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Analyzing Possible Market Implications of the Potential U.S. Presidential Impeachment

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Last year, President Donald Trump became the third U.S. president in history to be impeached. On December 19, 2019, the Democratic-controlled House of Representatives approved two articles of impeachment, accusing Trump of pressuring Ukraine to find damaging information on Joe Biden, one of his main challengers in the 2020 presidential election. According to Democrats, this amounts to an abuse of power for political gain and is grounds for impeachment. Trump is also accused of obstructing Congress by refusing to co-operate with the inquiry.

Impeachment is a political process designed to remove a president from office for “Treason, Bribery, or other high Crimes and Misdemeanors” according to the U.S. Constitution. This process happens over several stages. First, Congress investigates and then the House debates and votes on whether to bring charges against the president via a simple majority approval of an impeachment resolution. Finally, the process moves to a trial in the Senate where the chief justice of the United States presides over the proceedings. Conviction and removal of a president requires a two-thirds majority vote in the Senate. Currently, the Senate has 53 Republicans, 45 Democrats and two independents. As such, as long as the votes roughly follow party lines, the conviction and removal of Trump from office appears unlikely at this time.

While public opinion could potentially sway senators, it is dependent on the availability of clear evidence. According to polling aggregator FiveThirtyEight, approximately 47% of Americans currently support removing Trump from office. Moreover, the public is split along party lines with almost 83% of Democrats supporting Trump’s removal, while less than 10% of Republicans would support such a move.

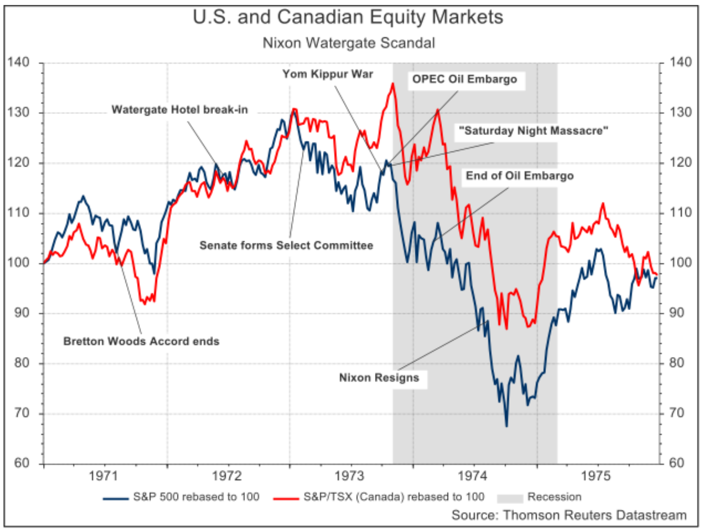
What history tells us: It is difficult to isolate the effect of impeachment on equity markets

We have two modern examples of presidents facing impeachment: Presidents Richard Nixon and Bill Clinton. We also have recent examples with the impeachment proceedings in South Korea (December 2016) and Brazil (August 2016).

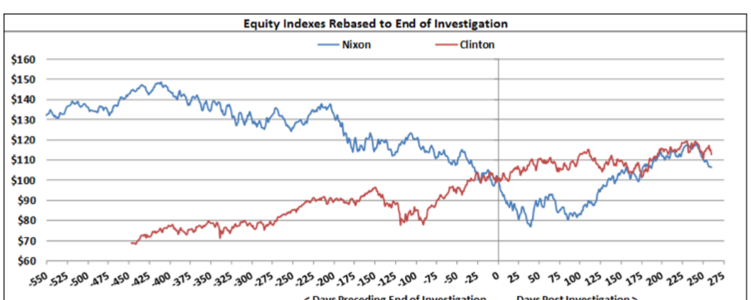
Example 1: Nixon’s Watergate Scandal

The Watergate scandal’s roots go back to June 17, 1972 when burglars were caught in the office of the Democratic National Committee. The burglars, who were connected to Nixon’s re-election campaign, were involved in wiretapping phones and stealing documents. After attempting to cover up the crimes and to obstruct justice, Nixon resigned two years later on August 8, 1974.

During the Watergate scandal, markets exhibited a high level of volatility, but the political upheaval in the United States was only one of many factors affecting global markets. The Yom Kippur War, the OPEC oil embargo, emergent inflation and a particularly difficult recession all contributed to market weakness and volatility. The following graph shows how the S&P 500 and the S&P/TSX fared during the mid-1970s, both in absolute and relative terms, to the MSCI World excluding U.S. Interestingly, immediately following Nixon’s resignation, the S&P 500 underperformed. While Watergate likely produced increased volatility and some market weakness, it is difficult to see a clear lesson from this era that applies to today’s situation due to the amount of factors buffeting the market during that time.



