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Market Update: 4th November 2020

US Election Day

Today's headlines are fixated on what could be the highest US election turnout in over a century. The two respective parties have been rallying voters to turnout and cast their vote by the 3rd November, as American citizens have been asked to cast their presidential and congressional nominees. This historically unique election has required an unusually high mail-in ballot count, which had led to our belief that the election outlook may remain uncertain in the following days after the election. As it stands on 4th November the electoral map is notably divided, significantly more so than the inaccurate pre-election polls forecasted. This update will focus on the 2020 election, providing a review of counted votes and those still yet to be tallied, as well as an analysis of the election going forward.

The Election Numbers So Far

Almost 101 million votes were cast early through mail-in ballots, far outstripping the 47 million who voted before the election day in 2016. Significantly influenced by the global pandemic and the desire to socially distance, the US is on track to receive record turnout numbers in over a century. Although the accuracy of forecasts can be questioned, Bloomberg predicts between 157-165 million total votes for the 2020 US election, a possible record.

The current election outlook can be best understood with a brief on how the results are measured. To determine who becomes President, the respective political parties try to earn as many electoral college votes as possible, which are then used to elect the President. The number of electoral college votes vary by state, but it is calculated by adding the two votes for its senators plus a number of votes equal to the number of its congressional districts. To win, 270 electoral college votes are required.

The US congress is split into the Senate and the House of Representatives, both of which conduct law making, perform oversight and represent the public among other things.

US senators serve six-year terms, which means that roughly a third of the 100 Senate seats are up for grabs at each federal or midterm election. 35 seats are up for election this year, 12 held by Democrats and 23 held by Republicans. 50 seats are required to control the Senate.

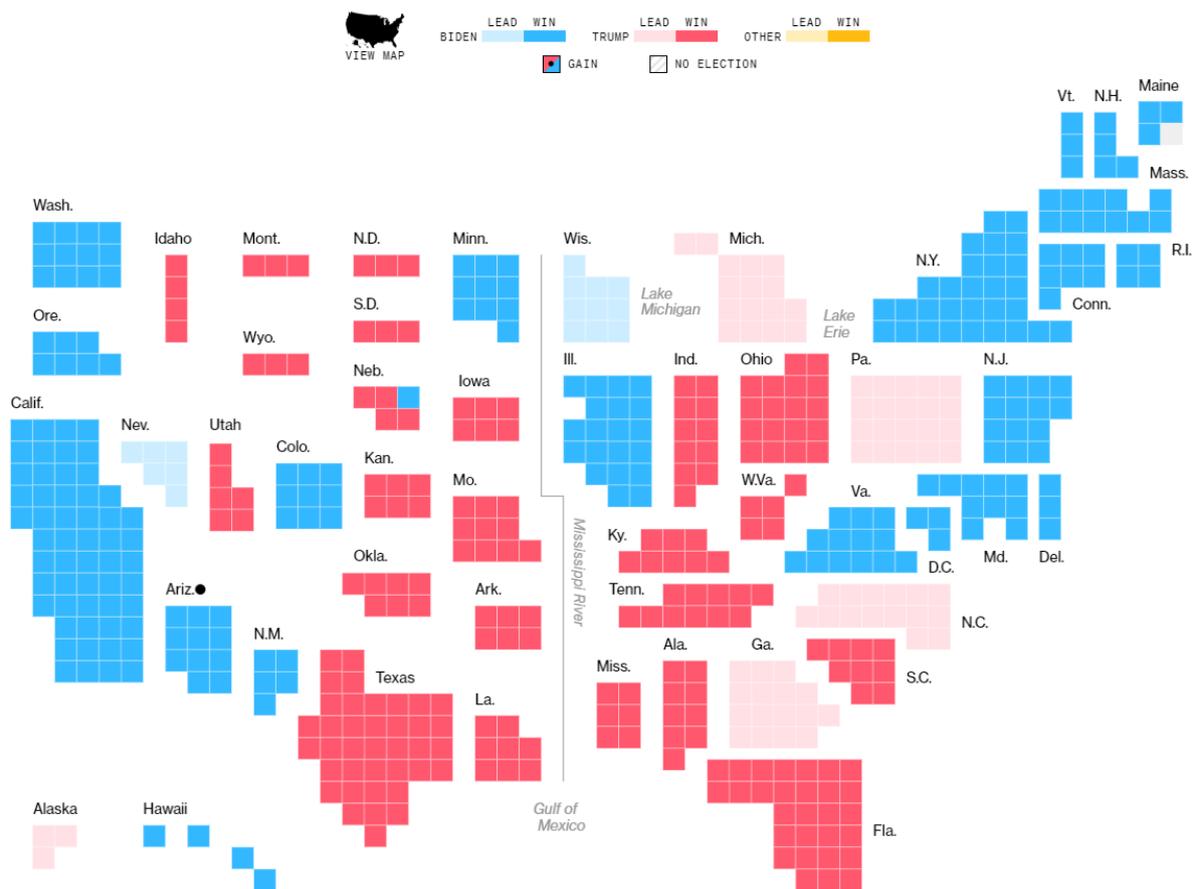
All 435 of the seats in the House are up for election, where they serve 2-year terms. To control the House, 218 seats are required.

