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Elect, Inject & Stimulate

After a very Covid weary year so far, one might be tempted to think "Who needs a contentious US election on top?" More to think about, and it's still 2020? Polls have suggested that Joe Biden would be on for a win with a wide enough margin to close down any dispute from Donald Trump but now, as the moment of truth dawns tomorrow, bookmakers have increased Trump's implied chance of winning significantly overnight.

Yesterday, Joe Biden's 2020 US election odds sat at 8/15, and implied he had a 65.2% chance of winning the 2020 election. That percentage has now dropped to 61.9% chance with his price drifting to 8/13 in places.

Donald Trump may be getting his second wind today as more and more people gamble he could stay for another term. Trump's odds on Monday implied he had just a 34.8% chance of winning the 2020 election. However, his current odds of 6/4 imply he's got 40% chance.

In preparation for a contested election we have counselled keeping some powder dry before the big event and to be ready for what comes if the hurdle is jumped cleanly. As expected, volatility (as expressed by the Vix Index) has picked up to near 40, a level that gives no doubt that there is distress in the markets. It was at 12 before the Covid crisis started and kicked up to 80 during the major panic in late March.

Fig 1 - Volatility Rising

The election comes in conjunction with a significant pickup in infections, the so-called "second wave", as more lockdowns enacted by panicked and clumsy politicians sweep across the globe. It is not an easy market to read and most would not expect portfolios to be positive based upon all the negative news and nasty predictions of death rates. Yet they are positive thanks to a few outperforming sectors and the avoidance of those suffering the most heavily.

What's next?

If the election passes without dispute then investors need to look at what is coming down the pipe for the next year and beyond. Short term - in other words trying to time the market - it's anyone's guess as to what the market reaction will be. Relief that the next four years in the US is under way - probably. Then a return to worry that the Covid pandemic will drag on and depress growth. A study of US and international equity market returns both just before and soon after a US election is inconclusive. On balance you would make money by being invested so long as you didn't participate in 1984, 2000 and 2008.

Election Day	Return 1 Month Before	Return 1 Week Before	Return 1 Week After	Return 1 Month After	Return into Year-End
11/6/1984	3.6%	1.0%	-1.5%	-3.7%	-1.4%
11/8/1988	-1.5%	-1.8%	-2.0%	1.1%	1.4%
11/3/1992	3.0%	1.0%	-1.0%	2.2%	3.8%
11/5/1996	0.8%	0.7%	3.2%	4.7%	6.7%
11/7/2000	1.6%	0.2%	-3.4%	-4.3%	-7.8%
11/2/2004	-0.1%	1.7%	3.0%	5.4%	7.3%
11/4/2008	-12.1%	2.7%	-7.0%	-9.3%	-7.8%
11/6/2012	-3.0%	0.4%	-3.0%	0.1%	-1.0%
11/8/2016	-1.0%	0.9%	2.3%	6.0%	5.0%

US Equities	Return 1 Month Before	Return 1 Week Before	Return 1 Week After	Return 1 Month After	Return into Year-End
Average	-1.0%	0.8%	-1.1%	0.2%	0.7%
Median	-0.1%	0.9%	-1.5%	1.1%	1.4%
Min	-12.1%	-1.8%	-7.0%	-9.3%	-7.8%
Max	3.6%	2.7%	3.2%	6.0%	7.3%

Election Day	Return 1 Month Before	Return 1 Week Before	Return 1 Week After	Return 1 Month After	Return into Year-End
11/6/1984	4%	4%	-2%	-4%	-3%
11/8/1988	7%	-1%	4%	7%	7%
11/3/1992	-4%	-2%	-1%	1%	2%
11/5/1996	-1%	0%	3%	1%	2%
11/7/2000	0%	2%	-3%	-4%	-3%
11/2/2004	3%	2%	3%	6%	10%
11/4/2008	-19%	13%	-4%	-14%	-2%
11/6/2012	-2%	0%	-2%	3%	5%
11/8/2016	-2%	-1%	-1%	2%	2%

Non-US Equities	Return 1 Month Before	Return 1 Week Before	Return 1 Week After	Return 1 Month After	Return into Year-End
Average	-1.5%	2.0%	-0.5%	-0.1%	2.3%
Median	-0.5%	0.1%	-1.4%	1.0%	1.7%
Min	-18.8%	-1.7%	-4.4%	-14.0%	-3.2%
Max	7.1%	13.1%	4.0%	7.5%	10.2%

Fig 2 - Election Effect

US Market Returns vs Non US Market Returns

The adage is the same as ever, and oft' repeated - it's time in the market and not timing the market. To have an appropriate exposure to equities has made sense up to now and it will probably make sense to react to the longer term forces gradually to maximise portfolio risk adjusted returns.

If the election result is disputed then volatility will pick up and the dry powder will come in handy but may also be kept back to protect portfolio values. We will watch and react to the news flow accordingly but the base case is to look beyond the elections at the next stage.

Inject & Stimulate...

Once the election has passed, the realities in need of focus are twofold - there will be a vaccine for Covid and there will be a $2Trillion+ stimulus package in 2H2021. These two facts are reasons for optimism and for adjusting positioning. Experts in epidemiology see a possible 70% efficacy rate for early vaccines as the base case for their expectations. Combined with therapeutic treatments, this could create a sharp "normalisation" in most of the world economy in the second half 2021.

Equities will be the primary beneficiary of enormous government spending (not unlike 08/09) and it will likely be of greater impact to some sectors over others. Those that have suffered heavily may be the value trade but they may also be value traps as trends already underway have simply been accelerated and may not reverse with stimulus. We would still take a more careful approach and buy the major indices such as the

S&P500 and MSCI World while at the same time adding some exposure to an index of smaller companies such as the Russell 2000 that catches a broad expansion in the US, our favoured region.

China will experience growth in 2020 despite the shocking contractions of as much as -10% elsewhere. The Chinese economy may grow 1% this year and resume above average growth in 2021 while the rest of the world could grow at around 5%. That is a strong global rebound story to hang onto even if it doesn't get many G20 economies back above the end-2019 GDP levels by the end of next year. European equities will possibly lag as usual and we are cautious on the handling of the pandemic into the year end as well as the lack of pan-European federal control. Global growth will be uneven. The regional differences will become more obvious in 2021.

The message ahead of the US election result is to be content with the asset allocation plan in the face of significant uncertainty but not to feel the need to be moved to react too quickly. Aim to add equity exposure as we move to the next stage in the cycle and when the election is firmly behind us. We hope that the next phase can begin as soon as possible.

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