Raise Top Individual Tax Rate/Limiting Deductions for Top Bracket Filers	Legislative	✓		✓	✓	✓			✓		✓	
	Raise Capital Gains Tax	Legislative	✓	✓	✓	✓	✓			✓	✓	✓	
	Raise Corporate Tax Rate	Legislative	✓	✓			✓			✓	✓	✓	
	Create Wealth Tax/Exit Tax on High Net Wealth Individuals	Legislative		✓	✓	✓					✓		
	Impose 7% tax on corporate profits over $100mn	Legislative		✓									
	Supports Financial Transactions Tax	Legislative		✓	✓		✓	✓	✓				
	Increase Estate Tax	Legislative			✓	✓						✓	
	Supports Taxing Carried Interest at Ordinary Rates	Legislative		✓				✓					
	Increase Social Security Taxes on High Earners, Contribution on Investment Income	Legislative	✓	✓	✓								
	Value Added Tax	Legislative						✓					
	Increasing Personal Tax Credits	Legislative	✓				✓	✓	✓	✓		✓	
	Additional Medicare for All Payfors			✓									

Source: Morgan Stanley Research

Topic Focus: Multi-Employer Pension Reform

Snehaja Mogre, Todd Castagno, CFA, CPA, & Evan Silverberg, CPA

Is it time to fix multi-employer pensions? (H.R. 397)

Why H.R. 397? In an effort to save multi-employer pension plans from insolvency, the U.S. House of Representatives passed the Rehabilitation for Multi-employer Pensions Act of 2019 (H.R. 397) in July 2019. The Act would allow the federal government to make grants and loans to multi-employer pension plans that are insolvent or facing insolvency. To put things in context:

- The estimated funded status of all US multi-employer plans as of December 31, 2018, was close to ~$200bn (based on a smoothed 7% interest rate assumption)
- The Pension Benefit Guaranty Corporation (PBGC), a US government agency that insures the benefits of participants in pension plans, indicated that the multi-employer insurance program that it maintains is highly likely to become insolvent by 2025.

Although lawmakers in both parties agree on the need to shore up underfunded multi-employer plans, they differ over possible solutions. We think that H.R. 397 is unlikely to pass in the Republican-controlled Senate in its current form.

Key provisions in H.R. 397: Under H.R. 397, financially troubled multi-employer defined benefit plans could obtain federal loans and additional grants under a $68 billion approved aid package. Specifically, H.R. 397 would create a Pension Rehabilitation Administration (PRA) within the Treasury Department. The PRA will make loans to certain underfunded plans, given the plan meets any one of the following conditions:

- Is in "critical and declining" status as defined in the Pension Protection Act of 2006 (PPA).
- Is in "critical" status under PPA, is less than 40% funded and has an active-to-inactive participant ratio of less than two to five.
- Became insolvent after December 16, 2014, and has not yet been terminated.
- Has a suspension-of-benefits application approved under the Multi-employer Pension Reform Act (MPRA) of 2014.

Loan terms: Loan recipients will be restricted in terms of how they can use loan proceeds and are prohibited from increasing benefits, reducing their plan contributions, or accepting any collective bargaining agreements that would reduce contribution rates. A plan will also need to demonstrate that it could reasonably be expected to pay off the loan.

Loans given out by the PRA will have "as low an interest rate as is feasible" but will not be lower than the 30-year Treasury bond rate. Loan repayments would consist of only interest for 29 years, with the full principal due after 30 years. The bill also offers an accelerated repayment program that would come with reduced interest rates.

Amounts received under PRA loans would be required to be invested in a low-risk portfolio, which could have implications for debt market as discussed below. Should a plan be unable to make a scheduled repayment, the PRA could renegotiate new payment terms or forgive a portion of the principal.

Sectors exposed: Construction, Mining, Retail, and Transportation

Potential impact:

- Positive impact on credit rating
- Positive/negative impact on cash flows depending on final provisions
- Meaningful impact on debt inflows

Other Considerations

Michael Zezas, Meredith Pickett, & Serena Tang

What's in the price? Here's what we're watching

At the moment, we don't think the USD or UST would be the "cleanest" bellwether for electoral results. Although survey respondents' instinctive answer to the question on whether the election outcome would have an impact on their view of the USD and UST is "yes," the detailed results suggest the expected results under the two presidential election outcomes are not that different. On one hand, fiscal spending policies associated with a Republican president could boost growth and lead yields higher; on the other hand, a Democratic president is seen as more likely to de-escalate trade tensions, which should also see risk-on and yields move higher.

One wrinkle in monitoring these markets is that across investor types, about 90% of survey respondents expect the economy to move into a contraction/recession in 2020 or 2021. This partly explains why there's little difference in expected performance across the defensive sectors such as Staples, Utilities and Telecom Services — in a recession, these sectors have consistently outperformed or underperformed anyway (see Cross-Asset Strategy, US Equity Strategy & US Economics: The Recession Playbook [22 Jul 2019]). The expectation for an eventual downturn regardless of who becomes president means that potentially, downside priced into markets may be more driven by cautious macro outlook rather than election outcome.

Our Public Policy Strategy team believes that post-election policy paths tend to become moderated and constrained by the makeup of Congress, and hence, survey respondents are probably expecting more extreme outcomes than the eventual result. That said, these *expectations* for divergent policy environments and performance suggest the following markets could be useful gauges for different electoral outcomes:

- **US equities:** On net, a significantly higher share of investors believe equities could benefit significantly/moderately in the first 3 months of a Trump second term compared to a Democratic presidency. This is likely because a Republican win is associated with removing concerns over increased financial regulations and addressing concerns over tax policies, both of which are major concerns for investors. This suggests to us *investors associate a Republican win with higher equity valuations, and a Democrat win with lower equity valuations.*

- **Financials:** Financial regulation is one of the top concerns for survey respondents. An overwhelming share of survey respondents associate a Democrat candidate with increased financial regulations; on net, a significantly higher share of investors believe financials could benefit significantly/moderately in the first three months of a Trump second term compared to a Democratic presidency. The clearly delineated scenarios suggests *investors associate a Republican win with higher financials valuations, and a Democrat win with lower financials valuations.*

- **Energy:** A majority of those surveyed see energy benefiting significantly/moderately

in the first 3 months of a Trump second term, while in a Democrat win scenario most investors see no fundamental benefit. This suggests *investors associate a Republican win with higher energy valuations, and a Democrat win with lower energy valuations.*

- **Healthcare:** An large share of survey respondents associate a Democrat candidate with prescription drug reforms, and more investors predict healthcare benefiting significantly/moderately in the first 3 months of a Trump second term compared to a Democratic presidency. This suggests *investors associate a Republican win with higher healthcare valuations, and a Democrat win with lower healthcare valuations.*

- **Technology:** Tech regulation is not one of the top areas of concern for survey respondents, but it is the sector with the most divergent expected outcomes under a Trump or Democratic presidency, after financials and energy. The survey results suggests *investors associate a Republican win with higher technology valuations, and a Democrat win with lower technology valuations.*

Election 101

The 2020 presidential election won't truly kick off until there is a Democratic nominee and potentially third-party nominee(s). Once the candidates are finalized, the key number is 270 — that is the number of electoral votes needed to win the election.

