

## US election: Blue fade and red mirage

### Financial market events

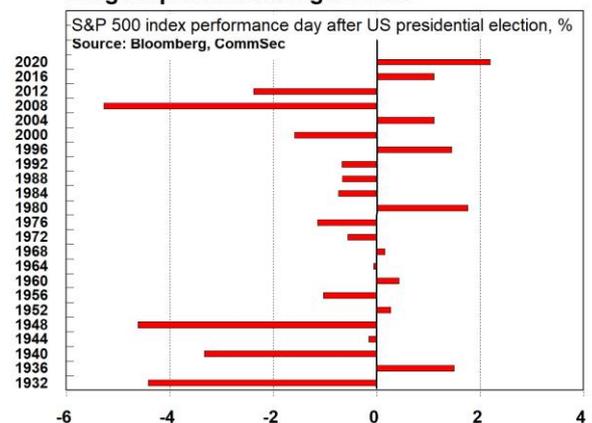
- The US Presidential election was held on Tuesday 3 November 2020 (Wednesday 4 November 2020 AEDT).
- At the time of writing (12.20pm AEDT), there is no clear election outcome or winner. Results for at least five ‘battleground’ states remain in the balance as counting continues. The Democratic Party is on track to retain control of the US House of Representatives, but the Republican Party are ahead in a very tight US Senate race.
- Vice-President Joe Biden can reach the necessary 270 Electoral College votes if he can win Michigan and Nevada, presuming that he wins Wisconsin. President Trump needs to win Georgia, North Carolina, Michigan and Pennsylvania in order to be returned to the White House.
- A delayed, contested or disputed election outcome is probable after US President Trump’s campaign manager Bill Stepien cited *“irregularities in several Wisconsin counties”*, before confirming that the president has filed lawsuits in both Michigan and Pennsylvania and sought a recount in Wisconsin.
- US sharemarket investors shrugged off the potential for a divided US Congress. The Dow Jones index closed higher by 368 points or 1.3 per cent after being up 821 points. The S&P500 index was up by 2.2 per cent – the largest post-election day gain ever. The Nasdaq index was up by 430 points or 3.9 per cent. But US 10-year treasury yields fell 11 points to 0.77 per cent on fears about prolonged uncertainty on the election result. And the Aussie dollar rose from lows near US70.60 cents to highs near US72 cents and was near US71.80 cents in late US trade.

*US Presidential elections are periods of uncertainty, potentially affecting investors, businesses and consumers decision-making.*

### What does it all mean?

- The counting continues across a divided United States. Former Vice-President Joe Biden appears to be on the cusp of victory - edging ahead in the all-important Electoral College - with political analysts on CNN and NBC both projecting the Democratic Party presidential nominee had won the key swing states of Michigan and Wisconsin. But the prospect of a Democratic ‘clean sweep’ of the White House and US Congress has faded with the Republicans increasingly likely to retain control of the US Senate.
- Investor fears over a potential disputed or contested election outcome have heightened with President Trump’s campaign manager Bill Stepien citing *“irregularities in several Wisconsin counties”*, before confirming that the President has filed lawsuits in Georgia, Michigan and Pennsylvania to stop vote counting. President Trump has also sought a recount of votes in Wisconsin.
- The Democratic Party faithful had expressed concerns prior to election day of a ‘red mirage’ where Republican in-person voting would show Mr. Trump with an early lead in battleground states like Michigan, Pennsylvania and Wisconsin, before mainly Democratic mail-in and absentee votes were fully

Largest post election gain ever



Ryan Felsman, Senior Economist  
Twitter: @CommSec

#### IMPORTANT INFORMATION AND DISCLAIMER FOR RETAIL CLIENTS

The Economic Insights Series provides general market-related commentary on Australian macroeconomic themes that have been selected for coverage by the Commonwealth Securities Limited (CommSec) Chief Economist. Economic Insights are not intended to be investment research reports. This report has been prepared without taking into account your objectives, financial situation or needs. It is not to be construed as a solicitation or an offer to buy or sell any securities or financial instruments, or as a recommendation and/or investment advice. Before acting on the information in this report, you should consider the appropriateness and suitability of the information, having regard to your own objectives, financial situation and needs and, if necessary, seek appropriate professional of financial advice. CommSec believes that the information in this report is correct and any opinions, conclusions or recommendations are reasonably held or made based on information available at the time of its compilation, but no representation or warranty is made as to the accuracy, reliability or completeness of any statements made in this report. Any opinions, conclusions or recommendations set forth in this report are subject to change without notice and may differ or be contrary to the opinions, conclusions or recommendations expressed by any other member of the Commonwealth Bank of Australia group of companies. CommSec is under no obligation to, and does not, update or keep current the information contained in this report. Neither Commonwealth Bank of Australia nor any of its affiliates or subsidiaries accepts liability for loss or damage arising out of the use of all or any part of this report. All material presented in this report, unless specifically indicated otherwise, is under copyright of CommSec. This report is approved and distributed in Australia by Commonwealth Securities Limited ABN 60 067 254 399, a wholly owned but not guaranteed subsidiary of Commonwealth Bank of Australia ABN 48 123 123 124. This report is not directed to, nor intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or that would subject any entity within the Commonwealth Bank group of companies to any registration or licensing requirement within such jurisdiction.

counted. Of course, President Trump has now been overtaken in some states, but the 'window of opportunity' enabled him to claim a premature victory on the basis that the mail-in voting count was "a fraud on the American public".

