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US election volatility

Market Comment, October 2020

One of the most momentous political events is approaching: the United States of America is about to elect its next President and a new House of Representatives, along with part of the Senate. The Democratic candidate, former Vice President Joe Biden, is heading into this electoral battle with an agenda that tends towards the social democratic/green end of the spectrum, whereas Donald Trump is campaigning on the basis of conservative positions such as less regulation and tax cuts. True, electoral promises often fall by the wayside after the election itself, but the different plans of the two candidates are still relevant. From the investor's perspective, in the event of no clarity emerging over the actual winner, US equities could remain volatile for weeks, while economic activity could be influenced by uncertainty.

The coronavirus crisis made it abundantly clear that the United States of America requires calm, objective and capable leadership. In particular, many older voters who plumped for Donald Trump four years ago have been heavily affected by the pandemic crisis, and are hoping for an expansion of the US healthcare system and hence health insurance – historically an important issue for the Democrats. As the US Senate (which represents the federal states, rather like the Council of States in Switzerland) is even more important than the House of Representatives when it comes to implementing US legislation, and as 35 of the 100 Senate seats are up for re-election (23 of which have Republican incumbents compared to just 12 for the Democrats), it is crucial which party ends up with a majority here.

The Democrats have used the social unrest that unfolded in June 2020 to put social inequality high on the political agenda, along with climate protection. One issue that could prove particularly damaging for Donald Trump – just as it did for many of his predecessors – is the rise in US unemployment. According to the various surveys, the Democrats currently have an approximate 60-65% chance of gaining control of the Senate and occupying the White House. However, we have seen plenty of elections in recent years – not least during the Brexit referendum of 2016 – where surveys failed to prove reliable indicators.

The electoral programme of the Republicans under Donald Trump is all about putting "America first": an uncompromising stance vis-à-vis China, less immigration, lower taxes for higher earners, and above all a low tax burden for companies. Corporate earnings have developed much more impressively in the US than in other regions thanks to Donald Trump's decision to cut corporate taxes by around 15%. However, his aggressive approach in the trade conflict with China has also resulted in greater volatility in global equity markets due to rising political risks. In the event of a Republican victory, Donald Trump could continue to pursue – or even intensify – his current policy towards China, which in turn could impact the equities or currencies of the **emerging markets**.

The Democrats meanwhile are putting greater social justice and the need for climate protection at the heart of their electoral campaign, with plans to reduce US carbon dioxide emissions, channel government funding into renewable energies, and impose additional taxes on US companies and wealthy individuals.

> "Our focus modul "Equities Global Impact" is an interesting way of preparing for political change and supplementing an existing portfolio."
>
> Gérard Piasko, Chief Investment Officer

The coastal regions of the US, which include the major urban clusters of California, Boston and New York, are traditionally Democrat-leaning, whereas more rural states tend to have a strong Republican base. For their part, the so-called swing states of Florida, Michigan, Ohio, Pennsylvania and Wisconsin have frequently been the deciding factor in US elections, and are very difficult to predict. Donald Trump's clumsy response to the protests of last

June and to the coronavirus crisis have resulted in Joe Biden becoming the slight favourite in this election.

A rise in volatility in both **bonds** and the **US dollar** in the event of a Democratic victory would not surprise us. This would be particularly true in the event of the Democrats gaining a majority in the Senate too. An increase in government expenditure on renewable energies, social justice or healthcare could lead to higher yields on government bonds. On the other hand, increased tax receipts due to higher taxes could later have the effect of lowering them again. For that reason, the aspect of **quality** remains important in the fixed-income market.

Where **equity markets** are concerned, the planned tax increases and potentially greater regulation of the dominant US technology giants or the financial sector could lead to a phase of high volatility in the event of a Democratic victory. Banks and oil companies could be more affected by higher taxes and an increase in regulation than other sectors of the US economy. It could therefore make sense to be more conscious regarding US equities in favour of their European counterparts.

By contrast, a more balanced distribution of power in the US would be an interesting electoral outcome: If one party were to hold the White House and the other the Senate, it would be difficult to push through radical ideas. However, a very close result that triggered legal disputes and possible social unrest would be a negative for the financial markets.

Many of the ideas put forward by the Democrats have the potential to support growth in the area of infrastructure/climate protection/renewable energies thanks to greater government expenditure. For that reason, gaining exposure to forward-looking, innovative companies (including a focus on climate protection), e.g. through our **focus module "Equities Global Impact"**, would be an interesting way of both preparing for political change in the US and supplementing an existing portfolio.

Gérard Piasko

Gérard Piasko is CIO and head of the investment committee of private bank Maerki Baumann & Co. AG. Before he was for many years CIO of Julius Baer, Sal. Oppenheim and Deutsche Bank.

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