Democratic Primary

The Democratic Party is in the process of determining its nominee. Debates will continue throughout the fall with increasingly stricter parameters for making the debate stage. Candidates will try to win the most delegates to gain the nomination, with candidates dropping out as they lose support. The primary process officially begins in February with the Iowa caucus and New Hampshire primary, which is why current polls are very focused on those two states. The next important day is March 3 — Super Tuesday — when 15 states, including California and Texas, the largest states – hold their primaries on the same day. The nominee should be clear after the primaries in New York and other states on April 28 and will be officially selected at the Democratic Convention on July 13-16, 2020.

Exhibit 69: 2020 Election Season Calendar

2020 Election Calendar	
2019	
Nov. 20	5th Democratic Primary Debate
Dec. TBD	6th Democratic Primary Debate
2020	
Feb 3	Iowa Caucus
Feb 11	New Hampshire Primary
Feb 22	Nevada Caucus
Feb 29	South Carolina Primary
Mar 3	Super Tuesday (15 states including TX and CA)
Mar 10	MI, ID, MS, MO, ND, WA Primaries
Mar 17	AZ, FL, IL, OH Primaries
Mar 24	Georgia Primary
April 4	AK, HI, LA, WY Primaries
April 7	Wisconsin Primary
April 28	NY, PA, CT, DE, MD, RI Primaries
May 2	Kansas Primary
May 5	Indiana Primary
May 12	NE, WV Primaries
May 19	KY, OR Primaries
June 2	DC, MT, NJ, NM, SD Primaries
July 13-16	Democratic National Convention
August 24-27	Republican National Convention
Sept 29	First Presidential Debate
Oct 7	Vice Presidential Debate
Oct 15	Second Presidential Debate
Oct 22	Third Presidential Debate
Nov 3	Election Day

Source: Morgan Stanley Research, *New York Times*

Swing States

The definition of what can be considered a "swing state" (a true toss-up between the Democratic and Republican candidates) will change as the year progresses, and also may change once the Democratic nominee is selected. And of course, there can be surprises. According to the consensus of experts on the website, 270toWin.com, the states to watch currently are Florida, Pennsylvania, Arizona, Wisconsin, North Carolina, and the second district of Nebraska.

Exhibit 70: While the map will change, consensus is focusing on six states

Potential Toss-Ups		
State	**Electoral Votes**	**Trump approval rating Sept '19**
FL	29	-2
PA	20	-8
NC	15	-3
AZ	11	-4
WI	10	-11
NE-2	1	-2

Source: 270toWin.com; Morning Consult; Morgan Stanley Research

A Note on Methodology

In our prior election and other policy outlooks, we've typically relied solely on qualitative logic assessments to define potential post-election policy paths. Typically, we've established historical precedents on policy topics and legislative patterns and then adjusted them higher or lower using one or more of the following: breaking down pieces of legislation into its component parts and gauging Congressional support; analyzing what could and could not be implemented via various policy alternatives (i.e., executive action and budget reconciliation), building Congressional vote counts by interpreting public statements and geographic economic exposures; polling data; and game theory. While we were confident about our process, we also recognize the potential for human error and cognitive bias. For that reason, for this outlook we wanted to augment our approach by adding another process to check our qualitative assessments.

We commissioned Skopos Labs to assist in developing bill enactment probabilities. Skopos developed a proprietary machine learning model trained on a variety of factors including sponsor ideology, party control, and various content tags. The model was trained with about 100,000 bills from the 104th through the 115th Congresses.

Given that we are making predictions for a Congress that has not yet begun, we asked Skopos to exclude variables that are unknowable at such an early stage. In other words, we attempted to avoid mixing *ex-post* and *ex-ante* variables. For that reason, we excluded from consideration whether or not a bill got out of committee. In other cases, however, it was difficult to fully exclude all *ex-post* values. The legislative dataset available did not necessarily distinguish between initial committee assignment and subsequent assignments that are added as a bill progresses through Congress. It is also difficult to run analyses on initial bill text: bills become more complex as they proceed through committee, which in turn can indicate better odds for passage.

Because Skopos' specific modeling techniques are proprietary, and because of the aforementioned nuance in distinguishing between *ex-ante* and *ex-post* factors, we applied a qualitative descriptive overlay to the model output probabilities.

We used the Skopos model to evaluate bill passage probabilities under four election scenarios:

- A continuation of the status quo — Republican president with a Congressional status quo
- A Democratic president with a Congressional status quo
- A Democratic president with a Democratic Congress
- A Republican president with a Republican Congress

As few as 3% of all bills become law. Guessing that a bill *never* became law would be right about 97% of the time. In our training data, a 5% probability of becoming law would be around the 92nd percentile of all bills. That is, just 8 bills out of every 100

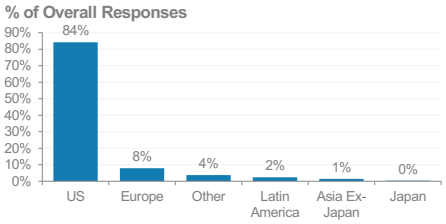
bills would have at least a 5% probability of passage. That makes sense – the vast majority of bills have essentially zero likelihood of becoming law. The model output probabilities help us sift through and separate the wheat from the chaff. Based on model output probabilities and our own qualitative assessment, we grouped legislation into one of 3 categories for each election outcome scenario:

- **Minimal (not worth watching):** Bills that scored less than 3% likelihood (in the bottom 90% of likelihood of the Skopos model), which also based on our qualitative assessment stood little chance of enactment.
- **Modest (worth watching):** Bills where the Skopos model and our qualitative assessment disagreed.
- **Meaningful (a "fighting chance" of enactment):** These are bills in at least the 90th percentile of likelihood (3% chance or better), per the model output, where we also agreed qualitatively. Note that output probabilities from the Skopos model in this bucket can still be quite low — less than 10%, for example — but about 20% of bills that carried such a score, or higher, were enacted. Subjectively, 20% seems right to us when we qualitatively agree with the model, meaning the bill would get a serious chance at enactment, but a far from guaranteed one given uncertainties such as post-election policy sequencing and in the case of a Democratic White House.

Why is legislation that we identify as significant still relatively unlikely, all else equal? All classification exercises involve a trade-off between "false positives" and "false negatives." A "false negative" in this context means saying that a bill won't pass, when in fact it does. We would rather cast a broader net, so we used a relatively low threshold to minimize the risk of a false negative.

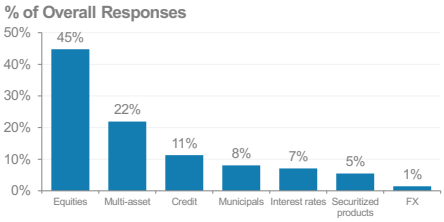
Appendix: Survey Results

Exhibit 71: Q1: What country/region are you primarily focused on?



