CURRENT MARKET NEWS

The focus narrows, but too close to call

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Election night clarity was probably too much to hope for. As of the early hours on November 4, key states including Georgia, Pennsylvania, Michigan, and Wisconsin remain too close to call. A few other states also fall into this category but are leaning more clearly in one direction (e.g., North Carolina for Trump and Nevada for Biden). In the four remaining battleground states, the outcome is coming down to *which* counties within the states have large amounts of uncounted votes – urban or rural – and how far along mail-in ballot counting has progressed. States such as Pennsylvania, for example, have seen mail-in ballots requested by registered democrats at a 3-to-1 ratio over registered republicans[1].

As an indication of how quickly results can change, Trump's sizable lead in Wisconsin vanished when Milwaukee turned in its votes early this morning. Complicating matters is that Pennsylvania's mail-in vote counting is expected to take multiple days and is already behind schedule according to reports. One or more of these remaining states could have recounts or other court challenges. Equity futures, along with overseas betting markets, have gyrated throughout the late evening and early morning hours which continues to indicate a close race.

The other election result we are watching closely is a little clearer – the Senate will not swing decisively to the Democrats. The blue wave that some were forecasting to sweep through simply didn't rise. That development narrows the possible outcomes to Biden + a Republican or narrow Democratic majority Senate ("Republican leaning") or the status quo of Trump + Republican Senate. In the status quo scenario, although Trump has not laid out detailed plans for a second term, we can expect more of the same – deregulation, tough trade policy on China (that may extend to Europe as well), and a push for fiscal stimulus.

Under the other scenario – a Biden presidency plus a Republican leaning Senate – we would expect gridlock to ensue on major policy initiatives. A moderate Senate would put an effective halt to Biden's major tax and health care proposals. Similarly, Biden's enormous spending package -- $5 trillion over 10 years – is likely reduced in the face of a Republican-controlled Senate. And, not to be forgotten, the still under negotiation COVID stimulus package may end up coming in much closer to the lower end of the range favored by Senate Republicans rather than the $2+ trillion Democratic House proposal.

Despite the halt to sweeping legislation, the possibility of a Biden presidency would still bring changes. Stricter environmental regulation would affect a host of industries and accelerate renewable energy development. For the finance industry, expect tighter risk management guidelines. More aggressive anti-trust enforcement could also slow M&A activity across the economy, and additional technology sector scrutiny is likely to offset some of the secular forces that favor large cap tech. These considerations, however, are primarily sector-specific rather than market-wide issues.

A Biden win would almost certainly reduce trade policy tensions, and Europe in particular is a beneficiary relative to the expected approach under a second Trump administration. Conventional wisdom has been asserting that the path forward with China trade relations would continue to be highly contentious under a Biden presidency. This may be true in the near-term, but we believe that U.S.-China frictions would gradually lessen under a Biden administration and the focus will pivot toward environmental commitments rather than additional measures to restrict China's growth. On net, we regard the possibility of a Biden presidency as supportive for Chinese assets and investments, and a Trump presidency a headwind for these same investments. In the short term, a Biden presidency may also disappoint markets that appear to have priced in greater expectations for fiscal spending.

As a Republican leaning Senate will rein in larger spending initiatives, neither presidential outcome is likely to see sharply rising long-term interest rates driven by near-term economic growth. Long-term trends such as reduced capital intensity, technological innovation, and aging demographics will also limit the impact of any additional fiscal spending. That said, under a Trump presidency + Republican Senate, we would expect greater potential for fiscal stimulus and a somewhat sharper cyclical upturn than under a Biden + a Republican leaning Senate scenario. Trump also has a greater chance at passing an additional COVID relief package during the "lame duck" session of Congress. On net, the Trump presidency scenario lends itself to a more favorable growth profile, modestly higher interest rates, and better environment for taking equity risk.

In both scenarios, core fixed income remains a recommended underweight, but is even less attractive under the Trump presidency as the return expectation would diminish due to the prospect of marginally higher rates. Also, it is worth noting that regardless of the eventual outcome we continue to be optimistic on vaccine developments to reinvigorate economic growth later in 2021.

[1]Associated Press, 10/13/2020

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