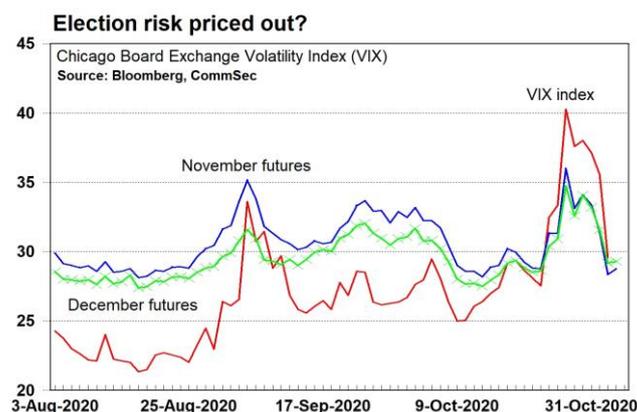
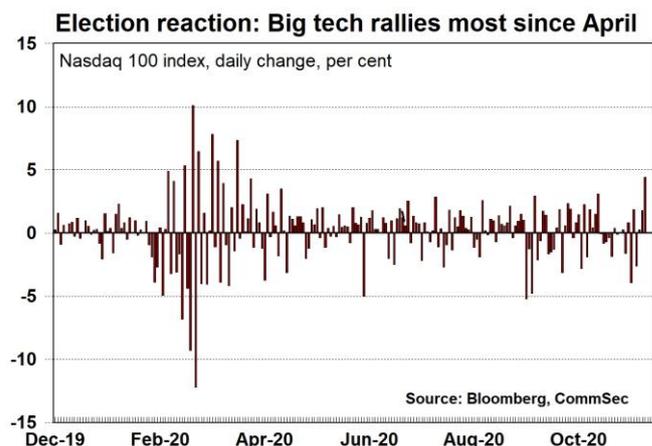
- Of course, the polling industry was the biggest loser on US election night with its methodology and relevance again called into question after the much-hyped Democratic Party 'Blue Wave' failed to materialise. After President Donald Trump's unexpected 2016 election victory, he again outperformed in several key 'battleground' US states by up to eight percentage points more than major poll aggregators had forecast.

### Contested election

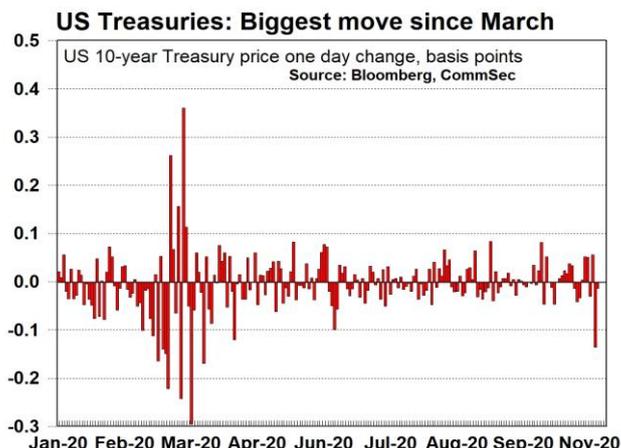
- Will history repeat itself? The coming hours, days and weeks may feel like 2000 all over again if President Trump has his way. With his path to victory diminishing with each mail-in and absentee vote counted, a repeat of the Bush-Gore Florida recount - which delivered victory for the Republicans via the US Supreme Court - could yet eventuate. Already President Trump and his campaign team have confirmed their intention to mount legal challenges across disputed states with the highest court in the land tilted in his favour.
- So what are the alternative scenarios? With a Democratic 'clean sweep' looking increasingly unlikely there are two likely electoral outcomes, subject to legal challenges. Firstly, a Biden presidency, Democratic House and a Republican Senate is firming as the most likely outcome. Should this eventuate - as expected by political pundits - the Republican controlled Senate would oppose Mr Biden's progressive policy agenda with gridlock likely for at least two years. Another pandemic economic relief package would eventually be passed - after much haggling - but would likely be smaller given Republican opposition to infrastructure improvements. The Senate would also oppose Biden's plans for higher taxes, obstruct Biden's roll-back of Trump deregulation and battle over healthcare. The White House may re-start trade negotiations with Asia-Pacific nations.
- The second scenario, considered less probable: President Trump is returned, the Republicans control the Senate and the Democrats control the House. The continuation of President Trump's 'America First' trade conflict and technology decoupling with China and his deregulation agenda would continue. But the Democratic-led House would resist further tax cuts - especially on capital gains, and for individuals and businesses.

