Market Update: 28th October 2020

A Week To Go Until The US Election

October was dominated by political headlines in the US as the 3rd November Presidential election date fast approaches. Having witnessed two out of three scheduled presidential debates, with one cancelled due to the President's bout of coronavirus, markets followed the historical trend of becoming increasingly volatile around the vote. Legislative gridlock and election uncertainty have largely influenced investor decision making. Additionally, coronavirus cases reached an all-time high this week and jobless claims have been mixed across the nation. Although a Biden win in November could improve the chances of a decisive outcome and hence provide a boost to financial markets, a Trump win could also support US stocks with the continuation of his existing policy stance. This update provides an overview of recent US developments, a comparison of polls between 2016 and 2020, and potential market reactions.

US Political And Economic Developments

Spiking coronavirus case numbers and rising hospitalisations in battleground states could become a key factor in election decision making. This could influence Republican voters in two ways. The first way is the disapproval in President Trump's handling of the pandemic, from his initial denial of its existence to the inability to pass the much-needed stimulus package. It is reported that a proportion of 2016 Trump voters do not believe the President has been taking the pandemic seriously enough, as his contrasting view to scientific advice has seen the death toll reach 232,000 and a total of 9 million COVID-19 cases. This accounts for over 20% of global cases, driven by the nation's lacklustre pandemic approach as well as greater testing capabilities compared to other nations.

Second, the heightened case count is expected to reduce the likelihood of voters casting their ballot in person and increase the likelihood of mail-in voting, the latter of which has been said to benefit the Democrats. Yet, this has been questioned by academics, as studies suggest there's little historical evidence that this is true. Albeit there is a firm reason to believe the 65+ demographic may behave differently in this presidential election. The majority voted for Trump in 2016, however the demographic has accounted for 80% of Covid-19 deaths in the US.

In the mid-west, pandemic outbreaks have driven the recent surge in virus cases to near their respective 2020 record. One of these, Wisconsin, was a key win for the President in 2016 due to its heavily blue-collar population. However, recent polling has shown Biden with a slight but consistent advantage, as Trump's handling the pandemic dropped his approval from 51% in March to 41% in October.

Additionally, the number of jobless claims has been mixed across states. The national unemployment rate dropped more than expected in September to 7.9% from 8.4%, a decline driven in part by a lower labour-force participation rate. 30 states including the likes of Wisconsin and Iowa added jobs in September, which could support a Trump re-election for those who re-entered the labour market.

Several contested states were worse off however, including North Carolina and Arizona. The unemployment rate has historically been key to voter decision making, but it is important that this macroeconomic outlook is different. Without a pandemic benchmark to compare to, it is difficult to determine whether voters view President Trump's labour market as good enough or not.

President Trump has also achieved a significant feat in recent weeks with the confirmation of Amy Coney Barrett's appointment to the Supreme Court. Although seen by critics as improper and illegitimate, the Republicans have cemented a 6-3 conservative majority at the top of the judicial branch of government, which could have a profound consequence for public policy going forward. As an undeniable conservative, appointed at 48 years of age to a lifetime position, she has replaced an undeniable liberal, which has arguably increased the importance of the Democrats securing the next four-year term.

Voting Turnout Picks Up Momentum

As highlighted above, mail-in voting is expected to be significant for this year's election. Americans have already casted more than half the total votes which were counted in 2016, with more than 71 million early votes casted as of this morning. A record number of mail-in ballots are expected to be cast, as voters show intense enthusiasm in the midst of the pandemic. Among the states with the highest percentage of its total 2016 vote already cast so far are Texas at 86.9% and Washington at 76.1%. In the critical battleground state of Pennsylvania, 1.85 million of the more than 3 million mail-in ballots requested have been returned so far, with Democrats accounting for 69%.

Although they have slightly narrowed, polls have continued to point towards a Biden victory. The snapshot below shows the outlook for two highly rated pollsters, YouGov and Morning Consult.

	DATES	POLLSTER	SAMPLE	RESULT				NET RESULT
President: general election	OCT 25-27, 2020	B YouGov	1,365 LV	Biden	54%	43%	Trump	Biden +11
	OCT 25-27, 2020	B YouGov	1,500 RV	Biden	51%	40%	Trump	Biden +11
	OCT 23-25, 2020	B/C Morning Consult	15,509 LV	Biden	52%	43%	Trump	Biden +9

Source: FiveThirtyEight. LV represents likely voters, whilst RV represents registered voters.

As the polls narrow, commentators have begun to highlight a potential repeat of the 2016 election, when polls continued to point toward a Clinton victory until the final week of the election. Despite Biden's national lead shrinking over the past week, the wide margin between the candidates make a repeat of 2016 highly unlikely. After briefly leading nationally by double-digits, Biden's lead is down to 9.5% on FiveThirtyEight and 7.8% on RealClearPolitics, which is still a much, much stronger position than Hillary Clinton was in with one week to go. Hypothetically, if Biden wins the popular vote of about 8%, it will make it highly unlikely for Trump to win the Electoral College votes. Additionally, it is clear that Biden has a stronger lead than Clinton had in Michigan, Arizona, Florida, and North Carolina. Biden's lead is similar to Clinton's in Wisconsin and Pennsylvania, but that can be at least partially attributed to the fact that neither state was heavily polled in the final weeks of the 2016 race since the two were thought to be somewhat safe states for Democrats.

