US PRESIDENTIAL ELECTION:
Risks and Opportunities

The United States (US) presidential election, on 8 November, between Republican candidate Donald Trump and Democratic candidate Hillary Clinton is a hotly contested race. More recently, we have seen some widening of opinion polls, however, this is a fluid and fast moving landscape and political uncertainty remains. We anticipate that the potential for increased market volatility over coming weeks is high.

This paper draws on the insights of AMP Capital’s investment teams to assess the risks and opportunities for individual asset classes from both possible outcomes, based on known policies. We accept that the details of some policies are not clear, and may not be clear for some time, particularly given that control of the two houses of Congress, as always, will be a key factor in determining which elements of a candidate’s policy platform ultimately becomes law.

KEY POINTS

› Policy differences will have some specific asset class impacts. In general, however, the perception is that a Clinton victory represents continuation of the Democratic party status quo, and associated with this is the expectation of fewer policy surprises. The change to a Republican administration under Trump has the potential to result in more dramatic shifts in intended policies. Once again, the ability of either party to implement policy will be dependent on Congress.

› US bond markets could weaken on a Trump victory, reflecting an expected increase in the budget deficit and allow the Fed to assume a more aggressive rate hike path than currently. This has the potential to push the USD higher. A Clinton victory is unlikely to point to a different path for interest rates than is currently priced into the market.

› Both candidates seek to increase infrastructure spending, which is one of the few areas of spending agreement. For US listed infrastructure, particularly the energy and pipeline sector, neither of the candidates have plans that would be detrimental. A Trump victory may spark short-term share price gains.

› For direct infrastructure, a key area to monitor is the view of each candidate on the use of private capital to fund the nation’s infrastructure development. However, this is currently unclear. Irrespective of the election outcome we don’t envisage any immediate changes to our deal flow or opportunity base.

› In general a Clinton victory, assuming a Republican-controlled Congress, would likely result in more of a status-quo environment for US REITs. A Trump victory could see some sectors doing better, such as the office sector. Regardless of who wins, defence spending is almost certain to increase.

› Historically, elections have been meaningful drivers of equity volatility. Looking back at all post-war elections (1948-2012), realised volatility is highest in October of an election year than any other month during election season (Jul-Nov). If history is our guide, increased volatility that causes increased trading volumes will likely precede the election rather than follow it. We do not foresee a lasting impact on liquidity of either the equity or fixed income markets as a result of the US election.

› A summary of Trump and Clinton’s policies can be found on page 7.
Shane Oliver, Head of Investment Strategy and Chief Economist, AMP Capital, makes the observation that Congress is likely to be the constraining factor for the new Administration. What politicians would like to do versus what they actually can do in elected office is often quite different. He identifies the key possible election outcomes as:

1. Trump president, Republicans retain control of the House and Senate. There are two further scenarios:
   - (a) Republicans provide little constraint on Trump's policies.
   - (b) Republicans prove to be an effective constraint on Trump's policies, given the Republican Party has generally supported free trade, global engagement and curtailing the budget deficit.

2. Clinton president, Republicans retain control of the House and Senate.

3. Clinton president, Republicans retain the House but Democrats win a small but not controlling majority in Senate.

4. Clinton president, Democrat majorities in both House and Senate.

A Clinton victory, except for scenario 4, is largely regarded as representing more of the same from a policy perspective. Despite recent improvements in opinion polls, a low probability is attached to scenario 4 but this is on the rise.

Our investment teams have been following developments closely and we capture below our teams’ opinions on the implications for each asset class.

**GLOBAL FIXED INCOME AND US DOLLAR PERSPECTIVES**

**ANDREW SCOTT**
Portfolio Manager, Macro, Global Fixed Income

**ASSESSING THE POLICIES AND AREAS OF IMPACTS**

It’s likely that some degree of capital expenditure has been delayed in the US by corporates as the polls have narrowed, generating more uncertainty about the future state.

Large scale spending on infrastructure will act as positive for growth but will take some time to impact the economy.

**Trump**: On balance, a Trump victory is more likely to be negative for the US budget position not only because of the differences in taxation and spending plans (although that is a factor) but because it is likely that the Lower House will still have a Republican majority. The Senate outcome seems less clear but it appears likely that if Trump wins the Presidency, then the Republicans are also likely to retain control of the Senate.

