Webcast Summary:
U.S. Election Watch - The Final Countdown

Michael P. Stritch, CFA, Chief Investment Officer, BMO Wealth Management - U.S.

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The U.S. election is in the home stretch, but this has been an election season unlike any other. Given how quickly circumstances can change, as well as the outstanding Senate races, there's still plenty of uncertainty. From an investment perspective, it's a tricky terrain to navigate.

To get a sense of where we may be headed, I recently hosted an online discussion with a pair of experts on the intersection of politics and markets: **Matt Gertken,** Geopolitical Strategist at BCA Research, and **Marko Papic,** Partner and Chief Strategist at Clocktower Group, also the author of newly released **Geopolitical Alpha: An Investment Framework for Predicting the Future**. Among other topics, we discussed the ramifications of the ongoing stimulus negotiations, how the markets could respond to various scenarios, and why taking a dispassionate, unbiased approach to politics and policy is beneficial to investors.

Following is a summary of our conversation.

Fiscally Speaking

For Gertken, the lack of an agreement on a stimulus bill has been the biggest surprise leading up to this point. *"I thought it was pretty clear that the Republicans going into the final months of the campaign would go ahead and provide that fiscal relief and just agree to a higher price tag than they really wanted in order to give a boost to themselves and the president ahead of the election,"* he said. *"I figured Republican voters might be angry about large budget deficits, but they're really going to be unhappy if there's a blue Democratic sweep and the Republicans are pushed out of office. So it's been surprising to me how much trouble Republicans have had negotiating that deal."*

Since our last conversation, House Speaker Nancy Pelosi and Treasury Secretary Steven Mnuchin have continued negotiating on a deal. Papic noted that financial markets have lately been dominated by fiscal policy. That's certainly been reflected in some of the recent swings driven by the prospects of a new round of stimulus.

"When interest rates are at zero for the foreseeable future, and when you have this sort of Jackson Hole consensus[1] where the Federal Reserve says we're good with higher inflation… the policy fulcrum for an investor has to become fiscal plans," Papic said. *"Focusing on the Fed minutes or this or that speech by this or that FOMC member it just doesn't matter anymore."*

Papic did note, however, that there is a scenario in which the markets shrug off a possible collapse in phase four stimulus negotiations. *"What happened in September is that the odds of phase four collapsed but 'blue wave' odds went up. The market started to rally even though the odds of phase four went down, and the reason for that is that the odds of united government behind Biden that would allay the market's fears about fiscal thrust in 2021, those probabilities went up. The market can look through short-term disruptions, such as a phase four failure, but it would then have to be satisfied on the back end that 2021 would see a much larger fiscal thrust."*

Impact on Markets

We conducted a flash poll during the conversation, asking participants whether the winner of the election would have a significant impact on market performance. Nearly 60% of respondents said it does matter. Gertken agreed with that assessment, particularly in light of the contrasting approaches to international trade from Trump and Biden. Noting that the U.S. has long been hesitant to interfere in free markets, Gertken said the country is now in a more interventionist role.

"I do think Biden will still have some elements of protectionism, specifically on China," he said. *"But the risk of a global trade war where, say, the U.S. could put tariffs on Europe as well as China, I don't think that's very likely under Biden. So I think in that respect there is a risk to the stock market, particularly because President Trump uses these broad-based tariffs, and S&P 500 companies get as much as 40% of their earnings from abroad."*

Papic, on the other hand, believes that while there is a stark difference in terms of short-term market impacts, the winner of the election won't have a significant effect through end of the presidential term.

[1] International Monetary Fund

"I think that, over four years, that there are two trends that are so powerful that both Donald Trump and Joe Biden would have to respond to them," he said. *"The first is that the median voter seems to be shifting left [on] economic policies—including Republican voters, who six or eight years ago were not happy with budget deficits being expanded. Today, there's no real constituency that's extremely worried about that. And the second thing is deglobalization. That's also a structural trend, and I think Biden would struggle to push against it."*

Papic also believes that the market hasn't properly priced in the possibility of a divided government—that is, a Biden presidency with a GOP-controlled Senate. *"There is this complacency because gridlock tended to generate higher annual returns for the S&P 500. Since 1980, if you look at the annual performance of the S&P 500 based on the distribution of power, unified government has actually underperformed gridlock. But I think we're in a different paradigm. If you look at 1930 to 1980, unified government significantly outperformed gridlock. I think we're back in that world where policy really matters. I think fiscal policy matters more, and that's why I would be bearish in that divided government outcome, at least until the Republicans in the Senate capitulate [on a stimulus bill]."*

Then there's the issue of when we'll get the final election results. The COVID-19 pandemic has increased demand for mail-in voting, which could delay the declaration of a winner. There's also the possibility of a candidate contesting the results. Any uncertainty on that front could have a negative impact on the markets.

"If the polling doesn't tighten between now and the election, then I think it could be a pretty clear answer in favor of Joe Biden," Gertken said. *"But you're starting to get some tightening—in Florida, maybe in Pennsylvania—and that could then translate to some other [swing] states as well. If that's true, and if President Trump does well in the third debate and we do get a stimulus package, then you get tighter margins in the swing states, and you can have one or more swing state where the legal battles really get out of control in November."*

"You've got to see whether there's a clear result in the first week after the election," Gertken continued. *"If not, that means we could have a month of volatility because December 14 is when all the Electoral College members across the country have to vote, and states need to get their answers by that date. If they haven't wrapped up their own internal disputes by that time, then they won't get an Electoral College vote. So the states are going to have to do battle internally. If any of those disputes go beyond that, and if they're actually relevant to the threshold of getting a majority in the Electoral College, then we have to wait till January 6 for the counting of the votes, which has never in history truly been contentious. I do think it's fairly likely if the race tightens, that we will have November and December filled with volatility until we get to that Electoral College voting day on December 14."*

An Unbiased Approach

For a variety of reasons, it's been an especially intense election year. It's easy to get caught up in the noise and passions that come with politics. From an investment perspective, however, Papic emphasized the need to remove bias from one's decision making. Rather than focusing on what policymakers say are their preferences, Papic advised to focus on the material constraints they face.

"This isn't to say that the preferences of politicians don't matter, it's just that we cannot have a statistically significant view of what they truly are," he said. *"What I always say is that preferences are optional. They can be acted upon or not, and they are subject to constraints. Whereas constraints are neither optional nor subject to preferences. So, the investment-relevant method of political analysis is to focus on the material reality that surrounds policy makers and that will force them into the path of least resistance."*

Papic returned to the stimulus negotiations as an example. He pointed out that whatever the rhetoric from the Republican side, the fact is Trump's reelection chances likely diminish without the passage of a stimulus bill.

"By focusing on constraints you can really meditate on your biases," Papic said. *"Whatever the outcome in November, you can sit down very objectively and start to ask yourself: Does the winner control both houses of Congress? What could pass given a slight edge in the Senate? What can be done in foreign policy? When you focus from the material constraints side, you can reduce the biases in your own analysis, which is so important in this day and age. If you get passionate about politics, given how important politics is to generating alpha, you can really be led astray."*

To hear the full discussion, including a review of the potential market reaction to several election scenarios, please find the webinar replay here: **Election watch: Final countdown.**

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