It is possible for Republican voters to come out in strength on the election day and significantly narrow the polls, but many see it as being too tough to make a significant difference to electoral college votes. Alternatively, if we do see a contested race, some commentators have begun to suggest the Supreme

Court may influence the final outcome. Earlier this week, the conservative dominated court rejected Democratic calls to reinstate a six-day extension for the receipt of mail ballots in Wisconsin, one of the battle ground states. Two other pivotal states, Pennsylvania and North Carolina, are awaiting Supreme Court action in cases raising similar issues. A further concern for Democrats is the argument surfaced by Brent Kavanaugh, that Republican-controlled state legislatures could override results certified by Democratic officials. That argument, developed by three conservative justices in the 2000 Bush v. Gore case, says the Supreme Court should intervene in a presidential election dispute even when a state court is interpreting its own laws.

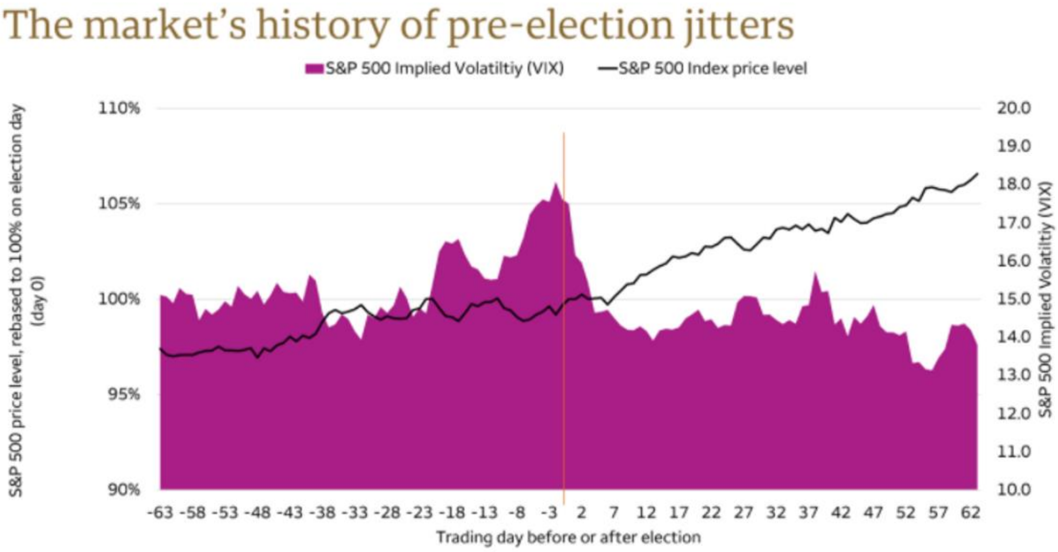
Although it is not clear which scenario will unravel on election day, the points above highlight some of the potential issues that could develop in the case of a contested election, which would drive financial market uncertainty in the near term.

Expected Market Reactions

Since 1932, an incumbent US president has never failed to win re-election unless a recession has occurred during their time in office. A Biden win in a Democratic 'Blue wave', will bring expectations of a large stimulus package soon after the president is sworn in. This will likely be in the $2.5-$3 trillion range, which will provide much needed aid to the 34 million US adults living in households that find it difficult to pay for their usual expenses. This would add momentum to US stocks, which have lagged over recent months. As the large stimulus packages targeting a variety of sectors improve individual wellbeing and those most vulnerable, certain sectors would benefit greatly, such as green / sustainable firms. This is in coordination to the $2 trillion ESG package Biden has said he would push through.

A Trump win, as depicted by JPMorgan strategists, also points towards a boost for American equities. As a result, the strategists believe a Trump victory could push the S&P 500 index higher by 13%, stemming from the momentum of energy and financial sectors. This win would likely result in a stimulus package like the $2trillion package currently being discussed in the weeks following the election.

Both will have contrasting policies in the long run; however, most economists expect the president's policies to remain accommodative to the current needs of the US, with Democrats slightly more so. That being said, the chart below provides an indicator of the level of volatility around the election date, and the S&P500 performance throughout. The key insight from this is that financial markets will typically benefit from increased certainty when a president is inaugurated, regardless of which candidate wins and their long-term policy objectives. That being said, the long run outlook may be best under a divided government for financial markets. Wall Street and the stock market typically like a divided White House and Congress, since it puts the brakes on one or the other. As long as a contested election does not lead to Donald Trump refuting the results of the election, markets should benefit from added certainty in November.



Sources: Bloomberg, Wells Fargo Investment Institute. Average of past presidential election years since 1988, except when recession overlaps with election (i.e. 2008). S&P 500 price is rebased to 100% on the Election Day. Date axis shows the days before and after Election Day. S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market. The CBOE Volatility Index (VIX) is a real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 Index options, it provides a measure of market risk and investors' sentiments. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Our Outlook

The economic and political developments within the US have significantly contributed to volatile markets in the past month, in line with the market's expectations and those expectations we previously laid out in September. In the chart above, the two weeks in the lead up to the election show how the level of volatility as shown in the VIX index abates significantly a week after the election. It is still difficult to identify the outcome of the election, however we see financial markets benefitting from the clarity of an election result.

The number of voters this year is forecasted to be greater than the numbers we saw in 2016, suggesting that Americans are keen on actively participating in who drives political decision making for the next four years. The battleground states are hotly contested; however, polls point towards a Biden victory in many of them, supporting his chance of being inaugurated. Although the previous election makes a claim like this difficult, the difference in the polling results for Biden and Trump has been consistent in recent months, with Biden claiming a wide margin with just a week to go to the election. As a result, the polls may be better guidance this election cycle. Whatever the outcome may be, our portfolios remain well positioned despite the expected short-term volatility, with a potential uplift in US stocks to follow the 3rd November date.