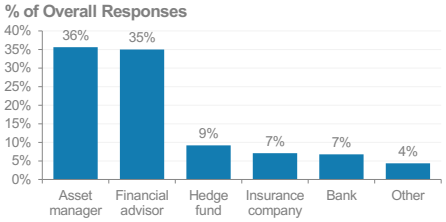
Source: Morgan Stanley Research

Exhibit 72: Q2: What ~~is your primary asset class of focus~~?



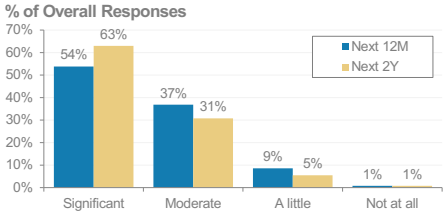
Source: Morgan Stanley Research

Exhibit 73: Q3: Which of the following most accurately describes your organization?



Source: Morgan Stanley Research

Exhibit 74: Q4 & 5: What impact, if any, does the US presidential election have on your market outlook over the next 12 months?



Source: Morgan Stanley Research

Exhibit 75: Q6: Please rate how important each of the following US policy areas are to the outlook for your market of focus over the next two years.

Q6. Please rate how important each of the following US policy areas are to the outlook for your market of focus over the next two years (1=Low, 5=High)										
Investor Type		Trade policy	Healthcare	Fiscal policy	Taxes	Infra. spending	Immigration	Fin. regulation	Tech regulation	Energy/ climate policy
	All	4.4	3.5	4.0	4.0	3.2	2.5	3.6	3.2	2.9
	Multi-Asset	4.4	3.4	4.1	4.1	3.1	2.5	3.5	3.4	3.1
	FX	4.9	2.6	4.6	4.0	3.7	2.2	3.2	3.0	2.6
US	Equities	4.4	3.6	3.9	4.0	3.1	2.6	3.6	3.4	2.9
	Interest rates	4.4	3.0	4.5	4.5	3.4	1.7	3.5	2.8	2.4
	Municipals	3.7	4.0	3.9	4.6	4.1	2.4	3.0	2.4	2.7
	Credit	4.6	3.8	4.0	3.9	3.1	2.3	3.6	3.2	3.2
	Securitized products	4.2	2.6	4.0	3.6	2.8	2.2	3.9	2.6	2.4
Europe	Equities	4.6	3.0	3.7	3.5	3.3	1.6	3.4	3.6	3.1
	Interest rates	4.8	3.1	4.3	3.8	3.3	2.3	3.3	2.7	3.0
	Credit	4.2	2.0	4.2	3.8	2.5	1.3	3.0	2.7	2.7

Source: Morgan Stanley Research

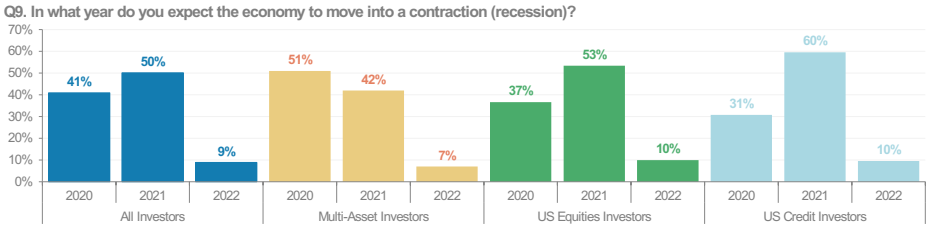
Exhibit 76: Q7: Please rate how concerned you are about the changes to each policy area impacting your market of focus over the next two years.

Q7. Please rate how concerned you are about the changes to each policy area impacting your market of focus over the next two years. (1=Low, 5=High)

Investor Type		Trade policy	Healthcare	Fiscal policy	Taxes	Infra. spending	Immigration	Fin. regulation	Tech regulation	Energy/ climate policy
	All	4.3	3.4	3.8	3.9	3.0	2.3	3.6	3.2	2.9
	Multi-Asset	4.2	3.3	3.9	3.7	2.9	2.3	3.6	3.4	2.9
	FX	4.9	2.4	4.3	4.0	3.2	2.4	3.2	2.8	2.7
US	Equities	4.3	3.7	3.6	3.9	2.8	2.4	3.5	3.3	2.8
	Interest rates	4.4	2.6	4.3	4.3	3.0	1.7	3.6	2.6	2.0
	Municipals	3.8	3.8	3.7	4.3	3.7	2.2	3.1	2.3	2.6
	Credit	4.2	3.5	3.6	3.6	2.6	2.1	3.3	3.0	3.1
	Securitized products	4.1	2.4	3.9	3.4	2.6	1.9	3.7	2.4	2.5
Europe	Equities	3.8	2.3	2.5	2.3	2.5	1.4	2.9	3.0	2.4
	Interest rates	4.4	2.0	4.0	3.5	2.9	1.6	2.6	2.2	2.6
	Credit	3.7	2.0	3.8	3.8	2.7	1.5	3.5	3.0	3.0

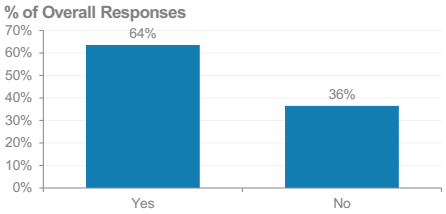
Source: Morgan Stanley Research

Exhibit 77: Q9: The current business cycle expansion is now the longest since 1945. In what year do you expect the economy to move into a contraction (recession)?



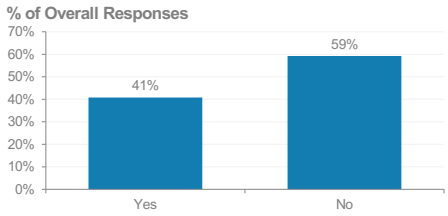
Source: Morgan Stanley Research

Exhibit 78: Q8: Could the US presidential election outcome cause you to materially change your view on the USD or US Treasuries?



Source: Morgan Stanley Research

Exhibit 79: Q10: Did your expectation of who will be the next president influence your answer to question 9?



Source: Morgan Stanley Research

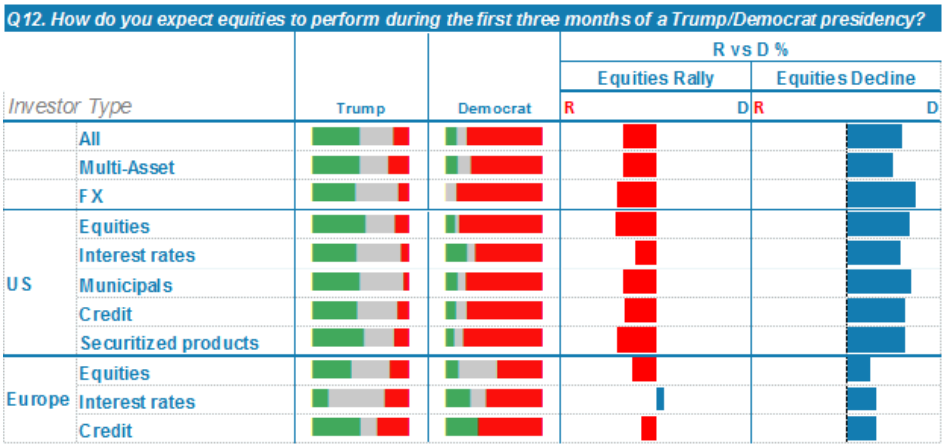
Exhibit 80: Q11 - Which presidential candidate do you believe would be most likely to implement the following policies?

