Special Coverage:

US Elections: Positioning your portfolio for the polls

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The US Election season is now well underway, with Congressional and Presidential elections set for 3 November. Their outcome has the potential to shape the policies of the world's largest economy, with a knock-on impact for financial markets.

As things stand, the result is far from certain, and may ultimately depend on a few "swing states" that together decide the election. Voter participation levels, particularly in light of the COVID-19 pandemic, may also play a key role.

What is certain is that stock markets dislike uncertainty, and that's one of the reasons why they have become more volatile recently. Markets also fear higher taxes and increased regulation - arguably most likely in the event of a Democrat "clean sweep" (with the party gaining both the Presidency and the Senate, while retaining control of the House). However, it's unclear how probable this scenario is.

Until the result is confirmed, we think the prudent course is to position one's portfolio for short-term volatility. In particular, that means diversifying across asset classes, including high quality bonds and gold.

Once the elections are over, we expect equities and credit markets to be buoyed by the ongoing economic recovery, as well as by support measures from central banks and fiscal authorities. We're therefore maintaining our tactical overweight position on global equities, investment grade bonds and EM hard currency bonds, all with a 3-6 month horizon.

Key dates

22 Oct – Scheduled third US presidential debate

3 Nov – US presidential and congressional elections

14 Dec – Electoral college representatives formally cast votes to elect the US President

20 Jan – Inauguration Day: President-elect formally sworn into office

The US Elections: three things to look out for

1. **Polls currently give Biden a substantial lead over President Trump.** However, voter attitudes vary and shift, and it's important to note that a candidate needs to achieve a majority of the Electoral College vote, rather than of the popular vote. These two measures often differ, with many smaller rural states receiving more Electoral College votes per inhabitant than the larger coastal states. This often creates an advantage for the Republican party.
2. **The election may be decided by the "swing states".** In many states, there is a clear majority for one of the two candidates. In others, however, the result may depend on just a few thousand votes swinging to one side. Because of this, the results in Florida, Pennsylvania and Wisconsin could well decide the election. The outcome in these states and others will largely be a function of voter turnout (especially among Latino and Black populations), as well as the state of the job market, the evolving COVID-19 situation, and how the country reacts to President Trump's own illness.
3. **Unlike previous elections, the result may not be decided on election night.** This is because many ballots are likely to be sent by post, which takes time to process. Meanwhile, in some states the result may be extremely close, creating a chance that the overall US Election result might be contested.

Why does the election matter?

In the short term, the election causes uncertainty about future policy direction. Markets don't like uncertainty, so expect continued volatility in the run-up to the vote. This may even continue for a few days after the election if authorities need more time to determine the final result. Should the result be contested – a possibility if the numbers are close – then volatility may linger even longer while the relevant appeals take place.

In the longer term, the election outcome will affect policy in the world's largest economy, with financial implications for several US industry sectors (more detail on this in the next section).

Three potential outcomes

Realistically, we believe there are three possible outcomes. The fourth, a Republican sweep, is considered highly unlikely as Democrats are expected to keep control of the House.

1. **Status quo: Victory for President Trump, with a split Congress.** In this scenario, everything remains the same. This would be the most positive outcome for financial markets, simply because it provides the most continuity and clarity around policy.
2. **A Biden victory with a split Congress.** Expect a small negative impact for markets short-term. Biden is an advocate for higher taxes and greater regulation of key sectors like technology so markets may react negatively immediately. But fiscal stimulus may also increase, boosting the economy and helping markets recover. Moreover, if Republicans keep control ofthe Senate, many of Biden's current proposals may not be approved by Congress. This "gridlock" could ironically be good for markets in the months following the US Elections, since Biden's planned changes to the tax and regulatory environment would be more restricted and markets can focus instead on a strengthening economy supported by fiscal and monetary measures.
3. **Democratic Clean Sweep: a Biden Presidency with a Democrat-controlled Congress.** This would initially be negative for financial markets, but they could soon rebound (after an initial bout of volatility) if spending is raised to stimulate the economy.

The investment implications of each scenario

1. **Trump victory:** positive for US domestic stocks, the energy sector and high yield bonds.
2. **Biden victory:** positive for European stocks and green investment themes.
3. **Technology stocks:** we are optimistic about tech stocks in either scenario. Even with a Biden victory, we think regulation will take time to materialise, while the accelerated digital adoption among businesses and consumers continues to make technology companies attractive. Overall, tech stocks have been volatile in recent weeks but we see recent profit-taking as temporary.

The situation is fluid, but likely outcomes include:

A Democratic win: Expect markets to react negatively in the short-term because of expected tax hikes and more stringent regulation. However, a bounce back may happen relatively quickly as authorities will be focused on stimulating growth to continue the recovery.

	Biden Victory; Split Congress	Democratic Clean Sweep
Overall risk sentiment	• Small & temporary negative impact for markets short-term but markets to recover on basis of economic recovery • Mild pickup in volatility	• Negative for markets initially but could recover if more government stimulus is introduced • Pickup in volatility (at least temporarily)
Tax	• Tax hikes would be negative for risk appetite, though not easy to implement amid an already vulnerable economy or a split Congress	
Sector impact	• Despite possible tougher regulation, the structural growth of the technology and healthcare sectors is expected to remain • Biden wants to spend $1.7trn on green tech in the next 10 years and reach net zero emissions by 2050 – a positive for green investment themes, and a negative for the oil sector	
USD	• USD is most likely "range bound"	• USD could see a partial reversal of its recent weakening due to risk-off mode
"Safe-haven" investments	• Risk-off sentiment would be positive for these assets	
Credit	• Minimal change expected • Risk-off sentiment could mean a minor sell-off leading to slightly higher yields • A Democratic victory could lead to more regulation for financials and a widening in US HY spreads, led by the energy sector	

A Republican win: US equities should respond positively if the status quo prevails at the White House, although risk-on sentiment could be negative for gold and US Treasuries.

	Status Quo: President Trump Victory; Split Congress
Overall risk sentiment	• Positive for risk appetite • No large change in volatility
Tax	• Tax cuts would be positive for risk appetite, though not easy to implement with a split Congress
Sector impact	• Technology should benefit from a reversal of recent rotation and profit taking • The healthcare sector should benefit from continued structural growth
USD	• USD is most likely "range bound"
"Safe-haven" investments	• Risk-on sentiment would be slightly negative but any sell-off in US Treasuries, for example, should be supported by central bank support • However, central bank support should limit any sell-off in the Treasury market
Credit	• Minimal change expected • High yield bonds up (possible) due to risk-on sentiment and oil sector support

Stay positive and stay invested: It's all about the economy

The 2000 and 2016 US Elections taught us that short-term volatility around the elections is probably inevitable. It's still important to look through the noise however, because it's ultimately the longer-term strength of the economy that will drive market performance.

Although COVID-19 has stifled economic activity so far this year (our global GDP forecast for 2020 is -4.1%), we're expecting a 4.7% rebound in 2021. If consumer confidence picks up thanks to a viable treatment or vaccine, growth could push even higher. With consumption currently weak, analysts' expectations still remain low, giving rise to the potential for positive surprises.

Meanwhile, continued low interest rates, along with a willingness among governments to stimulate their economies through fiscal policy, encourage us to stay positive on riskier assets like equities, investment grade bonds and EM hard currency bonds. This, of course, assumes that clients can look beyond the expected short-term volatility.

In our opinion, clients shouldn't try to "trade" the US Elections by guessing the election outcome. Why? Because most of the time, timing the market correctly is virtually impossible. Our preference is to remain invested and position your portfolio for the range of potential policy outcomes, while managing short-term volatility through diversification.

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