Election 2020: Assessing the market impact

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With the nominating conventions in the books, the campaign season is officially in full swing. So it's a good time to take a look at the U.S. election's potential impact on future policy direction and the possible market implications.

I recently spoke with Matt Gertken, Geopolitical Strategist at BCA Research, a Montreal-based global investment research firm. Among other topics, we discussed the prospects for another round of fiscal stimulus, the importance of key Senate races, and why political gridlock is good for markets.

Following is a summary of our discussion.

Another round of stimulus?

It was widely assumed that a second fiscal stimulus package would have been passed by now. But the White House and congressional Democrats have been at an impasse on key details. It's a situation that Gertken said could lead to market turmoil.

"I'm not surprised it was delayed a little bit, but I am surprised at the Republicans were willing to delay all the way into September," he said. *"If they fumble the ball here, financial markets would be very concerned. I would be very surprised if they delay this beyond mid-September. I think that could be a debacle."*

House Democrats passed a $3.4 trillion bill in May; Senate Republicans countered with a much smaller package. A compromise of around $2 trillion appears to be on the table right now, though Gertken had expected that figure to come in a little higher. *"Because every time the Republicans and Democrats in this Congress have gotten together under Trump's watch, they've ended up with very large spending bills."*

Gertken added that any market volatility caused by the lack of a stimulus bill would likely spell trouble for Republicans on Election Day, and that should provide enough of an incentive to come to an agreement. *"I think it would be a policy mistake for the Republicans,"* he said. *"But I think the Republicans know that and I think they'd be in trouble if they didn't get something passed. So they're going to be moving forward."*

All about the Senate

While the winner of the presidential election is obviously of great importance, from a market perspective, the outcome of several key Senate races matters just as much. Republicans currently hold 53 seats, but several races are in play that could flip the majority to the Democrats, who are expected to hold their majority in the House of Representatives.

Gertken said that whoever wins the presidential election, maintaining at least one oppositional chamber of Congress would be the best outcome for markets. That's because the political gridlock would keep a check on actions from either Donald Trump or Joe Biden that could adversely impact financial markets.

"If Trump is constrained by a Democratic Senate or Biden constrained by Republican Senate, then investors have reason to cheer," Gertken said. *"If voters keep Trump and yet the Democrats win the Senate, then Trump would be constrained by the ability of a united Congress to prevent him from acting aggressively on trade and tariffs. Similarly, if Biden were to win but the Republicans kept the Senate, then he wouldn't be able to raise taxes."*

In the event that Democrats sweep the White House and the Senate, Gertken pointed out risks that could impact the healthcare and fossil fuel energy sectors. *"What would come with the Democratic Senate and White House would be a huge shift in public provision of health care insurance,"* he said. *"Also, I think there's a pretty good chance that the Democrats would remove the filibuster, which would then open up the ability for them to pass some pretty significant laws in other areas, potentially even on climate change."*

Gridlock is good

Anything can happen in the next two months, so it's still too early to tell where the elections are headed. Equity markets have rallied steadily since cratering in the early days of the pandemic. To that end, Gertken believes the market is currently trading in line with presidential elections that result in gridlock.

"On the whole there is a headline risk to markets from a Democratic sweep," he said. *"Typically, if you do have a clean sweep and a government change, you get a market pullback either right ahead of the election—like in October—or right after the inauguration. But with other elections we've seen, let's say there's a gridlocked outcome, any pullback would usually be in the spring, or even next fall. And this is looking at elections ever since World War II. There's more upside risk if it's a gridlock situation."*

With that in mind, Gertken offered this prediction from a market perspective. *"I think strictly speaking for the markets, Biden winning with a Republican Senate is the best outcome,"* he said. *"His foreign and trade policies will be more predictable. Meanwhile, it would remove a lot of what Biden would try to do on the tax front, so it's hard for me to see that the market wouldn't be particularly excited by that outcome."*

Along with covering these topics in greater detail, Gertken and I also discussed the odds of a Trump or Biden victory, the federal budget deficit and what would happen in the event of a contested election. You can listen to the full conversation here: Geopolitical Market Outlook featuring Mike Stritch, Chief Investment Officer, BMO Wealth Management and Matt Gertken, Strategist, Geopolitical Strategy, BCA Research.

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