Q11. Which presidential candidate do you believe would be most likely to implement the following policies?

Investor Type		Fiscals stimulus	Prescription drug reforms	De-escalation of China tariffs	Infrastructure spending	Increased financial regulation
	All					
	Multi-Asset					
	FX					
US	Equities					
	Interest rates					
	Municipals					
	Credit					
	Securitized products					
Europe	Equities					
	Interest rates					
	Credit					

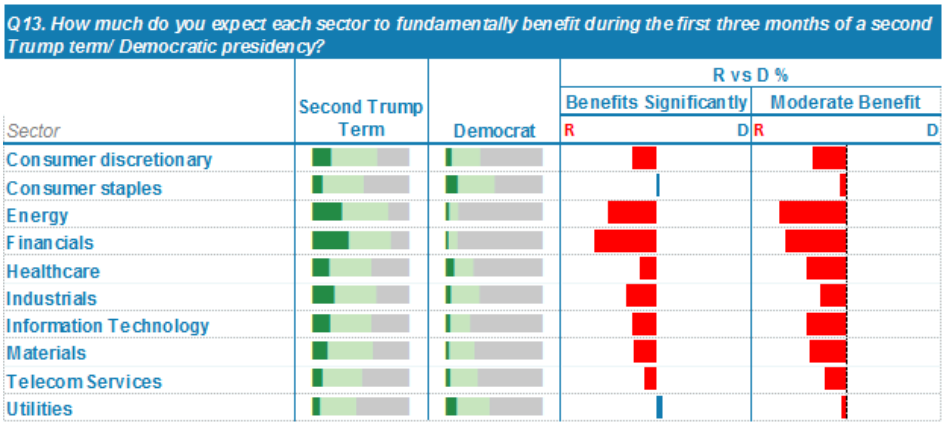
Source: Morgan Stanley Research. Note: Red shows share of replies for Republican candidate, blue for Democratic candidate.

Exhibit 81: Q12 - How do you expect equities to perform during the first three months of a Trump/ Democrat presidency?



Source: Morgan Stanley Research; Note: Red shows share of replies for "Equities will decline", green for "Equities will rally", grey for "Equities will be unchanged".

Exhibit 82: Q13 - How much do you expect each sector to fundamentally benefit during the first three months of a second Trump term/ Democratic presidency?



Source: Morgan Stanley Research; Note: Dark green shows share for 'Benefits Significantly'; light green for 'Moderate Benefit', grey for 'No Benefit At All'. Red shows net share of replies for Republican candidate, blue for Democratic candidate,

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Endnotes

1 see: https://www.govtrack.us/congress/bills/statistics

2 http://library.law.columbia.edu/urlmirror/CLR/100CLR524/ptpreselec.html

3 Sylvain Leduc and Daniel Wilson, "Roads to Prosperity or Bridges to Nowhere? Theory and Evidence on the Impact of Public Infrastructure Investment", NBER Working Paper No. 18042, May 2012.

4 Sylvain, Leduc and Daniel Wilson, FRBSF Economic Letter, "Highway Grants: Roads to Prosperity?", November 26, 2012.

5 See Scott R. Baker, Nicholas Bloom and Steve Davis, "Measuring Economic Policy Uncertainty", NBER Working Paper No. 21633, OCtober 2015.

6 BAT is covered by Richard Taylor and IMB is covered by Sanath Sudarsan.

7 Erica Werner, Josh Dawsey. "White House Officials Ramp up New Tax Cut Talks, as Trump Seeks Sharp Contrast with 2020 Democrats." The Washington Post, WP Company, 31 Oct. 2019, https://www.washingtonpost.com/us-policy/2019/10/31/white-house-officials-ramp-up-new-tax-cut-talks-trump-seeks-sharp-contrast-with-democrats/

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(as of October 31, 2019)

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	COVERAGE UNIVERSE		INVESTMENT BANKING CLIENTS (IBC)			OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC)	
STOCK RATING CATEGORY	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MISC
Overweight/Buy	**1161**	**37%**	**281**	**42%**	**24%**	**530**	**37%**
Equal-weight/Hold	**1438**	**45%**	**310**	**46%**	**22%**	**679**	**47%**
Not-Rated/Hold	**1**	**0%**	**0**	**0%**	**0%**	**1**	**0%**
Underweight/Sell	**568**	**18%**	**77**	**12%**	**14%**	**229**	**16%**
TOTAL	**3,168**		**668**			**1439**	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a

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Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
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Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

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INDUSTRY COVERAGE: Healthcare Facilities & Managed Care

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Ricky R Goldwasser		
Anthem Inc (ANTM.N)	O (09/04/2018)	$270.75
Centene Corp (CNC.N)	O (06/06/2017)	$52.13
Cigna Corp (CI.N)	O (12/13/2018)	$179.51
Humana Inc (HUM.N)	O (07/12/2018)	$296.20
Molina Healthcare Inc (MOH.N)	O (08/17/2017)	$118.83
UnitedHealth Group Inc (UNH.N)	O (06/06/2017)	$252.21
Wellcare Health Plans Inc (WCG.N)	E (06/06/2017)	$293.33

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* Historical prices are not split adjusted.

INDUSTRY COVERAGE: Healthcare Services & Distribution

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Ricky R Goldwasser		
Allscripts Healthcare Solutions Inc. (MDRX.O)	U (12/13/2016)	$11.19
AmerisourceBergen Corp. (ABC.N)	E (09/14/2017)	$86.87
Cardinal Health Inc (CAH.N)	U (11/19/2017)	$50.44
Catalent, Inc. (CTLT.N)	O (09/21/2017)	$49.63
Cerner Corporation (CERN.O)	U (02/28/2019)	$67.53
Charles River Laboratories International (CRL.N)	E (03/03/2010)	$132.72
CVS Health Corp (CVS.N)	O (01/05/2018)	$67.24
Diplomat Pharmacy Inc (DPLO.N)	E (10/01/2015)	$5.68
Inovalon Holdings Inc (INOV.O)	E (12/19/2018)	$15.90
Iqvia Holdings Inc (IQV.N)	O (06/18/2013)	$146.74
Laboratory Corp. of America Holdings (LH.N)	O (02/23/2015)	$166.53
Livongo Health Inc (LVGO.O)	O (08/28/2019)	$22.52
McKesson Corporation (MCK.N)	E (09/14/2017)	$137.11
Nextgen Healthcare Inc (NXGN.O)	E (11/01/2018)	$16.99
Quest Diagnostics Inc. (DGX.N)	O (05/29/2018)	$101.59
Walgreens Boots Alliance Inc (WBA.O)	E (10/06/2017)	$57.38

