Our experts discuss the political process and the market implications of an uncertain outcome

As of midnight EST Nov 3, the 2020 presidential election remains up in the air. With ballots remaining to be counted in several states, an official result may not be known for some time. Below, our experts discuss the next steps in the political process, the policy issues that the markets will be watching, and two critical questions for investors to ask themselves right now.

The importance of the election process

Marty Flanagan, President and CEO, Invesco. While the US presidential election looked different this year, participating in the democratic process continues to be one of the most important responsibilities for all Americans. Participating in elections is one of the key freedoms for Americans, and it’s important that we allow the process to unfold, ensuring that the voice of the American people is heard.

The United States of America and the democratic process have endured times of uncertainty over our history, and I have complete confidence that we will do so again as the election results process continues.

The political process: What happens next?

Andy Blocker, Head of US Government Affairs: As of midnight EST on Nov. 3, the results of the election remain unclear. President Trump was able to hold onto many of the early reporting contested states that he won in 2016 – Florida, Texas, Georgia, and Ohio. And as of this hour, Arizona and North Carolina are still too close to call.

If President Trump is able to hold onto Arizona and North Carolina, it will be déjà vu all over again. This election will once again come down to the same rust belt states of Wisconsin, Michigan and Pennsylvania that determined the 2016 election. As expected, they have yet to count all of their mail-in votes and are not ready to be called for either candidate. We would expect to have final results from Wisconsin and Michigan on Wednesday, but Pennsylvania will not have final results until Friday, the deadline for receiving mail-in ballots in Pennsylvania. As a result, at the time of this writing, neither candidate has yet reached the 270-vote threshold in the Electoral College that is needed to win.

Four policy issues the markets will be watching

Kristina Hooper, Chief Global Market Strategist: Whoever prevails in this contested election will face significant challenges ahead. These are four areas I’ll be watching closely, due to their potential to impact markets and the economy:

1. COVID-19. Since the start of the pandemic, I’ve written about the importance of a three-pronged policy response to coronavirus: 1) public health policy to contain the virus, 2) monetary measures to ensure financial liquidity and functionality, and 3) fiscal support to contain the real economic damage. The Federal Reserve has provided massive monetary policy accommodation throughout the crisis – but what about the other two prongs?

In terms of public health policy, Trump has suggested he might pursue a “herd immunity” strategy if there is another resurgence of the virus. In contrast, Biden has suggested that if recommended by medical experts, he would be open to implementing another widescale lockdown similar to the one experienced last spring. These approaches have the potential to significantly impact economic activity.

In terms of fiscal support, I believe the next president needs to think of pandemic-related stimulus as akin to coupon payments on a bond. In other words, stimulus payments need to be adequate and at regular intervals in order for the economy to continue to be supported in the face of serious headwinds until an effective vaccine is developed and widely distributed.
2. China. We will be very focused on the next president’s plans for engaging with China. The Trump administration’s approach has created significant volatility in markets, and there is fear that a second term would mean even more unpredictable and aggressive moves against China. On the other hand, there is some uncertainty about what a Biden administration might mean for the US-China relationship. In our view, there are two main possibilities: One is that a Biden presidency would hit the “reset” button on relations with China, while another is that Biden would continue to be aggressive with China, but in a more measured and multilateral way.

3. Taxes. If Biden prevails, markets will be monitoring the potential for taxes to increase. He has said he wants to raise taxes, but when? Clearly the economic recovery is still very fragile, so raising taxes next year could be problematic, in our view. On the other hand, markets did not seem deterred by October polls that projected a decisive Biden victory. I believe one critical reason is that a “Blue Wave” could very well mean a large stimulus package in 2021 — and in the final weeks of the campaign, that seemed to outweigh concerns about an increase in corporate taxes.

4. Infrastructure. This is one area that both candidates have said they would spend more on, but we haven’t gotten much in the way of details. I will be waiting for details from the next president on his infrastructure spending plan: the amount he plans to spend, how it will be financed, and perhaps even when it might be implemented. In the 1930s, government spending on infrastructure was used as a way to fight unemployment and put people back to work, and it was successful in reducing unemployment and helping the economy. Might the same be true going forward?

We have to recognize that market volatility is what we get when there is policy uncertainty, but we can’t let it shake us as we are experiencing this uncertainty against a backdrop of massive monetary policy accommodation, which has helped support stocks throughout the pandemic. While we work through the political and legal processes to determine the winner, I believe it is important to remain well diversified and stay the course — and of course to be on the outlook for opportunities if stocks experience any heavy bouts of downward volatility.