As of writing, 135 million votes had been counted. The current results are the following:

- The electoral college votes stand at 238 to 213 for Democrats to Republicans, with 270 needed to be elected to the White House.
- In Congress, the Senate results currently stand at 47 to 47, with 50 seats needed for a majority.
- Additionally, in Congress, the House of Representatives stands at 188 to 181 for Democrats to Republicans, with 218 needed for a majority.

Based on the current standings, the electoral map below provides an understanding of the distribution of results across the US.

The Electoral Map



Note: In addition to awarding electoral votes to the winner statewide, Maine and Nebraska award an elector to the winner in each congressional district.

Source: Bloomberg

On the map above, each cube represents an electoral college vote, with the deep blue and deep red illustrating they have already been allocated to either Democrats or Republicans. As such, there are a number of states which are yet to declare who has won, and it must be remembered that those already determined as Democrat and Republican could change when the total number of votes have been counted.

Paths to Victory and Expectations

With 270 electoral college votes needed, both candidates are required to pick up the key battleground states. Currently, Joe Biden is leading in Nevada, which was expected to be Democratic but remains narrower than initially expected. He is expected to continue to hold the state. From the electoral map, it appears that Trump is leading in key battleground states such as Michigan, Pennsylvania, Georgia and North Carolina. That being said, this may be misleading given the type of votes which have been counted so far. In our update last week, we highlighted that a higher proportion of Republicans were expected to vote on election day, whilst a higher proportion of Democrats had opted in to mail-in voting. Subsequently, it seems likely that Republican votes have already been counted, with mail-in ballots expected to be counted over the following days. Although this is only representative of Pennsylvania, 64% of mail-in ballots are from registered Democrats, as compared to 23.44% from registered Republicans. As such, the Republican leads in many of this battle ground states will narrow and possibly flip to Democrats.

Although highly unlikely, there remains at least four ways the electoral college count could still end in a 269-269 tie. At this point, according to the 12th amendment, the newly elected House chooses the president from among the three leading candidates according to the electoral college vote. The new Senate, meanwhile, gets to pick the vice-president, also among the three leading candidates after the electoral college votes. This will remain in the back of investor minds as this election becomes increasingly contested.

In terms of reaching election results, Pennsylvania will not have counted its total votes until Friday this week, and the earliest Michigan will announce its results is by Wednesday night or Thursday morning. Hence, we are not expecting certainty until the end of this week.

Financial Markets and Uncertainty

A startling survey by YouGov of 1999 registered voters in October found that 47% disagreed that the election 'is likely to be fair and honest', with 61% worried the US could be on the verge of another 'civil war'. As the potential for a contested election increases, both financial markets and American citizens may become increasingly concerned, as demonstrated by the numerous businesses boarding up its windows in the run-up to election day.

Prior to the election, individuals highlighted the possible scenario which would see a presidential candidate declare victory prior to the official count being completed. Despite Trump's attempts to reassure the public that this would not happen earlier this week, the current president surprised markets by announcing that "Frankly, we did win". Alongside this, Donald Trump also announced his desire to stop counting votes due to 'fraudulent' accusations. It is not surprising to see the current President taking this stance with his current lead in the undetermined battleground states, yet his announcements solidify the belief that a growing wave of Democratic votes are expected to be counted in the next few days. His recent success in appointing a Republican Supreme Court judge has driven his claim that the Supreme Court should rule against counting the remaining votes.

As highlighted last week, the VIX has historically reached its monthly highs in the days leading up to election day, where it then decreases as certainty improves due to a clearer presidential picture. This year is no different, with the VIX reaching its highs of 40.28 by 28th October, where the volatility measure has since reduced to 33.17 as of 4th November. As such, going forward, we continue to see financial markets benefitting from a clearer presidential picture and an idea of the incoming president's policy objectives.

Our View

Our analysis last week highlighted that the pre-election polls pointed towards a Biden victory, however his lead was reducing in the days leading up to the election. As it currently stands, the Democrats are positioned to retain the House of Representatives, whereas the Republicans appear as if they could pip the Democrats to 50 seats in the Senate. As such, a democratic blue wave currently is unlikely, with expectations that a divided government will be elected. As last week highlighted, Wall Street will prefer a divided government, due to the ability for each party to put the brakes on one or the other.

The electoral college outlook will be of most interest to financial markets. As such, with impending Democratic mail-in votes, we see a narrowing of Trump's lead in key battle ground states, improving the odds of Biden becoming elected. Despite this, Trump's Republican party may maintain momentum, or, in the case of a contested result, Trump could declare himself victorious. A clear winner by the end of the week would be of most benefit to financial markets. Although we do not see financial market uncertainty declining completely, we see a positive momentum for stock markets going forward from next week onwards.

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