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INDUSTRY COVERAGE: Major Pharmaceuticals

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
David Risinger		
Abbvie Inc. (ABBV.N)	++	$81.75
Bristol-Myers Squibb Co (BMY.N)	++	$57.16
Eli Lilly & Co. (LLY.N)	E (04/17/2017)	$112.51
Merck & Co., Inc. (MRK.N)	O (04/17/2018)	$84.94
Pfizer Inc (PFE.N)	E (07/30/2019)	$38.39

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INDUSTRY COVERAGE: Medical Technology

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
David R. Lewis		
Abbott Laboratories (ABT.N)	O (01/02/2018)	$82.66
Abiomed (ABMD.O)	E (08/01/2019)	$216.79
Alcon Inc (ALC.N)	O (04/09/2019)	$58.94
Avanos Medical Inc (AVNS.N)	U (10/12/2015)	$44.78
Axonics Modulation Technologies Inc. (AXNX.O)	O (11/26/2018)	$25.10
Baxter International (BAX.N)	O (01/02/2019)	$77.91
Becton Dickinson (BDX.N)	E (01/04/2016)	$258.15
Boston Scientific (BSX.N)	O (10/16/2015)	$41.51
DexCom Inc (DXCM.O)	E (01/03/2017)	$157.30
Edwards Lifesciences (EW.N)	O (07/06/2015)	$236.74
Envista Holdings Corporation (NVST.N)	E (10/14/2019)	$29.61
Globus Medical Inc (GMED.N)	E (01/02/2019)	$52.01
Haemonetics Corporation (HAE.N)	O (01/02/2018)	$129.46
Hill-Rom Holdings Inc. (HRC.N)	E (01/02/2018)	$107.91
Hologic, Inc. (HOLX.O)	U (01/02/2019)	$48.66
Insulet Corp. (PODD.O)	E (11/02/2015)	$146.48
Intuitive Surgical Inc. (ISRG.O)	O (01/04/2016)	$559.37
IRHYTHM TECHNOLOGIES INC (IRTC.O)	O (11/14/2016)	$68.32
Johnson & Johnson (JNJ.N)	E (08/10/2010)	$131.20
Medtronic PLC (MDT.N)	E (01/03/2017)	$108.57
Nevro Corp (NVRO.N)	O (03/20/2019)	$86.63
NuVasive Inc (NUVA.O)	E (09/14/2015)	$70.58
Shockwave Medical Inc. (SWAV.O)	E (04/01/2019)	$33.69
SI-BONE Inc. (SIBN.O)	O (11/12/2018)	$16.58
Stryker Corporation (SYK.N)	O (01/08/2010)	$212.77
Teleflex Inc. (TFX.N)	O (09/06/2017)	$346.00
Transmedics Group Inc (TMDX.O)	E (05/28/2019)	$19.51
ViewRay Inc (VRAY.O)	E (12/11/2018)	$2.80
Zimmer Biomet Holdings Inc (ZBH.N)	O (01/05/2015)	$138.22

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INDUSTRY COVERAGE: Banking - Large Cap Banks

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Betsy L. Graseck, CFA		
Ally Financial Inc (ALLY.N)	E (12/20/2016)	$31.25
American Express Company (AXP.N)	O (04/25/2019)	$119.14
Bank of America (BAC.N)	O (04/23/2013)	$31.80
BB&T Corporation (BBT.N)	E (01/07/2018)	$54.10
BNY Mellon (BK.N)	U (07/08/2019)	$47.16
Capital One Financial Corporation (COF.N)	E (09/08/2017)	$95.25
Citigroup Inc. (C.N)	O (11/14/2016)	$73.84
Discover Financial Services (DFS.N)	O (01/28/2014)	$81.72
Goldman Sachs Group Inc (GS.N)	E (11/21/2018)	$217.39
J.P.Morgan Chase & Co. (JPM.N)	O (07/05/2017)	$127.80
Northern Trust Corp. (NTRS.O)	U (11/28/2011)	$101.42
PNC Financial Services (PNC.N)	E (07/25/2013)	$148.81
Regions Financial Corp (RF.N)	E (02/11/2016)	$16.55
Santander Consumer USA Holdings Inc (SC.N)	E (12/20/2016)	$25.50
State Street Corporation (STT.N)	U (07/08/2019)	$67.76
SunTrust (STI.N)	E (03/11/2019)	$69.89
Synchrony Financial (SYF.N)	E (09/08/2017)	$35.74
U.S. Bancorp (USB.N)	U (11/14/2016)	$57.58
Wells Fargo & Co. (WFC.N)	E (07/02/2018)	$52.18

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INDUSTRY COVERAGE: Brokers & Asset Managers

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Michael J. Cyprys, CFA, CPA		
Apollo Global Management Inc (APO.N)	E (11/14/2018)	$43.25
Ares Management Corp (ARES.N)	E (12/15/2014)	$31.37
BlackRock Inc. (BLK.N)	O (09/18/2015)	$469.17
Brightsphere Investment Group INC (BSIG.N)	E (01/26/2016)	$10.05
Charles Schwab Corp (SCHW.N)	O (09/26/2016)	$41.78
E*Trade Financial Corp (ETFC.O)	O (01/03/2018)	$42.55
Franklin Resources Inc. (BEN.N)	U (03/16/2017)	$28.05
Hamilton Lane Incorporated (HLNE.O)	O (04/11/2019)	$60.00
Invesco (IVZ.N)	E (01/03/2018)	$17.21
KKR & CO. Inc (KKR.N)	E (02/17/2016)	$29.46
Legg Mason Inc. (LM.N)	U (10/05/2017)	$37.57
LPL Financial Holdings Inc. (LPLA.O)	E (01/03/2018)	$83.30
T. Rowe Price Group, Inc. (TROW.O)	E (10/05/2017)	$116.97
TD Ameritrade Holding Corp. (AMTD.O)	E (07/11/2019)	$39.21
The Blackstone Group Inc (BX.N)	O (12/15/2014)	$53.66
The Carlyle Group L.P. (CG.O)	E (11/14/2018)	$27.99
Tradeweb Markets Inc (TW.O)	++	$41.65
Victory Capital Holdings Inc (VCTR.O)	E (04/11/2019)	$15.86
Virtu Financial Inc (VIRT.O)	E (08/08/2018)	$16.72
Virtus Investment Partners (VRTS.O)	E (06/01/2017)	$109.86
Waddell & Reed Financial Inc (WDR.N)	U (09/18/2015)	$16.73
WisdomTree Investments, Inc. (WETF.O)	E (09/18/2015)	$5.18

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INDUSTRY COVERAGE: Business & Education Services