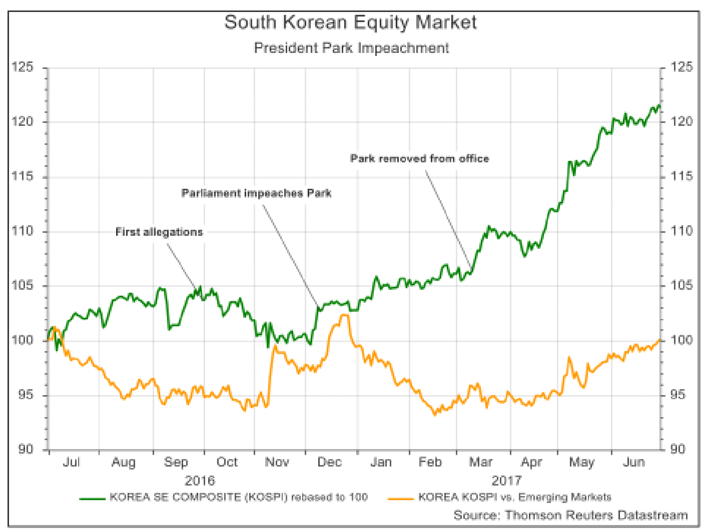
This graph illustrates that the end of the impeachment process in the United States, either through resignation or acquittal, does not change the overall trend of the market. During the Clinton proceedings, the uptrend of the market simply continued. Following Nixon's resignation, the downtrend continued but seemed to accelerate, however acceleration was potentially caused by worsening economic conditions.



Index denominator based on Day 0 value
Day 0 = End of Investigation [Nixon = Resignation, Clinton = Acquitted]
Nixon & Clinton Indexes = $USD S&P500
Source: Thomson Reuters Datastream

Example 2: South Korea's President Park Geun-hye

In South Korea, President Park Geun-hye was accused of being overly influenced by a presidential aide who was the daughter of a religious cult leader. Initially, Park Geun-hye was suspended for 180 days, then fired from her position on March 10, 2017. During the impeachment process, Korean equities outperformed the rest of the emerging markets. However, the positive effect did not last long and the outperformance was all but erased by the time Park Geun-hye was removed from office. Following her removal, Korean equities started outperforming, but this could also be tied to the arrest of a Samsung VP and the renewed hope of corporate governance reforms.



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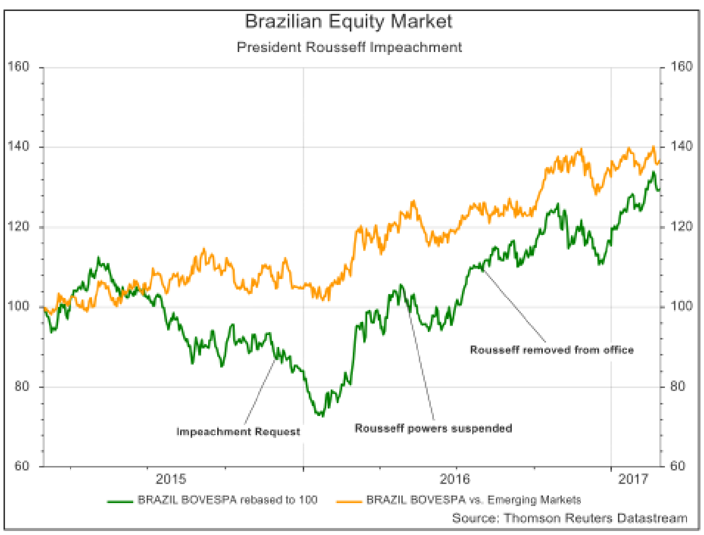
Example 3: Brazil's President Rousseff

In Brazil, President Dilma Rousseff was plagued by a money laundering scandal which revealed corruption at the highest levels of Brazilian business and politics. As the prospect of Rousseff's removal increased, the outperformance of the Brazilian equity market became more evident. The outperformance was likely driven by the hope that the political paralysis would end and by the prospect of moving away from a left-wing government. Michel Temer, the subsequent Interim President and then President, was seen as a much more market-friendly option than Rousseff. In this case, the impeachment process and the ultimate removal of the president did lead to better equity market conditions.



What does this mean for the world today?

It is worth considering how America's adversaries might react to political instability in the United States. Will countries such as China or Russia take advantage to achieve national goals opposed by the United States? Taiwan, the South China Sea, Ukraine, Yemen and Syria are all flashpoints that could give financial markets pause and are all worth monitoring.

A final scenario to consider is the ability of the U.S. government to react to potential economic shocks during the impeachment process. On one hand, one can imagine how much worse the financial crisis could have been if the U.S. government's executive branch had been incapable of acting decisively. It is also worth noting that the 2008 financial crisis, occurring as the Bush administration left office and the Obama administration took over, demonstrated the amazing resilience and flexibility of the U.S. political system. Ultimately, it is difficult to accurately gauge this scenario but, with an aging economic cycle, governments may be called to action in the next few years as we potentially enter a recession.

Putting it all together

The events leading to an impeachment, and the impeachment process itself, add a layer of volatility to financial markets. However, as long as the process is orderly, its effects on the overall economy and financial markets should be limited. If Trump ultimately gets removed from office, "President" Pence would likely be a neutral-to-positive economic factor and, as such, the overall trend of the market should be unaffected. In the event that the process is disorderly, impeachment proceedings would likely be quite negative for equity markets and the risks to the economy would grow meaningfully.

In the case of a more disruptive impeachment process, it is worth noting that Canada, with its stable political system and solid public finances, would likely be able to weather the storm better than most. The situation could be similar to the outperformance of the Canadian economy during and following the financial crisis of 2008.

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