In a scenario where there is a Republican majority in Congress and Trump wins the Presidency, we would expect easier passage for his policies.

**Clinton**: If Clinton wins Presidency, it is far less likely that her administrations’ policies will be implemented given the probable composition of Congress.

One might assume that a Clinton administration could potentially remove a lot of short-term corporate uncertainty by being perceived as continuation of the status quo, which might improve US business activity data in the first quarter of 2017, all else being equal. This improvement could, in turn, remove some of the concerns that the US Federal Reserve (Fed) has in raising interest rates.

**PORTFOLIO IMPLICATIONS**

Realistically any long-running large-scale deficit spending program will likely put the Fed in a position to hike further than they otherwise would because it takes some of the strain off monetary policy.

Generally we expect higher-than-current US interest rates over time regardless, but the current low level of market implied volatility together with significant short-term uncertainty argues for expressing some of this view via options rather than via an outright short duration position. Higher yields in the US will likely lead to steeper yield curves in Australia.

We raise a concern that Republicans in general have been questioning the Fed’s political bias, that is, that the Fed has not been independent for some time. Credible and independent central banking has been a cornerstone of markets over the last quarter century or so but ultimately the President, with Senate confirmation, appoints governors and the Fed is responsible to Congress. This is a tail risk but in the event of a Trump victory, there could be changes in the way the Fed is structured over time.

**GLOBAL LISTED INFRASTRUCTURE PERSPECTIVES**

**JONATHAN REYES**
Portfolio Manager, Global Listed Infrastructure

**ASSESSING THE POLICIES AND AREAS OF IMPACT**

Clinton has called for **$275 billion in infrastructure spending** over five years. This would include the creation of a national infrastructure bank, which would be given $25 billion to support loans and loan guarantees for infrastructure projects. In total the plan would support about **$500 billion** in spending on infrastructure. Trump has said he would like to spend at least twice as much as Clinton on infrastructure but has not indicated how the spending would be funded.

Under both candidates, it is likely that most of this spending would be undertaken by the government to improve highways, airports and seaports. This investment in infrastructure should lead to improved overall economic activity but offers limited private capital participation opportunities for our investors.

The key opportunity for global listed infrastructure will be in the energy infrastructure sector; specifically, oil and gas pipelines.
**Trump:** Being a climate change sceptic, Trump has promised the energy industry that he would cut taxes and reduce regulation on fossil fuel energy production and infrastructure. This would unleash what he called “a treasure trove” of coal, oil and natural gas in the United States.

Along with a reduced focus on renewable energy and increased fossil fuel production, we are likely to see increased demand for infrastructure that transports these commodities: rail for coal, and pipelines for natural gas, oil and refined products. Also, the political landscape will likely be more constructive to help these projects get built. Trump has vowed to approve the contested Keystone XL pipeline if elected.

**Clinton:** While the Democratic party is generally viewed as being more focused on combating climate change than the Republican party, the Obama administration has been supportive of the oil and pipeline sector. In fact, US oil production increased more than 80% under the Obama administration to near-record levels and natural gas is up by nearly one-quarter.

Instead of shutting down hydraulic fracturing, Obama promoted natural gas as a stepping-stone to a greener, renewable future. The current administration also permitted drilling in the Arctic Ocean over the objections of environmentalists and opened the door to a new generation of oil and gas drilling in Atlantic waters on the East Coast. Obama also signed a measure to lift a 40-year-old ban on the export of most U.S. crude – all of which has combined to be a large tail-wind for the energy infrastructure and pipeline sector.

**PORTFOLIO IMPLICATIONS**

Neither candidate presents significant downside risk to the infrastructure sector.

To date, neither of the candidates have plans that would be detrimental to the overall pipeline sector. Therefore, the short-term risks to our portfolio are fairly limited. Under a Clinton Administration, we would expect the status quo from a policy perspective while free market factors will continue to drive overall US hydrocarbon production.

With a Trump victory, we could see an improvement in energy industry sentiment in the short-term, and pipeline stocks, in particular, could experience higher share prices in anticipation of higher future production. However, we believe that the same market factors will drive production in the long term.