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Javier Martinez de Olcoz Cerdan		
Laureate Education Inc (LAUR.O)	O (02/27/2017)	$15.60
Jeffrey D Goldstein, CFA		
H&R Block (HRB.N)	E (06/27/2019)	$24.95
Houghton Mifflin Harcourt Co (HMHC.O)	E (02/23/2018)	$6.23
Toni Kaplan		
ADT Inc (ADT.N)	E (05/13/2019)	$7.92
Advanced Disposal Services, Inc. (ADSW.N)	E (10/12/2018)	$32.81
Aramark Holdings Corporation (ARMK.N)	E (08/10/2016)	$43.25
Bright Horizons Family Solutions Inc (BFAM.N)	E (10/08/2019)	$144.84
Charah Solutions Inc (CHRA.N)	E (08/15/2019)	$2.00
Cintas Corp (CTAS.O)	U (07/20/2016)	$268.89
Equifax Inc (EFX.N)	E (01/18/2017)	$138.70
FactSet Research Systems Inc. (FDS.N)	U (07/16/2019)	$255.87
Gartner Inc. (IT.N)	E (09/24/2015)	$156.09
IHS Markit Ltd (INFO.N)	U (07/14/2016)	$70.70
Moody's Corp (MCO.N)	U (01/08/2019)	$220.50
MSCI Inc. (MSCI.N)	E (03/24/2014)	$245.91
Nielsen Holdings NV (NLSN.N)	O (12/14/2016)	$20.44
S&P Global Inc (SPGI.N)	E (03/26/2015)	$258.80
ServiceMaster Global Holdings Inc. (SERV.N)	E (10/02/2018)	$40.55
Thomson Reuters Corp. (TRI.N)		$67.61
TransUnion (TRU.N)	E (10/30/2017)	$83.45
Verisk Analytics, Inc. (VRSK.O)	E (01/18/2017)	$145.36

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INDUSTRY COVERAGE: IT Hardware

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Erik W Woodring		
Garmin Ltd (GRMN.O)	E (01/07/2015)	$94.46
GoPro Inc (GPRO.O)	U (01/23/2018)	$4.37
Katy L. Huberty, CFA		
Apple, Inc. (AAPL.O)	O (05/26/2009)	$255.82
CDW Corporation (CDW.O)	E (08/06/2013)	$131.20
Dell Technologies Inc. (DELL.N)	E (01/15/2019)	$53.24
Fitbit Inc (FIT.N)	E (11/01/2019)	$7.14
Hewlett Packard Enterprise (HPE.N)	E (01/15/2019)	$16.50
HP Inc. (HPQ.N)	E (01/23/2018)	$17.78
IBM (IBM.N)	O (08/01/2019)	$135.53
NCR Corp. (NCR.N)	E (09/25/2011)	$29.72
NetApp Inc (NTAP.O)	U (01/15/2019)	$57.09
Nutanix Inc (NTNX.O)	E (05/28/2019)	$28.92
Pure Storage Inc (PSTG.N)	E (05/18/2017)	$19.40
Seagate Technology (STX.O)	O (04/09/2018)	$57.62
Sonos Inc. (SONO.O)	O (01/28/2019)	$13.42
Teradata (TDC.N)	O (01/15/2019)	$30.31
Xerox Corp (XRX.N)	++	$33.48

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INDUSTRY COVERAGE: Internet

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Brian Nowak, CFA		
Activision Blizzard Inc (ATVI.O)	O (09/23/2016)	$55.82
Alphabet Inc. (GOOGL.O)	O (08/11/2015)	$1,272.25
Amazon.com Inc (AMZN.O)	O (04/24/2015)	$1,791.44
Blue Apron Holdings Inc (APRN.N)	E (07/24/2017)	$8.30
Booking Holdings Inc (BKNG.O)	E (01/09/2019)	$2,032.02
Chewy Inc (CHWY.N)	E (07/09/2019)	$23.91
Criteo SA (CRTO.O)	E (01/26/2016)	$17.05
Despegar.com Corp (DESP.N)	E (10/16/2017)	$11.16
eBay Inc (EBAY.O)	E (12/12/2018)	$35.25
Electronic Arts Inc (EA.O)	E (01/12/2018)	$95.30
Etsy Inc (ETSY.O)	E (10/24/2018)	$45.66
Expedia Inc. (EXPE.O)	E (01/09/2019)	$137.80
Facebook Inc (FB.O)	O (04/27/2016)	$193.62
Groupon, Inc. (GRPN.O)	E (03/05/2018)	$2.87
GrubHub Inc. (GRUB.N)	E (04/18/2018)	$33.72
Jumia Technologies AG (JMIA.N)	E (08/19/2019)	$6.32
Lyft Inc (LYFT.O)	E (10/24/2019)	$42.98
SciPlay Corporation (SCPL.O)	E (05/28/2019)	$9.68
Snap Inc. (SNAP.N)	E (10/04/2019)	$15.18
Take-Two Interactive Software (TTWO.O)	O (02/01/2018)	$116.90
TRIVAGO NV (TRVG.O)	E (09/28/2017)	$3.40
Twitter Inc (TWTR.N)	E (04/17/2018)	$29.62
Uber Technologies Inc (UBER.N)	O (06/04/2019)	$31.37
Yelp Inc (YELP.N)	U (01/10/2019)	$35.06
Zillow Group Inc (Z.O)	E (04/18/2018)	$33.69
Zynga Inc (ZNGA.O)	O (06/08/2017)	$6.35

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INDUSTRY COVERAGE: Telecom Services

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Simon Flannery		
AT&T, Inc. (T.N)	O (06/27/2018)	$38.95
BCE Inc. (BCE.TO)	E (12/17/2015)	C$62.45
CenturyLink, Inc. (CTL.N)	O (03/29/2017)	$13.32
Cincinnati Bell Inc. (CBB.N)	E (02/15/2019)	$5.18
Frontier Communications Corp (FTR.O)	E (07/18/2016)	$0.98
Globalstar Inc (GSAT.A)	E (04/11/2018)	$0.39
Gogo Inc (GOGO.O)	U (11/15/2013)	$6.17
Intelsat S.A. (I.N)	E (11/12/2018)	$25.50
Rogers Communications, Inc. (RCIb.TO)	E (12/17/2015)	C$61.77
Sprint Corp (S.N)	++	$6.30
Telephone & Data Systems (TDS.N)	O (06/18/2019)	$21.93
TELUS Corp. (T.TO)	O (04/30/2018)	C$46.57
T-Mobile US, Inc. (TMUS.O)	++	$82.47
US Cellular Corporation (USM.N)	O (06/18/2019)	$31.49
Verizon Communications (VZ.N)	E (12/12/2018)	$60.37
ViaSat Inc (VSAT.O)	E (12/15/2017)	$68.20

Stock Ratings are subject to change. Please see latest research for each company.
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INDUSTRY COVERAGE: Freight Transportation