Two critical question for investors

Brian Levitt, Global Market Strategist: It’s officially the moment that many investors expected might occur. The outcome of the election is unknown and the counting may take some time.

It is said that the equity market and those who invest in it don’t like uncertainty, particularly policy uncertainty. As a result, the potential for near-term bouts of equity market volatility may be elevated. Critically however, the current political uncertainty is unlikely to change the trajectory of the economy and markets over the next years, in my view.

Providing the obligatory historical perspective of contested US elections is challenging. After all, the grand experiment is only 245 years old, and the 1876 election between Rutherford B. Hayes and Samuel Tilden may be of little significance to current investors. For what it’s worth, US large-cap equities fell 18% between the election of November 1876 and Hayes’ inauguration in March 1877, only to subsequently climb by 160% over his single term as president.1

In this century, the Nov. 7, 2000, election between George W. Bush and Al Gore didn’t have a victor declared until Dec. 13, 2000, when the US Supreme Court effectively ended the recount in Florida. The S&P 500 Index was down 4.9% between election day and the Supreme Court decision over a month later.2 Gold was up 3.9% over the same time frame, and the 10-year US Treasury rate fell 85 basis points from 5.85% to 5.00%.3 That’s not a great outcome but not a disaster either.

Notably, average market volatility in the 25 trading days between the 2000 election and the official result did not rise to the levels reached multiple times during the elongated business and market cycles of 2009-2019.4 In short, we have been through a lot of events in recent years that rattled markets more than the delayed election result of Bush v. Gore (see chart below). This includes, but is not limited to, the European debt crisis, the Chinese currency devaluation, the many shifts in US Federal Reserve policy, and the US-China trade war, not to mention the COVID-19 outbreak, which ultimately concluded the business cycle.

Chart 1: CBOE Volatility Index (VIX) since 2010

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Source: Bloomberg, Chicago Board Options Exchange. The VIX Index is a financial benchmark designed to be an up-to-the-minute market estimate of the expected volatility of the S&P 500 Index and is calculated by using the midpoint of real-time S&P 500 Index (SPX) option bid/ask quotes.
In my view, when assessing the impact of specific events on the financial markets, investors should always ask themselves two primary questions:

1. Does the event change the trajectory of the world’s major economies over the next years?

2. Has monetary policy reversed course and/or does the event change the direction of monetary policy over the next years?

Seen from that lens, it is not surprising that the markets experienced greater volatility from the events listed above – the European Central Bank inexplicably raising rates in 2011, the US Federal Reserve raising rates in 2015, and an evolving and uncertain trade war between the world’s two largest economies in 2018 – than it did during Bush v. Gore. Election outcomes, as well as regional events (such as the Syrian Civil War), natural disasters (such as the hurricanes in Puerto Rico and Houston), massive protests and civil strife (such as Ferguson, Baltimore, Portland, and Kenosha), tend to not have the same impact on financial markets. This is because elections, regional events, natural disasters, and protests, while disconcerting, tend to not change the trajectory of the national or global economy nor of monetary policy.

In my view, the trajectory of the US economy in the next few years will be determined by the ability to compress COVID cases and re-engage in more segments of the US service economy. Plain and simple. Admittedly, the next president and his administration could hasten the US economic recovery through the right policy mix. Nonetheless, I believe that betting against that recovery over the next couple of years, irrespective of the ultimate outcome of the 2020 election, is akin to betting against medicine, science and human ingenuity. In addition, the Federal Reserve has telegraphed easy monetary policy conditions for at least the better part of the next presidential term.

As we stress over the outcome of the election and refresh foxnews.com or msnbc.com for the 50th time each day, remember there is a confluence of factors that I expect to favor stocks: The US economy is recovering and may continue to recover from a very depressed state. Stocks are cheap compared to bonds. 5 Cash yields little 6 and the Fed intends to inflate away 2% of the value of that cash each year. In short, I see few alternatives to equities for investors seeking growth. Those factors are expected to stay the same, regardless of who is taking the oath of office in January.

Therefore, I’ll spend this unsettling time focusing on my two primary questions, rather than on the breaking news from the 24-hour news stations.

1 Source: Yale, Robert Shiller database
2 Source: Bloomberg, Standard & Poor’s
3 Source: Bloomberg. The gold spot price is quoted as US dollars per troy ounce.
4 Source: Bloomberg
5 Source: Bloomberg, Standard & Poor’s, as of 9/30/20. As represented by the difference between the earnings yield of the S&P 500 Index and the 10-year US Treasury rate.
6 Source: Bankrate.com, as of 9/30/20
Investment risks

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