We continue to watch developments closely and examine and evaluate any new statements from the two candidates. However at this stage, we feel comfortable that our portfolios will not be negatively impacted long-term, regardless of the outcome.

**DIRECT INFRASTRUCTURE EQUITY PERSPECTIVES**

**DYLANFoo**

Head of Americas Infrastructure

**ASSESSING THE POLICIES AND AREAS OF IMPACTS**

Both candidates have agreed to increase infrastructure spending, and this is one of the few areas of agreement.

Unlike much of Europe and Australia, infrastructure spending in the US has primarily been a function of the public sector. Often infrastructure spending is regarded as an obligation of the government to stimulate the economy and reduce unemployment. The view in the US that infrastructure spending should be the responsibility of the government is increasingly changing as states, cities, and universities begin to explore the use of Public Private Partnerships.

As legislation at the state level evolves to welcome more Public Private Partnerships investments, the declared spending by candidates and their respective plans to fund such investments becomes less meaningful. While each candidate has not specifically stated their opinion on private investment in infrastructure, the current sentiment on broad issues is that a Clinton victory is likely to be more of the status quo while Trump’s position is unknown.

However, it’s too early to form an opinion on how each candidate will treat legislation around the use of private capital to fund the nation’s infrastructure development.

**PORTFOLIO IMPLICATIONS**

Following the election, irrespective of the outcome, we don’t envisage any immediate, significant changes to our deal flow or opportunity base.

**US LISTED REAL ESTATE PERSPECTIVES**

**JOSEPH PAVNICA**

Head of North America Listed Real Estate

**ASSESSING THE POLICIES AND AREAS OF IMPACTS**

Regardless of who wins, defence spending is almost certain to increase. Consequently, the area around Washington DC is likely to be a beneficiary, specifically in the office sector and lodging, retail and housing markets.

Both candidates intend to increase infrastructure spending. This is generally positive for listed property.

Government spending increases are likely to be funded to some extent with partial entitlement cuts; for example, Medicare reimbursement rates. This could put further pressure on hospitals and healthcare operators, such as skilled nursing facilities, many of which already have low rent coverage levels. This could put added stress on the healthcare REIT owners of such properties.

In the event of short-term market volatility following the election outcome, a risk-off environment would likely benefit REITs.

**Trump:** Lowering corporate taxes is one of Trump’s priorities. This would be positive for corporate profitability and potential hiring decisions. From a property perspective, this would be positive for the office sector and the major office markets.

Stricter trade policies could result in major importers, such as lower quality retailers, being negatively impacted. By extension, this could be negative for lower quality retail property owners and industrial property owners.

Stricter enforcement of immigration and deportation policies could disrupt the labour supply, with areas such as restaurants, hospitality, and some lower quality retail, construction and agriculture adversely affected. From a property perspective, we would be mindful of the potential negative effects on the lower quality retail REITs with lower margins and lodging REITs. We would also be mindful of the impact on development margins for those REITs with a development pipeline.
Clinton: In general, a Clinton win would likely result in a status-quo environment, as her policies are largely expected to be in-line with Obama’s. It’s important to note that from a REIT perspective, Clinton opposed favourable REIT taxation rules, however this does not appear to be a top priority.

A higher minimum wage could disrupt the labour supply in a similar way to Trump’s immigration policies noted above) with the same sectors impacted: restaurants, hospitality, lower quality retail, construction and agriculture adversely affected. From a property perspective, we would be mindful of the potential negative effects on the lower quality retail REITs with lower margins and lodging REITs. We would also be mindful of the impact on development margins for those REITs with a development pipeline.

Clinton opposes private prisons, which is a clear negative for prison REITs. The Department of Justice has already announced that it will either not renew or limit the scope of contracts with for-profit prisons when they are up for renewal.

PORTFOLIO IMPLICATIONS FOR GLOBAL REITS
We position our global REITs portfolios for long-term investment trends and see the asset class as a solid anchor to a diversified strategy under either political scenario.

In the very short term, the election result could dominate market flow and likely cause pricing dislocation if major political change starts being priced. That change is associated with a Trump victory and would likely send pricing of yield and bond proxy assets when they are up for renewal.

GLOBAL EQUITIES PERSPECTIVES
Simon Steel
Head of Global Equities

ASSESSING THE POLICIES AND AREAS OF IMPACTS
Trump: A key area of interest to us is the potential removal of all free trade agreements. As a worst case outcome, that will negatively impact globalisation and trade flows.