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Ravi Shanker		
ArcBest Corp (ARCB.O)	E (10/06/2011)	$29.54
C.H. Robinson Worldwide Inc. (CHRW.O)	U (06/09/2013)	$74.70
Canadian National Railway Co. (CNR.TO)	O (02/23/2016)	C$120.25
Canadian Pacific Railway Ltd. (CP.TO)	O (06/03/2016)	C$306.78
CSX Corporation (CSX.O)	U (10/02/2017)	$72.27
Echo Global Logistics Inc (ECHO.O)	E (03/05/2019)	$20.18
Expeditors International of Washington I (EXPD.O)	E (02/25/2015)	$73.61
FedEx Corporation (FDX.N)	E (06/20/2013)	$156.52
Genesee & Wyoming Inc. (GWR.N)		$111.31
Heartland Express Inc. (HTLD.O)	U (05/06/2011)	$21.33
Hub Group Inc (HUBG.O)	E (02/13/2018)	$46.66
J.B. Hunt Transport Services Inc. (JBHT.O)	E (05/06/2011)	$119.90
Kansas City Southern (KSU.N)	E (02/23/2016)	$146.19
Knight-Swift Transportation Holdings Inc (KNX.N)	O (12/13/2017)	$37.55
Landstar System Inc (LSTR.O)	U (02/23/2016)	$114.66
Norfolk Southern Corp. (NSC.N)	U (06/03/2016)	$189.92
Old Dominion Freight Line Inc (ODFL.O)	E (10/22/2018)	$188.12
Saia, Inc. (SAIA.O)	U (02/23/2016)	$93.33
Schneider National Inc. (SNDR.N)	O (05/01/2017)	$23.75
Union Pacific Corp. (UNP.N)	U (10/22/2018)	$172.53
United Parcel Service (UPS.N)	U (02/23/2016)	$119.51
US Xpress Enterprises Inc (USX.N)	O (07/09/2018)	$4.78
Werner Enterprises (WERN.O)	O (02/23/2016)	$36.76
XPO Logistics, Inc. (XPO.N)	E (02/19/2019)	$79.37

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INDUSTRY COVERAGE: Exploration & Production

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Devin McDermott		
Apache Corp. (APA.N)	U (07/12/2018)	$23.81
Chesapeake Energy Corp (CHK.N)	O (06/28/2019)	$1.44
ConocoPhillips (COP.N)	O (07/12/2018)	$57.15
Devon Energy Corp (DVN.N)	E (07/12/2018)	$21.17
EOG Resources Inc (EOG.N)	E (07/12/2018)	$71.15
Hess Corp. (HES.N)	O (07/12/2018)	$68.91
Marathon Oil Corporation (MRO.N)	E (07/12/2018)	$12.05
Murphy Oil Corporation (MUR.N)	U (07/12/2018)	$22.01
Noble Energy Inc. (NBL.N)	O (01/09/2019)	$20.02
Occidental Petroleum Corp (OXY.N)	E (06/24/2019)	$42.29
Pioneer Natural Resources Co. (PXD.N)	O (07/12/2018)	$127.56
Drew Venker, CFA		
Antero Resources Corp (AR.N)	U (10/04/2019)	$2.67
Cabot Oil & Gas Corp. (COG.N)	E (09/26/2018)	$18.43
Callon Petroleum Company (CPE.N)	E (03/21/2019)	$3.96
Cimarex Energy Co. (XEC.N)	O (09/09/2013)	$43.98
Concho Resources Inc. (CXO.N)	U (08/06/2019)	$69.30
Continental Resources Inc. (CLR.N)	O (07/17/2013)	$30.10
Diamondback Energy Inc (FANG.O)	O (03/26/2015)	$86.79
EQT Corp. (EQT.N)	U (11/14/2018)	$10.56
Gulfport Energy Corp (GPOR.O)	U (03/28/2017)	$3.03
Oasis Petroleum Inc. (OAS.N)	E (06/24/2019)	$2.70
Parsley Energy Inc (PE.N)	E (01/30/2018)	$16.40
Range Resources Corp. (RRC.N)	U (01/23/2018)	$4.25
Southwestern Energy Co (SWN.N)	U (12/10/2012)	$2.11
Whiting Petroleum Corporation (WLL.N)	E (04/12/2019)	$6.79

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INDUSTRY COVERAGE: Integrated Oil

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Devin McDermott		
Chevron Corporation (CVX.N)	O (04/01/2019)	$116.21
Exxon Mobil Corporation (XOM.N)	E (04/01/2019)	$69.60

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INDUSTRY COVERAGE: Oil Services, Drilling & Equipment

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Connor Lynagh		
Baker Hughes Co (BKR.N)	O (09/18/2018)	$21.90
Cactus Inc (WHD.N)	O (09/18/2018)	$30.82
Chart Industries (GTLS.O)	O (06/27/2019)	$59.17
Core Laboratories NV (CLB.N)	E (09/18/2018)	$46.58
Covia Holdings Corp (CVIA.N)	U (10/11/2018)	$1.47
Diamond Offshore Drilling Inc (DO.N)	U (09/18/2018)	$5.90
Dril Quip Inc. (DRQ.N)	U (09/18/2018)	$42.84
Forum Energy Technologies Inc (FET.N)	E (09/18/2018)	$1.24
FTS International Inc (FTSI.N)	O (02/27/2018)	$1.47
Halliburton Co (HAL.N)	O (09/18/2018)	$20.09
Helmerich & Payne Inc (HP.N)	U (06/21/2017)	$40.18
Independence Contract Drilling, Inc. (ICD.N)	E (06/21/2017)	$0.92
Liberty Oilfield Services Inc (LBRT.N)	O (02/06/2018)	$9.81
Nabors Industries Inc. (NBR.N)	O (07/12/2018)	$1.94
National Oilwell Varco Inc. (NOV.N)	E (09/18/2018)	$23.15
Nextier Oilfield Solutions Inc (NEX.N)		$4.43
Noble Corporation PLC (NE.N)	U (09/18/2018)	$1.33
Oil States International Inc. (OIS.N)	E (09/18/2018)	$15.04
Patterson-UTI Energy (PTEN.O)	O (04/28/2017)	$8.93
Precision Drilling Corp (PDS.N)	O (07/12/2018)	$1.11
RPC (RES.N)	O (04/04/2019)	$4.27
Schlumberger NV (SLB.N)	O (09/10/2019)	$34.44
Source Energy Services Ltd (SHLE.TO)	E (06/21/2017)	C$0.34
Superior Energy Services Inc. (SPNV.PK)	U (07/12/2018)	$0.44
Tenaris SA (TS.N)	O (03/16/2018)	$22.01
Transocean Ltd. (RIG.N)	O (09/18/2018)	$5.14
U.S. Silica Holdings, Inc. (SLCA.N)	U (10/11/2018)	$4.90
Valaris PLC (VAL.N)	O (04/16/2019)	$4.55
Lillian Starke		
TECHNIPFMC (FTI.PA)	O (01/17/2017)	€18.09
TECHNIPFMC (FTI.N)	O (01/14/2013)	$20.51
Tenaris S.A (TENR.MI)	O (04/27/2018)	€9.83

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INDUSTRY COVERAGE: Refining & Marketing