### US financial market reaction

- Overnight, US sharemarket investors shrugged off the potential for a divided US Congress and diminished fiscal stimulus to support the US economic recovery. The Dow Jones index closed higher by 368 points or 1.3 per cent after being up 821 points. The S&P500 index finished up by 2.2 per cent - the biggest post-election day gain ever. The Nasdaq index was up by 430 points or 3.9 per cent. But US 10-year treasury yields fell 11 points to 0.77 per cent on fears about prolonged uncertainty on the election result. And the Aussie dollar rose from lows near US70.60 cents to highs near US72 cents and was near US71.80 cents in late US trade.
- Why? With the narrative around the 'Blue Wave' stimulus and reflation trade fading, investors revisited the possible 'deflationary' impact of a Biden presidency coupled with a Republican Senate. With a more conservative fiscal stance increasingly likely, and investor concerns about higher taxes and re-regulation of industry diminishing, Wall Street rotated back towards its 'go-to' pandemic trade - buying growth and mega-cap technology shares.
- The S&P healthcare index jumped 4.5 per cent on Wednesday to close at a record high, and the information technology sector gained 3.8 per cent, as a divided Congress meant slimmer chances for heightened anti-trust scrutiny, capital gains taxes and a restoration of parts of the Affordable Care Act. Pharma companies rose 4.7 per cent (NYSE Arca pharmaceutical index) as reforms were less likely.
- A potential split in the Congress and presidency saw investors also buy defence contractors with defence budgets potentially remaining intact. And the S&P Super composite Homebuilding Index has lifted around 12 per cent so far this week as a Biden win could be positive for builders that offer affordable homes, with first-time buyers' tax credits of as much as US\$15,000.



- Surprisingly, the Chicago Board Exchange Volatility index (VIX) hit a two-week low, closing at 29.6 points.
- But investors still sought shelter from safe-haven US government bonds with 10-year US treasury yields falling as much as 16 points during the trading session - the most in eight months. Bond traders that were 'short' Treasuries on stimulus hopes appeared to re-position their portfolios for lower economic growth, less infrastructure spending and even lower inflation ahead of the US Federal Reserve's policy announcement on Thursday.
- On currency markets, the Aussie dollar rose from lows near US70.60 cents to highs near US72 cents and was near US71.80 cents in late US trade as the odds of a Trump victory eased.



**What's ahead and implications for investors?**

- As always, sharemarket investors look ahead. Most are now positioning for a Biden presidency and Republican Senate as the most likely eventual election outcome.
- Despite the potential for a long drawn-out period of uncertainty, some investors view a gridlocked US Congress positively. This outcome would reduce risks around the China-US trade war - providing more certainty for multilateral businesses - while scaling-back significant Democratic economic reforms, including tax hikes.
- Of course, if a prolonged and messy contested election emerges - that isn't settled until mid-December or even into January – a risk-off period would be likely emerge given the increasing need to nurse the US economy through the 'second wave' of the pandemic. Partial lockdowns could impact confidence, job hiring and consumer spending. The failure to deliver a meaningful virus relief package would further erode market sentiment.
- As a template, investors could look back at the 2000 contested election as a guide to what is potentially ahead. Back then, US shares, bond yields and the US dollar lost significant ground during the period before the election was definitively called on December 12.
- The Reserve Bank of Australia's bond buying program, ultra-low interest rates and Australia's relatively 'virus free' economic bounce-back could help Aussie shares to continue outperforming its international peers in the coming months.
- Commonwealth Bank Group currency strategists note: *"The Aussie dollar (AUD) can lift modestly by some 2-3 per cent over one to two months if former Vice-President Biden wins but US Congress remains split. Alternatively, the AUD can fall around 4 per cent over the coming months if President Trump wins. We expect the Japanese Yen (JPY) to outperform the euro (EUR) and AUD because President Trump may feel less constrained to pursue his America First trade agenda with allies, especially Europe."*
- Of course, the next big event for investors occurs tomorrow morning when US Federal Reserve policymakers hand down their interest rate decision. While the FOMC are unlikely to make any drastic policy changes or significantly change the tone of their statement, the possibility of an abrupt financial market reaction to a possible contested election outcome – and gridlock over fiscal stimulus – could see the Fed announce emergency action ahead of the December meeting.

Ryan Felsman, Senior Economist, CommSec  
Twitter: @CommSec

**Election reaction**

