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It's not a finish line, yet another start

Who lives at the White House doesn't seem to matter much for financial markets. The underlying economic conditions and their driving factors are more important. Analyzing them to build investment portfolios is a process that always goes on, continuously.

And so November 3rd came and passed.

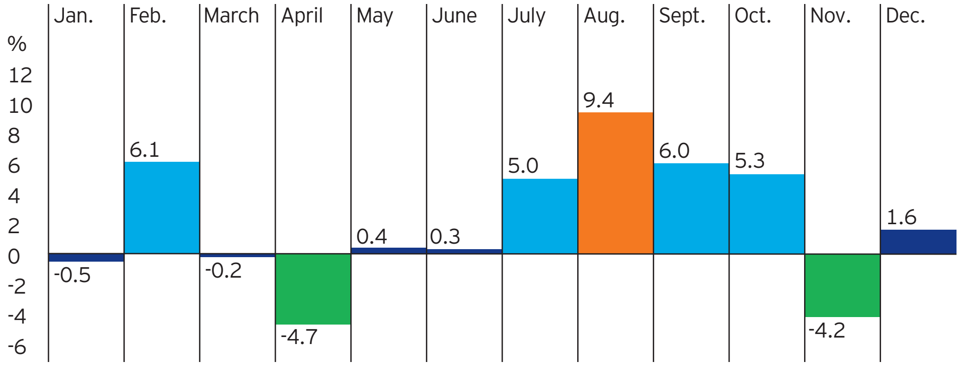
American democracy seems to be the winner of the 2020 presidential election, which saw the highest participation of voters in the last century: around 150 million, about 65% of the eligible population, higher than the 1908 record.

Democracy aside, there are still several steps before the electoral college process is complete. The recounting of votes, including postal ones, is going on in several important states. Biden has been named president elect, but the relatively small gap between the two candidates has expanded as the states complete their counts. In addition, Trump has filed lawsuits in several states to stay in the White House four more years. So it will be necessary to wait to know the name of the President, and wait to see whether the outcome is accepted or contested by the defeated candidate.

The scenario that seems realistic to exclude at the moment is the so-called "blue wave", that is a large victory of the Democrats for the presidency and the two branches of Congress. The Democrats have reconfirmed themselves and maintained their majority in the House of Representatives, but it is too early to tell whether they can win a majority in the Senate. If that happens, it will be by a narrow margin.

In the markets we have seen, as usual, a surge of volatility before the elections. A phenomenon that happened the last time in 2016 and that has repeated this year with a similar dynamic, simply at higher levels. November is a month when US stock market volatility typically falls materially - which usually happens when the market goes up (**Chart 1**).

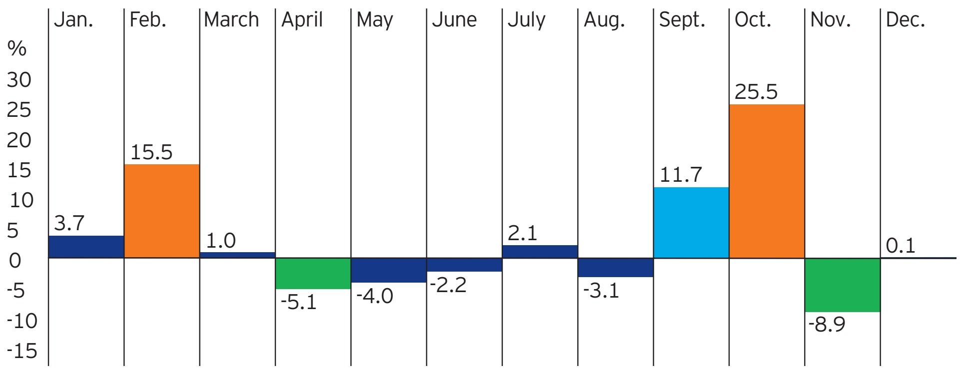
Chart 1: Monthly changes in S&P 500 volatility: 1990-2020



Source: Bloomberg, data from Jan. 31, 1990 to Oct. 30, 2020. "Volatility" is measured by the VIX, the CBOE Volatility Index that estimates the expected volatility of the S&P 500 index.

In presidential election years, the average volatility decline in November is much more pronounced than in other years, partly because it tends to follow a steeper surge in volatility (**Chart 2**).

