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# Market Update: 30th September 2020

**The Road to the US Election**

The first of three US presidential debates began on Tuesday evening, as President Donald Trump and the Democratic contender Joe Biden sparred on key matters including their respective records, the coronavirus pandemic and racial violence which have characterised 2020 in the US. With just over a month to go to election day, markets have begun pricing in the potential scenarios which may unravel. Yet, with significantly contrasting presidential nominees, pricing in both distinctive implications for the economy will be difficult, adding to the already volatile election cycle.

Since the small correction in US markets at the beginning of September, investors have become more responsive to political, economic, and pandemic related updates. Although there is little possibility of a US market rally before the end of the election cycle, investors will be looking to benefit from a potential rally when a clear presidential winner is announced. This update will provide an overview of the key election events, what each nominee's policy stance is, how markets have reacted so far and the potential outcomes after election day.

***Build up to the first debate***

Prior to the first debate, the stock market rally from the loosening of lockdown restrictions and decreasing Covid-19 cases was beginning to wane, as economic and pandemic concerns began to feed into investment decisions. With consumer spending struggling to maintain its pace from the initial pent-up demand, labour market data has stalled, with rising unemployment claims creating a drag on the economic recovery. In addition, the US government is still yet to provide an additional fiscal stimulus package to replace the package which ceased in mid-august, due to the inability of Republicans and Democrats to decide on the appropriate size of the fiscal package. Without the much-needed support for households and businesses, the US stock market experienced a selloff at the beginning of September as investors took profit and re-evaluated economic and company fundamentals. As a worsening economic outlook unravels, US citizens are considering which of the two presidential nominees and their associated policies best support their individual and the nation's needs for a gradual and sustained economic recovery.

The two candidates differ in many areas. Democrat Joe Biden is running on the legacy of the eight years he served alongside President Barack Obama and has proposed advancing that legacy on key issues like health care and climate change. Democratic supporters are hopeful that his centre-left position will help sway supporters who previously voted Republican but have lost patience during Trumps tenure.

Republican Donald Trump is running for re-election after a surprising 2016 victory and a tumultuous first term that has been dominated by the Russia investigation, impeachment proceedings and the coronavirus pandemic. His views are often characterised by populism, where the majority of his

support comes from the Midwest and the South, with strong movements behind the right to firearms, anti-immigration, and anti-trade to support the working-class.

Biden has been leading in the approval polls before the debate took place. Alongside the approval lead in the traditionally democratic states, Biden is currently beating Trump in seven battleground states, and is tied with the president in one state. Based on forecasts, for Trump to win in 2020, he would need to win in at least five of the states that Biden currently leads and cannot afford to lose anymore battleground states. Hence, Trump is expected to do all that he can in the next six weeks to help his chances. Albeit, Biden has not topped 50% in most battleground state poll averages so far, just like Hillary Clinton who subsequently lost the last election in 2016.

***Contrasting policy outcomes***

Both candidates' policies are less developed than usual, because of the ever-changing economic landscape and the unpredictable needs of the US economy in the short and medium-term. That being said, both candidates appear to be at opposite ends of the spectrum in terms of the chosen solution to the existing economic problems.

On the topic of Covid-19, President Trump has urged Americans to practice social distancing and mask wearing, despite his reluctance to wear a mask himself. He has repeatedly downplayed the need for increased testing, acknowledging that increased testing will find more Covid positive cases. Biden on the other hand is seeking to offer free testing to all Americans, as he has also assembled a plan to help businesses and schools reopen, whilst wanting to extend unemployment benefits.

In terms of taxes, President Trump has introduced several tax cuts for individuals and corporations which expire in 2025. Markets could respond positively to a Trump re-election in the short run based on his tax stance. Based on past policy decisions, it would usually be expected that Biden would look to increase taxes, which would likely be negative for markets. However, due to the recent developments in 2020, his stance appears flexible to maintain current tax rates to support the economic recovery.

Markets have been watching the lack of progress with the latest stimulus package, as Republicans and Democrats have a differing policy stance. Both Trump and Biden are representative of their political party's current stance. Trump has been reluctant to increase the budget deficit significantly, whilst Biden has pledged that under his presidency, he would pass a $2 trillion investment package to boost economic opportunities whilst tackling climate change. Trump has been a long-time disbeliever in climate change; however, Biden is advocating for a green investment push to reduce emissions whilst also providing economic growth and jobs.

Lastly, another policy they differ on is foreign trade and relations. Despite it not being specifically outlined, it is assumed a Biden presidency would be more cooperative with the US' historical allies in Western Europe and North America through increased trade agreements. However, it seems both Trump and Biden agree that a firm stance towards China is required to maintain the US' economic power.

As such, the presidential outcome will put the US economy on different recovery paths, making it hard for investors to predict which area's look attractive and which will be neglected under different Presidents. Furthermore, whether there is a blue wave, red wave or divided congress will influence the policy outcomes. Below provides a summary for what this may mean for US assets.