Globalisation plays a crucial role in the functioning of the US economy and its many benefits include lower goods prices, more purchasing power for consumers,
The US equity market is the most
A Trump victory is more likely to create
It is unclear whether US safe haven
growth and rising trade barriers.
are negatively exposed to slowing profits
many of the companies and sectors that
constraints that force investors to hold
risks stemming from this environment.
infrastructure spend across much of the
of stimulative fiscal policies benefiting
and wider adoption of increased defence
competition, and a significant contribution
to the overall competitiveness of the
US manufacturing sector through more
efficient and cheap access to supplies.
By some estimates, up to 80% of global
exports now sit within the supply chain
of the multinational companies large and
small, many of them domiciled in the US;
these intermediate goods are fluid, crossing
borders freely and inexpensively.
Increasing the cost of the supply of cheap
goods and intermediates could have
very negative impacts for growth and
employment in the US and for the rest of
the world. It would likely slow the volume
of economic output, raise US import and
export prices and erode disposable incomes
through higher import costs. This could
have negative implications for global
growth and global corporate profits.
Clinton: Trade and globalisation is an
economic policy issue that the two
candidates are more aligned than not.
Both Trump and Clinton have promised to
renegotiate or abandon trade agreements
with key US trading partners such as Mexico
and Canada. With respect to Asia, Clinton
has announced her opposition to the Trans
Pacific Partnership (TPP). This contrasts
with her previous position as secretary of
state where she had touted the TPP as the
“gold standard.” During the past 20 years,
she has outlined a multiplicity of different
ideas on trade and she has a more nuanced
approach to trade than Trump. However, it
is our view that her current position is not
conducive to growth and development.
PORTFOLIO IMPLICATIONS
The potential global pressure points related
to the removal of free trade agreements
could lower global growth and the
expansion of corporate profits. We should
be mindful that there are opportunities in
this environment, with increased defence
spending in the US and wider adoption of
stimulative fiscal policies benefiting
infrastructure spend across much of the
world, and supporting some sectors.
Managers of global share portfolios could
consider other means of mitigating the
risks stemming from this environment.
This might include removing benchmark
constraints that force investors to hold
many of the companies and sectors that
are negatively exposed to slowing profits
growth and rising trade barriers.
By focusing on investing in those companies
that can continue to drive profits growth
from a powerful combination of market-leading
positions, strong balance sheets
and structural growth tailwinds, we can
avoid the worst effects of potentially slower
growth. These trends to consider include
ageing populations, health care reforms,
business outsourcing, the ongoing shift to
the digital world, the powerful evolution
of virtual networks, the rise of tourism,
and the steady displacement of cash
transactions with electronic ones. In these
areas, we continue to find companies that
can grow their economic profits at a healthy
cip and generate increasing shareholder
value, almost regardless of the level of
headline global GDP growth.

AUSTRALIAN EQUITIES

PERSPECTIVES

ASSESSING THE POLICIES AND AREAS

OF IMPACTS

Like Brexit, the market is underestimating
the possibility of a Trump victory, but if he
does win, markets are likely to overestimate
the impact on the economy.
Irrespective of the election outcome, there
is likely to be an increased emphasis on
stimulatory fiscal spending especially on
infrastructure and a decreased focus on
deficit reduction.
PORTFOLIO IMPLICATIONS
Stimulatory fiscal spending could lead to
higher inflation and interest rates in the US,
which would benefit cyclical companies.
We have moved significantly underweight
long duration yield stocks and overweight
cyclical industrials. We have maintained our
overweight to offshore earners and reduced
our overweight to resources.
A Trump victory could have a short-term
negative impact on markets owing to
concerns that his protectionist policies, if
implemented, could lead to lower global
growth. We would see this as a buying
opportunity. However, we have also
increased our gold position to overweight,
as we believe a Trump victory could lead
to greater geopolitical uncertainty, which
could be reflected in a higher gold price.