Chart 2: Monthly changes in S&P 500 volatility in US presidential election years since 1990

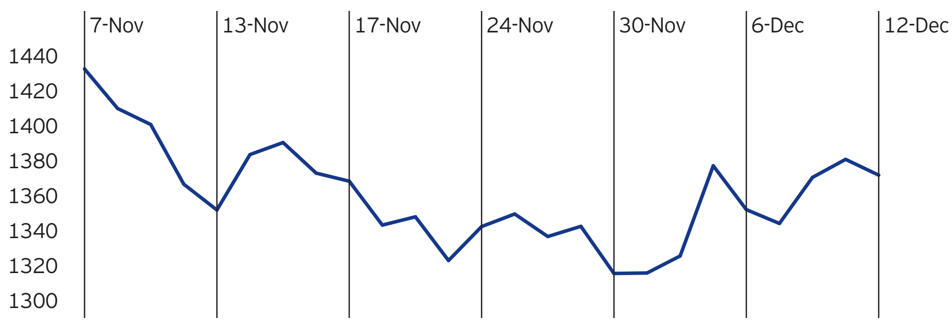


Source: Bloomberg, data from Jan. 31, 1990 to Oct. 30, 2020. "Volatility" is measured by the VIX, the CBOE Volatility Index that estimates the expected volatility of the S&P 500 index.

Therefore what we have seen in the run-up to the 2020 election does not seem very dissimilar from the usual election year pattern. Perhaps the context was, but not the dynamics.

What the markets do not like very much, as investors know, is uncertainty. In 2000, when the votes had to be recounted in Florida, and the official outcome of the election was the verdict of the Supreme Court accepted by Gore on December 11th, the market dropped, losing about 8.1% (**Chart 3**) to the period lows and ending the uncertainty phase on December 12th with a -4.2% decrease since the election day (November 7th). Nothing catastrophic, in short. And we were already in a declining trend after the burst of the technological bubble in March 2000.

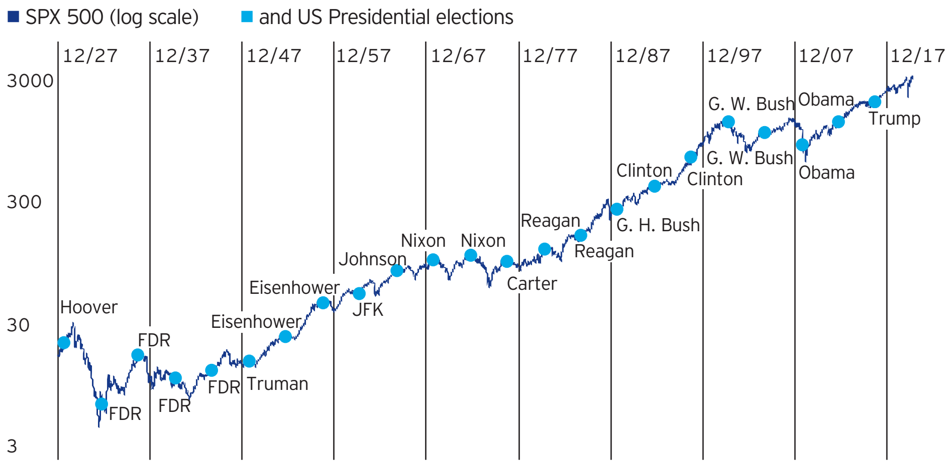
Chart 3: Performance of the S&P 500 from 7 November 2000 to 12 December 2000



Source: Bloomberg, data from November 7th to Dec. 12, 2000. Past performance is not a guide to future returns.

In fact, who lives in the White House seems to matter relatively little for the performance of financial markets in the medium to long term. As shown in **Chart 4**, the long-term trend remains intact regardless of the election result. Over the short term, on the other hand, anything can happen with any president of any political color.

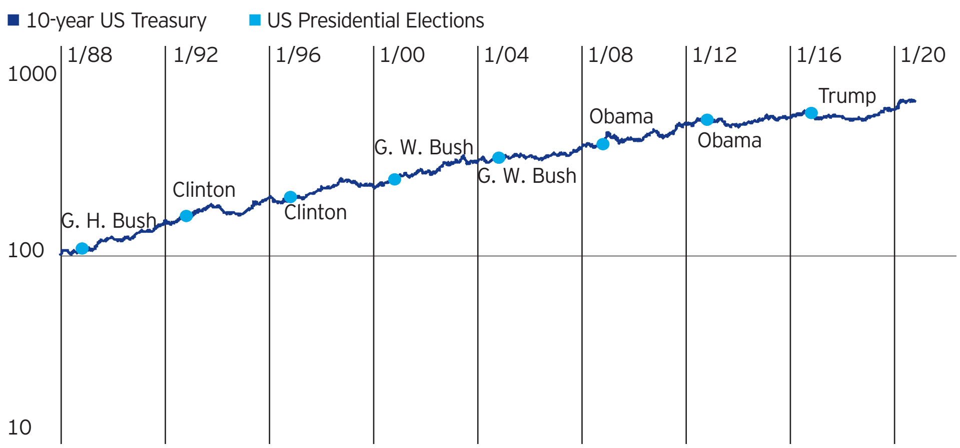
Chart 4: S&P 500 and US presidential elections, 1927-2020



Source: Bloomberg, data from Dec. 31, 1927 to Oct. 30, 2020. Past performance is not a guide to future returns.
Note: the chart includes only elections and does not consider changes in presidents during the 4-year mandates for any reason.