## Asset class implications under different election scenarios

In the table below, we analyze the asset class implications across the four possible election outcomes. Investors should put greater focus on the Blue Wave and status quo outcomes, which our colleagues in the UBS US Office of Public Policy see as the two most probable scenarios.

| Scenario | Blue Wave<br>DDD<br>50% probability* | Biden<br>Divided Congress<br>10% probability* | Trump<br>Status quo<br>35% probability* | Red Wave<br>RRR<br>5% probability* |
|---|---|---|---|---|
| **US macroeconomic growth outlook**<br>Brian Rose, Senior Economist Americas | | | | |
| Macroeconomic outlook | **Modest positive**<br>Focused on the economic recovery. Spending on stimulus, healthcare, infrastructure, and climate change more than offsets higher taxes (corporate, personal, investment). Risks: Tax increases may be gradual, but still negatively impact business sentiment now, along with more regulation. | **Neutral**<br>**Modest negative**<br>Tax increases constrained by Senate, same for spending initiatives, unless recovery still requires stimulus, then infrastructure spending. Negative for growth: Regulations go up on climate, energy, financials. But trade tensions and global uncertainty, especially ex-China, decline. | **Neutral**<br>Deregulation continues, but more uncertainty on trade and global conflicts. Possible infrastructure spending as pure stimulus, but amount is contingent on how economy is recovering. Tax cuts unlikely, but so are tax increases. | **Modest positive**<br>Extension of the tax cuts in the Tax Cuts and Jobs Act more likely than additional tax cuts. Potential infrastructure spending and continued deregulation. Risks: Additional tariffs on China and potentially other countries. |
| **Equities summary**<br>David Lefkowitz, Head of Equities Americas<br>See more detail starting on page 11. | | | | |
| Equities | **Neutral**<br>Fiscal expansion offsets tighter regulation and higher taxes. Negative: Financials, energy. Somewhat positive: Industrials, materials, utilities. Mixed: Healthcare. | **Neutral**<br>**Modest negative**<br>Increased regulation. Positive: Healthcare, utilities, industrials, materials. Negative: Energy, financials. | **Neutral**<br>Renewed trade war is a risk. Positive: Energy, financials, healthcare. Slight negative on trade war risks: Industrials, materials. | **Neutral**<br>**Positive**<br>Additional stimulus but renewed trade war risks. Positive: Financials, energy. Negative: Industrials. |

*Source: UBS*

***How did markets react, and how will they react?***

Historically, stock markets are increasingly volatile in the months leading up to and during an election, as heightened uncertainty around which party will occupy the white house for four years leads to investor speculation.

The first debate covered a range of topics this week, however it was as much about the scheduled topics as it was about personal comments. European stocks initially fell after the US debate, as sentiment took a knock and investors became cautious. However, these losses were recovered upon the release of positive US data. Treasury yields fell slightly lower because of the election jitters, with investors seeking low risk assets in a period of volatility.

Despite polls indicating a Biden win, anything can happen over the next couple of months. Speculation could begin to increase about the possibility of a contested election, and parallels may be drawn to the contested election of 2000. This example highlighted how a close race, coming down to one state and 537 votes, helped contribute to the US recession of 2001. With that being said, it is worth remembering there were numerous unique events which contributed to this recession. Furthermore, the economy and markets are in a different situation now, with a deep but fast recession arguably already having happened.

The method of voting is also expected to add some volatility to markets over the next few months. Due to the pandemic, many Americans may be casting their vote by mail, which has caused speculation that the Democrats will be boosted by this voting method. However, uncertainty could persist as counting votes by mail takes longer, and therefore it may not be clear who has won by the November 4th date. Additionally, President Trump commented "If it's a fair election, I'm 100% on board. But if I see tens of thousands of ballots being manipulated, I cannot go along with that", yet investors have speculated that he may declare ballot manipulation in any scenario where he loses. This situation will undoubtedly spook financial markets if it unravels.

The key upcoming election dates are:

- Second presidential debate, 15 Oct.
- Third presidential debate, 22 Oct.
- Election date, 3 Nov.
- Electoral college reps meet to formally cast votes, 14 Dec.
- Inauguration day, 20 Jan.

***Our view***

The latest developments have not contributed recent market volatility; however, it has signified the beginning of a very uncertain election cycle. The debate demonstrated that the nominees do not see eye to eye on many issues, and there arguably has not been a divide this deep between supporters and rival candidates in recent times. We believe it is too early to identify which nominee will become president, let alone whether it is a blue / red wave or whether it leads to a divided congress. However, if the gap between the two candidates narrows, the chance of a contested election increases, which will make the current outlook even more uncertain.

We continue to expect volatility, and our profit taking on some US positions earlier on in the month were well placed as the economic recovery wanes. It is expected a Biden presidency will reduce economic uncertainty, as he would push increased testing, proactive measures to recover the economy and has highlighted numerous spending packages which will support US jobs and economic growth. However, our portfolios are well positioned for either presidency, as our diverse allocation allow us to look past the short-term volatility and identify attractive positions which will benefit from the global economic recovery.