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Benny Wong		
Delek US Holdings Inc (DK.N)	E (01/09/2019)	$40.21
HollyFrontier Corporation (HFC.N)	E (02/12/2019)	$54.34
Marathon Petroleum Corporation (MPC.N)	O (12/14/2016)	$66.47
PBF Energy Inc (PBF.N)	O (01/09/2019)	$34.18
Phillips 66 (PSX.N)	E (12/14/2016)	$118.40
Valero Energy Corporation (VLO.N)	O (05/16/2018)	$99.86

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INDUSTRY COVERAGE: Canadian Oil & Gas

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Benny Wong		
Canadian Natural Resources Ltd (CNQ.TO)	O (07/19/2017)	C$34.08
Cenovus Energy Inc (CVE.TO)	U (10/22/2019)	C$11.44
Encana Corp. (ECA.N)	E (11/05/2018)	$4.16
Husky Energy Inc (HSE.TO)	E (10/22/2019)	C$9.40
Imperial Oil Ltd (IMO.TO)	E (04/30/2018)	C$33.08
MEG Energy Corp (MEG.TO)	U (10/22/2019)	C$5.45
Suncor Energy Inc (SU.TO)	O (11/02/2016)	C$40.63

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INDUSTRY COVERAGE: Clean Tech

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Ethan C Ellison		
TPI Composites Inc. (TPIC.O)	O (10/29/2018)	$20.80
Stephen C Byrd		
Bloom Energy Corp. (BE.N)	O (08/20/2018)	$3.34
First Solar Inc (FSLR.O)	E (02/07/2011)	$52.58
Hannon Armstrong (HASI.N)	E (02/03/2016)	$30.11
Plug Power Inc. (PLUG.O)	E (04/09/2015)	$2.78
SunPower Corp (SPWR.O)	U (09/27/2017)	$8.82
Sunrun Inc (RUN.O)	E (08/03/2018)	$15.59

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INDUSTRY COVERAGE: Regulated Utilities

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Stephen C Byrd		
Ameren Corp (AEE.N)	E (06/06/2018)	$77.36
Atmos Energy Corp. (ATO.N)	O (09/21/2018)	$111.70
CenterPoint Energy Inc (CNP.N)	E (06/05/2019)	$29.02
CMS Energy Corp (CMS.N)	E (07/31/2017)	$63.34
Consolidated Edison Inc (ED.N)	U (01/09/2017)	$91.12
Duke Energy Corp (DUK.N)	E (08/25/2014)	$94.38
Edison International (EIX.N)	E (01/12/2015)	$65.58
Entergy Corp (ETR.N)	E (09/06/2019)	$119.66
Eversource Energy (ES.N)	E (02/13/2018)	$82.79
FirstEnergy Corp (FE.N)	O (08/08/2016)	$48.36
ONE Gas Inc (OGS.N)	U (03/18/2016)	$92.27
PG&E Corp (PCG.N)	E (11/15/2018)	$6.43
Pinnacle West Capital Corp (PNW.N)	U (06/12/2019)	$93.49
PPL Corp (PPL.N)	E (07/16/2013)	$33.59
Sempra Energy (SRE.N)	E (08/10/2018)	$147.29
Southern Company (SO.N)	U (08/13/2014)	$62.26
South Jersey Industries Inc (SJI.N)	E (09/08/2016)	$32.15
Spire Inc (SR.N)	U (01/12/2016)	$84.22
Xcel Energy Inc (XEL.O)	E (09/21/2018)	$63.10

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INDUSTRY COVERAGE: Diversified Utilities / IPPs

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Stephen C Byrd		
AES Corp. (AES.N)	E (04/27/2018)	$17.51
American Electric Power Co (AEP.N)	E (04/18/2019)	$93.56
Dominion Energy Inc (D.N)	E (08/07/2019)	$83.27
Exelon Corp (EXC.O)	O (08/27/2019)	$45.34
NextEra Energy Inc (NEE.N)	O (07/22/2014)	$235.71
NRG Energy Inc (NRG.N)	O (09/06/2019)	$40.69
Public Service Enterprise Group Inc (PEG.N)	O (09/21/2017)	$62.99
Vistra Energy Corp (VST.N)	O (03/25/2019)	$27.17

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INDUSTRY COVERAGE: Machinery

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Courtney Yakavonis, CFA		
AGCO Corp (AGCO.N)	U (03/02/2018)	$77.70
Allison Transmission Holdings Inc (ALSN.N)	E (07/17/2019)	$44.03
Caterpillar Inc. (CAT.N)	E (10/18/2019)	$144.49
CNH Industrial NV (CNHI.N)	++	$11.18
Cummins Inc. (CMI.N)	E (03/02/2018)	$176.57
Deere & Co. (DE.N)	O (03/02/2018)	$176.11
Oshkosh Corp. (OSK.N)	E (03/02/2018)	$87.32
PACCAR Inc (PCAR.O)	U (03/02/2018)	$78.05
REV Group Inc. (REVG.N)	E (03/02/2018)	$12.76
Terex Corp. (TEX.N)	E (03/02/2018)	$28.61
Timken Co (TKR.N)	E (06/10/2019)	$51.50
United Rentals Inc. (URI.N)	O (03/02/2018)	$141.86
WABCO Holdings Inc (WBC.N)	E (12/17/2018)	$134.74
Westinghouse Air Brake Technologies Corp (WAB.N)	E (09/10/2019)	$74.69
WillScot Corporation (WSC.O)	O (10/01/2018)	$16.27

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INDUSTRY COVERAGE: Beverages

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Dara Mohsenian, CFA		
Brown-Forman Corporation (BFb.N)	E (06/28/2018)	$65.90
Coca-Cola Co. (KO.N)	O (05/14/2019)	$53.90
Coca-Cola European Partners PLC (CCEP.AS)	E (06/12/2019)	€48.30
Constellation Brands Inc (STZ.N)	E (05/24/2019)	$191.00
Keurig Dr Pepper Inc (KDP.N)	U (04/11/2019)	$28.21
Molson Coors Brewing Co (TAP.N)	E (01/09/2018)	$52.70
Monster Beverage Corp (MNST.O)	E (11/08/2018)	$56.25
PepsiCo Inc. (PEP.O)	O (05/06/2012)	$136.93

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INDUSTRY COVERAGE: Food

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Dara Mohsenian, CFA		
General Mills Inc (GIS.N)	E (09/17/2018)	$51.18
Kellogg Co. (K.N)	E (09/17/2018)	$63.68
Kraft Heinz Co (KHC.O)	E (03/03/2019)	$32.61
Mondelez International Inc (MDLZ.O)	O (08/07/2019)	$52.03
Pamela Kaufman, CFA		
Conagra Brands (CAG.N)	E (05/20/2019)	$27.47
Hostess Brands Inc (TWNK.O)	E (09/25/2017)	$12.73
J. M. Smucker Co (SJM.N)	E (04/18/2019)	$105.58

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INDUSTRY COVERAGE: Tobacco

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/01/2019)
Pamela Kaufman, CFA		
Altria Group, Inc. (MO.N)	E (08/23/2019)	$45.06
Philip Morris International Inc (PM.N)	O (03/31/2008)	$82.97

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