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Market Ethos

The latest market insights from the Richardson Wealth team

RICHARDSON Wealth

2020 Election: Sweet Gridlock?

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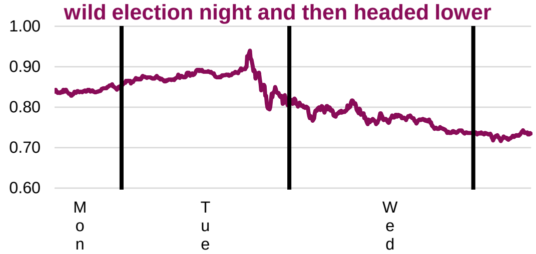
As we write this on November 4/5, prognosticating on the market's jubilent response so far, we are reminded that markets really dislike uncertainty. And while there is still a hefty amount remaining, not the least of which is about the eventual winner, there is less uncertainty today than before the vote. At this point it would appear, based on the odds and the views of political "experts", that Joe Biden will be the winner. The Senate will remain under Republican control and the House will be under Democratic control, albeit less so than before. So here are our thoughts on the market/economic implications with the HUGE caveate that the outcomes are not final and there are likely a few curve balls ahead.

Recount/Contested – Given how close the results appear in many key states, recounts and legal challenges will likely come flying pretty quickly. How long this draws out the election depends on how many are close. The good news is the market was already expecting a contested election based on comments made before the election. And remember, markets move on surprises.

As a result, this isn't a huge issue for markets at the moment. If it drags on, there would be a tipping point and the longer-than-expected uncertainty may weigh on equity markets. This is likely to be short lived though. From an historical perspective, Republicans have done better in fighting contested elections.

Stimulus – A blue sweep would likely have meant a couple trillion dollars of stimulus; under Trump, probably a trillion. Under gridlock, the current baseline case, likely lower. Republican senators were not willing to go along with a big stimulus package before the election, which did put their seats at more risk. Now that they have largely retained their seats and control, forget about it. With less stimuls, GDP growth/economic recovery will be hurt and bond yields will trend lower (which may have already been priced in on the day after the election, **Chart 1**).

Chart 1: 10-year U.S. Treasury yields had a wild election night and then headed lower



This gridlock will make it more difficult to manage or support the economic recovery from a fiscal perspective. Expect the U.S. Federal Reserve to continue much of the heavy lifting. Overall, this is slightly negative for GDP.

Less stimulus is negative for equity markets, certainly the more economically sensitive companies. The S&P 500 was up 2.2% the day after the election.

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Broken down by style, the S&P 500 Growth index was up 3.5% while the S&P 500 Value index was up 0.3%.

Corporate Taxes – While the Biden campaign included rolling back the corporate tax reductions instituted by the Trump administration, that may prove more difficult with the Senate under Republican control. This is a positive for the equity markets, but not a huge factor in our view. Corporate tax changes certainly have an impact on cash flows but the lift or hit to share prices is often muted. For one, companies are rather good at reducing their tax burden, more so for larger companies. Plus, investors much prefer real earnings growth that reflects improving business fundamentals, compared to earnings growth from a regulatory tax change. The opposite applies for tax increases as well.

Still, less tax is good for equities. This likely impacts smaller-cap companies more.

Trade Tensions – This has been a recurring issue for the markets over the past four years. The reason? Mainly because these tensions injected a massive amount of uncertainty. Companies couldn't invest and make plans with the uncertainty that operations could be disrupted with tariffs at any moment. This was mainly a U.S.-China issue but also impacted many other countries as well.

On a comparative basis, Biden would likely cause much less tension in this area. And his administration would likely work more closely with historical allies. This is good news for the markets and the economy today. In the longer term, the impact is less clear.

While we don't agree with the approach that the Trump administration took on the trade front, the end objective was sound. We are living in a more polarized world than much of the past couple of decades with the U.S. and China on opposite sides. Given each country's objectives, this conflict is not going away. Trade tensions will continue, regardless of who sits in the oval office.

Others – Without a blue wave and with the Senate controlled by the Republican party drug price reform will be less (pharma up big yesterday), the Green Deal will be less of a deal.

Investment Implications

Gridlock!! While initially we were in the camp that this would be a negative, perhaps this is not the case in the near term. Unable to make huge changes, unless all are in agreement (a rarity!), this can actually create a more stable environment. And again, less change does make for a more stable or certain world for markets. This is fuelling the rise since the election. The downside is that any changes to address longer-term issues such as climate, unrest, income disparity, etc., will be more difficult to implement or address.

Source: All charts are sourced to Bloomberg L.P. and Richardson Wealth unless otherwise stated.