After much uncertainty in the lead-up to voting day, the President’s “political firewall” of traditional blue-collar states like Ohio held in the end. By adding four more years to Obama’s tenure, voters have opted for a known horse over a less familiar one. However, the Republicans’ retention of the House, the Democrats the Senate, means Obama will face the same fractured landscape that impeded legislative progress during the last two years of his term. That leaves markets with significant policy uncertainty leading into the fiscal cliff and debt ceiling discussions.

Whereas Romney championed things like tax reform, Obama shied away from sweeping new commitments. However, the next four years could bring some changes relative to the first four, and there will be pressing items to deal with:

- Upcoming discussions around the fiscal cliff will be challenging as Obama faces a Republican-led House with which he must broker a deal. A multi-year deal could be struck during the Congressional “lame duck” session (starting November 13th), or barring that, a temporary spending bill to tide over expenditures for a few months would allow the President and Congress to work on a more comprehensive plan come 2013. Obama has indicated he would veto any tax relief for higher income earners under the Bush tax cuts (Table 1), while Republicans want to scale back automatic sequestration cuts to defense spending.

- The US is set to hit its $16.4tn debt limit by year-end although extraordinary measures could delay the day of reckoning by a few months. The current House Speaker Boehner indicated that any increase in the ceiling would need to be met with offsetting cuts. Obama, the House and Senate will be under pressure to come to an agreement to avoid a repeat of the mid-2011 brinkmanship game, although any deal involving new cuts to spending would only layer onto existing fiscal austerity.

- Beyond the immediate challenges at hand, the President faces pressure to address the longer-term fiscal sustainability. Earlier proposals such as Simpson-Bowles may be looked at again, although with divided leadership of the various houses, it’s unlikely that a deal will be reached with ease.
• Growth will likely track slightly higher than what a Romney presidency would have seen, given Obama’s preference for reducing the deficit via tax increases rather than cuts to government spending. Note that spending and transfers or tax cuts to the poor have a greater bang-for-buck than tax cuts for higher-income earners (Chart 1) according to the Congressional Budget Office, as they are more likely to be spent.

• Democratic presidents haven’t been all that bad for stocks (witness the Clinton years). However, Obama’s plans for a rise in qualified dividend/long-term capital gains rates could pose some near-term valuation risks for equities. A planned increase in maximum rates from the current 15% at year end, could spark some selling pressure now to “lock in” at the lower rate. Obama’s victory is a potential plus for alternative energy, although inexpensive shale gas will remain an impediment.

• Fixed income could gain ground in the days ahead, given renewed risk-off sentiment as attention turns to the fiscal cliff. A Romney win would have also raised the risks of the appointment of a hawk to lead the Fed when Bernanke’s term is up in February 2014. Obama may appoint Yellen, or another dove, removing risks that a more hawkish Fed would see a sharper rise in interest rates slow the momentum in an eventual acceleration of economic growth.

• On housing, Freddie Mac and Fannie Mae could face renewed pressure to provide mortgage holders with relief – particularly given the White House’s aggressive stance towards anti-foreclosure efforts. Such moves could provide some added support to housing at the margin.

• The Keystone XL pipeline should see approval in the months ahead, although on other elements of conventional energy production, the President has been less supportive. As opposed to a Romney presidency, Obama’s reign will likely see less offshore drilling on federal lands—a factor that could result in greater dependence on Canadian energy.

• With Obama hanging onto the reins of government, the risk of a swift end to Obamacare has been put to bed. Ultimately this should benefit pharmaceuticals on greater volumes, as well as care providers by lowering uninsured coverage costs.

• On a potentially important note for financial stocks, Obama’s win means that the implementation of Dodd-Frank will proceed. Romney had pledged to replace controversial 2010 Act with a “streamlined, modern regulatory framework”, as well as amending earlier Sarbanes-Oxley legislation to ease reporting requirements for mid-size companies.

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