DEBBIE ALLISTON
Head of Multi Asset
Portfolio Management
Multi Asset Group

It is difficult to be definitive about what a
Clinton or Trump victory will lead to over
time. However, we are comfortable making
the following assessments:
>
The US equity market is the most
expensive of the developed markets
>
A Trump victory is more likely to create
short term market volatility and introduce
more uncertainty than a Clinton victory.
>
The US Federal Reserve appears poised
to raise cash rates; bond yields remain close
to all-time lows.
>
It is unclear whether US safe haven
assets, such as bonds and the US Dollar,
would rally following a Trump victory.

As such, in our diversified funds, we have
maintained an overweight in portfolios
to US equities and a corresponding
overweight to European and emerging
markets on improving fundamentals and
relative valuations.
We are underweight US duration and have
introduced some inflation protection as we
see inflation indicators ticking up across
the board in the US. While we maintain a
small overweight to foreign currency at the
expense of the Australian Dollar for hedging
purposes we have switched from holding
our overweight in a US Dollars to a more
diversified currency basket.
In recognition of heightened event risk
and the potential for short term volatility
over coming months, we have taken out
option protection on US equities through
to December across most of our active
diversified portfolios using a risk reversal
strategy. This involves selling physical US
equities, selling an out of the money put
option and using that premium to buy a
marginally out of the money call option
for the same exposure. This provides
protection for any initial market selloff
while preserving most of the upside if the
market rallies. This trade was opportunistic
reflecting low volatility and the ability to
execute at zero cost.

MICHAEL PRICE
Head of Australian Equities

AMP CAPITAL US PRESIDENTIAL ELECTION 5
Broader implications from teams across AMP Capital

VOLATILITY MARKETS PERSPECTIVES

Our protected growth team manages drawdown risk for both policyholders and shareholders of our large institutional clients along with tail hedging services for diversified investment portfolios. Understanding market risk is critical to this process.

The US election is being regarded as a potential risk event in volatility markets. This view is supported in betting markets, where there is a base case that Clinton wins. A Trump victory is a tail event case that is not really priced and could result in market dislocation. However, the polls have at times been closer than the betting markets would imply.

We observe that little election risk is currently being priced into US equity volatility markets. As at early October, the overall level of S&P 500 implied volatility remains low. Historically, elections have been significant contributors to equity market volatility, especially in the month preceding election day.

Given the recent Brexit experience, we would expect a degree of tail hedging to occur at an earlier stage. There are preliminary signs that this has already started but not in large volumes, as yet. We would expect more tail hedges to be put in place as the election nears.

ASSESSING THE AREAS OF IMPACT

We don’t foresee a material lasting impact to liquidity regardless of the outcome of the US election. While a short-term increase in the liquidity of specific sectors impacted from the policy points of either Clinton or Trump is likely, we expect this to be followed by a return to the normal secular pattern of liquidity, which happens to be a secular decline. Furthermore, November and December fall into the seasonal pattern of reduced volumes for both equities and fixed income due to the holidays, and we expect these seasonal trends to continue to prevail.

Clinton: It is likely that a Clinton victory could result in relatively less risk to markets (and liquidity) in the short run because the discounting mechanism of the markets already appear to be favouring a Clinton victory (status quo). As such, we see less of a need for investors to reposition if this scenario plays out, so liquidity will likely be dictated by the overarching long-term secular trend of liquidity (declining) along with the short-term seasonal trend of liquidity (declining).

However, Clinton favours more regulations such as a risk fee on the largest financial institutions and a high frequency trading tax. These are measures that could occur in the case of a Democratic sweep (a majority in both houses of Congress), so such a scenario (Clinton victory and Democratic sweep) could likely have a long-term impact (resulting in lessened liquidity across markets) similar to Dodd-Frank and other regulations.

Trump: It is likely that a Trump victory could result in a relatively larger risk for markets since this outcome is relatively less factored in by markets. There is also a perception that a Trump victory is associated with greater uncertainty for markets. We think a short-term increase in volatility and liquidity would likely coincide with (and even precede a Trump victory), although the options market appears to be underestimating the chances of this occurrence.

Trading Implications: Historically, elections have been meaningful drivers of equity volatility. During the past six elections, the VIX index has increased every single time in the month leading up to election day, with an average gain of 3.5 volatility points. Looking back further at all post-war elections (1948-2012), realised volatility is highest in October of an election year than any other month during election season (Jul-Nov). If history is our guide, increased volatility that causes increased trading volumes will likely precede the election rather than follow it.

