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INVESTMENT VIEW

The US Election: A tight battle is now a waiting game

As was always possible, we didn't get a result on the US election night. While both Republican President Donald Trump and Democrat challenger Joe Biden have stated they're confident of victory it may be several more days until we have an official outcome. As the world watches and waits intently how will financial markets react?

Why was no winner declared on the night?

While a clear winner can usually be declared on the night of the election, this fiercely fought contest is still down to the wire at the time of writing. More Americans have voted by post because of the COVID-19 pandemic and this has caused a delay to counting as it's a more involved process to verify votes, such as checking signatures and addresses. Only some US states, such as Florida, can start checking postal votes before the election day.

While Biden is currently behind in some states there are still lots of postal votes to count and in general more Democrats have voted this way than Republicans. In addition, half of US states will accept postal ballots that arrive after election day if they're postmarked prior to 3 November 2020, but these votes may not be counted until many days after the election.

There may also be legal challenges and President Trump, often a critic of postal voting, is now saying that the election outcome could end up in the US Supreme Court.

Republicans have done much better than expected in both the Senate and the House of Representatives with the Democrat House majority whittled away and Republicans likely to have a thin red line majority in the Senate. We will very likely not know the final makeup of the Senate until January 2021, when one of the two Senate seats in Georgia holds a runoff election, though at the moment projections are for a one-seat Republican majority.

How are investment markets responding to likely gridlock?

Whatever the outcome, the Democrats didn't achieve the resounding rejection of 'Trumpism' that they, and the pollsters, had expected. Like the markets, we expected a thin Democrat sweep of the Senate and the Presidency. Signs that the markets had moved to this view and expected better growth prospects on the back of a larger fiscal deficit and possibly higher taxes were the sharp increase in longer dated bond yields and a rotation from technology to more value orientated stocks. As the results rolled in, and didn't support the Democrat program, the bond market very quickly rallied as the scale of fiscal deficits were wound in.

What may happen now?

At this stage, we think the most probable outcome is a paper-thin Biden presidency with a thin red line Republican Senate majority gridlock. This may be good for markets as tax cuts are more likely and the Democrat tax hikes will be off the table. The Democrat program is in tatters, but Biden may be a more conciliatory and steadier President if he is elected, particularly on the trade and foreign policy issues that have bothered markets under Trump's Presidency.

Overall, we consider that initially growth stocks will continue to be favoured relative to value stocks as the fiscal expansion is likely to be more modest. A more restrained spending program, rather than large deficits, is also likely to support the US dollar.

Bond markets have already priced in a gridlock on fiscal stimulus with a large rally across longer-dated securities and shares are adjusting as growth stocks rally on lower yields and possibly further US Federal Reserve support. If the final outcome is as we expect, Biden is likely to be more supportive of emerging markets as the trade rhetoric will be wound back. For Australia there are few direct implications other than a likely more steady regional policy.

At the time of writing, a Republican sweep of the Senate and the Presidency remains a slight possibility. This outcome would support markets, but the main risk would be a more uncertain and disruptive trade and foreign policy which would potentially be more unsettling for emerging markets.

What should investors do?

Whatever the outcome, it is likely to be a short-term impact as market expectations are re-set to expect a gridlock on any additional stimulus spending. Ultimately returns are driven by earnings and at this stage the earnings outlook for 2021 has improved sharply from a very low base in early 2020. However, clearly the impacts of the COVID-19 pandemic will continue to hang over markets once the election headlines settle.



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