It may be more surprising to note that the same dynamic took place in the government bond market (**Chart 5**). After all, policy can have a significant impact on public spending, deficit and debt, and this could reasonably affect government bonds. History, however, shows us evidence similar to that of stock markets: the president does not matter much over the mid- to long term.

Chart 5: US 10-year government bond performance and presidential election, 1988-2020



Source: Bloomberg, data from Jan. 1,1988 to Oct. 30, 2020. Past performance is not a guide to future returns.

From **Chart 4** we can learn an important lesson: it is not so much the president as the economic conditions that matter. The periods in which the US equity market has fallen more and taken longer to recover have been essentially three: the Great Depression, the oil crisis of the seventies, and finally the Great Financial Crisis and the Great Recession that followed. All linked to a context of serious economic weaknesses, not to politics. In this perspective, in my opinion, an assessment of possible scenarios about the pandemic could prove more useful than that of the mere outcome of the US presidential elections.

So, in the perspective that the economy in the medium to long term matters more for markets than politics, I try to propose four interpretative cues of these elections: four situations where the White House can affect economic developments.

1 **Management of the Covid-19 pandemic.** Trump has sided since the beginning with the "minimizers", if not even the "deniers". The US has, despite this, activated income support measures with few historical precedents, given their culture. However, an integrated and structured approach to pandemic management at national level, with coordinated containment measures in addition to economic allocations, has been lacking. If after the elections the attitude of the US administration changes, it could be important at a global level: an incentive for countries that have implemented more serious containment measures, but in a sparse order, to seek greater coordination, and an incentive to approve restrictive measures to fight the pandemic for those who refused to do so and found in President Trump's behavior a justification, albeit not the only one, for their decision.

2 **Fighting inequality.** Joe Biden has declared himself much more oriented than Donald Trump to try to reduce inequalities -- social and above all economic. The pandemic has widened the already very wide gap between the wealthiest and the most disadvantaged in the world and the US is one of the countries in which the phenomenon takes on a stronger connotation. This requires a significant revision of fiscal policy in a more redistributive direction than in recent years. Both in regards to the imposition of taxes and the granting of subsidies, and the management and use of debt and the public deficit. Reducing inequalities could mean, for example, changing the trajectory of some dynamics of spending on the consumption of goods and services and access to health and education, to make them potentially more widely available and sustainable. And we know how important consumption is for the global economy, especially for the most mature countries. Again, the path that the United States decides to walk on could also be a guide for other countries.

3 **Managing the relationship with China and multilateralism.** This is perhaps the point where the difference between the two candidates is sharper. Trump is faithful to his motto "America first", Biden is culturally inclined to multilateralism. Trump unleashed a trade war with tariffs and quotas, Biden proposes himself as a supporter of free and open markets and international trade. The arrival of the pandemic has turned the tables and it is difficult today to isolate the impact on economic growth of the trade restrictions imposed by the United States against China and other countries, including some European ones. However, it is reasonable to believe that this has potentially been a drag for global growth and an element of support of an increase in the prices of imported goods and services. Although "peak globalization" may have been reached anyway, I believe that the trade war provided a further unnatural boost to the process of retracement. Beyond the political implications, which I do not comment on in detail, a course change that could lead to more relaxed international relations and greater openness of economies could be a positive factor for global growth, and in particular for those economies, such as emerging ones, which have benefited from globalization and greater international integration of value and production chains.

4 **Technological War and National Security.** Although Biden has always been more inclined than Trump to international openness, multilateralism and global trade, I believe that no President of the United States is willing to compromise on national security. Some of the observations that Trump made about the security of communications, physical networks and software platforms for data transmission, seem to be grounded. If this eventuality were confirmed, the "technological front" of the commercial war would be fought by the White House, no matter who lives there. A possible scenario - in fact one of the most negative that I can envisage – would be between strategic moves and countermoves, a fragmentation of the global technology market, from the point of view of production chains, value chains and markets for products and services. Considering the contribution to the performance of global equity markets that has come from the technology sector and in particular from a handful of truly global platform companies, I think this is a scenario that investors should consider among the so-called tail risks, because it may not be significantly reflected in market valuations.

In summary, the vote for the election of the President of the United States is not the end, but the beginning of a new stage of the process that investors know well and that, in fact, never stops: that of analyzing and assessing the possible scenarios and their potential impacts on the markets, in order to build portfolios that are always up to date with the characteristics and financial objectives of customers.

And to conclude on a lighter note: your author has been making investment decisions for well over twenty years now, and has found in an old box of memories this gadget of long before an investment bank called Merrill Lynch became, at the time of the Great Financial Crisis, part of Bank of America: a polo shirt with the average Dow Jones performance over the presidential four-year cycles. Who knows, maybe even some of the readers remember it.

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