We do not foresee a lasting impact on liquidity of either the equity or fixed income markets as a result of the US election. We foresee a relatively higher degree of short-term uncertainty, volatility, and liquidity resulting from a Trump victory, although this would likely return to the secular and seasonal trends already in place. We see a relatively higher degree of market structure reform that could impact long-term liquidity assuming Clinton prevails and the Democrats sweep Congress. However, this would likely take considerable time to play out. It is our expectation that increased liquidity would likely precede the election rather than sustainably follow it.

General uncertainty could temporarily reduce demand for US assets (including Treasuries) and increase demand for gold. Assuming a Trump victory, we see specialised pockets of increased liquidity in sectors such as hospitals and managed care companies where Trump’s policies could have a lasting impact on the sectors exposed.

US DEALING DESK

ERIC CADOGAN

Senior Dealer, Chicago

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US INSTITUTIONAL INVESTOR PERSPECTIVES

CRAIG WATKINS
Institutional Director, Listed, Americas

Institutional investors generally don’t believe that presidential elections have a long-term effect on market performance. Investors tend to agree that historically speaking, market returns are not vastly different whether a Republican or a Democrat occupies the White House.

While the Presidential election is an important political event, institutional investors continue to position their portfolios for the long term and are focused on issues such as quality, duration, credit, overall portfolio risk, diversification, etc.

Consultants and clients can exhibit general concern for each candidate’s policy positions but it is unlikely that they will abandon long-endured and well-thought out investment plans that took years to implement based on a particular outcome. Investors are keenly tapped into what sectors will benefit from a Clinton or Trump victory but none are making wholesale shifts in their asset allocation schemes to take advantage of those eventualities.

Irrespective of the outcome, institutional investors are remaining focused on adhering to their policy objectives, ensuring that their portfolios are well diversified across asset classes and geographies, and continuing to take a long-term view.

POLICY SNAPSHOT

Shane Oliver, Head of Investment Strategy and Chief Economist summarises the key policies of Trump and Clinton are summarised as follows:

Taxation:
- Trump promises personal tax cuts including a cut in the top marginal tax rate to 33% from 39%, a cut in the corporate tax rate to 15% from as high as 39% and removal of estate tax.
- Clinton promises higher more progressive marginal tax rates, a cap on deductions, increased estate and gift taxes and a tax on high frequency trading.
- Infrastructure: Both want to increase infrastructure spending.

Government spending:
- Trump wants to reduce non-defence discretionary spending by 1% a year (the “penny plan”), but increase spending on defence and veterans.
- Clinton wants to increase non-defence discretionary spending.

Budget deficit:
The Wall Street Journal reported that the Committee for a Responsible Federal Budget, a non-partisan group, analysed the fiscal proposals of both candidates as at 21 September. Their analysis of the change in the fiscal position over a ten year period showed that while both candidates’ plans will increase debt, the deficit will be larger under Trump than under Clinton. Under Trump policies, the debt-to-GDP ratio would rise to 105. Under Clinton policies, the ratio would rise to 86% (it is currently 75%).

Trade:
- Trump largely proposes protectionist policies, for example, a 45% tariff on Chinese goods, 35% on Mexican goods.
- Clinton largely supports free trade as long as the United States isn’t harmed.

Regulation:
- Trump wants to dismantle Dodd-Frank financial regulations, return to Glass-Steagall policies that limit the activities of large banks, audit the Federal Reserve and limit its independence and reduce industry regulation generally, particularly on US energy.
- Clinton promises tougher industry regulation, policies that favour clean energy and indicated some support for Glass-Steagall like policies for large banks.

Immigration:
- Trump wants to build a wall with Mexico, deport illegal immigrants, and ensure that firms hire American workers first.
- Clinton tends to favour expanding immigration.

Healthcare:
- Trump wants to repeal Obamacare and cut drug prices in Medicare.
- Clinton has promised to defend Obamacare, expand access to healthcare and limit drug prices.

Foreign policy:
- Trump wants to reposition alliances to put “America first” and get allies to pay more, would confront China over the South China Sea and would attack oil fields under IS control.
- Clinton wants to strengthen alliances and would continue the US “pivot” to Asia (being one of its architects).