

AA View

US Election 2020 – Uncertainty and division the ultimate winner (November 5th, 2020, 4am EST)

Summary

- The US election is looking much closer than opinion polls suggested. At the time of writing it is looking likely that Joe Biden will win the Electoral College, but the margins are razor thin and judicial challenges are likely.
- The likelihood of a “blue wave” scenario has fallen substantially – the Democrats have probably failed to pick up the requisite Senate seats to gain control.
- The final result may not be official for many days, if not weeks, especially if legal challenges and recounts are launched.
- Initial market reaction has centred on the US Treasury market where bond yields have fallen substantially, from their run up pre-election, driven by the likelihood of a divided government being less able to enact new stimulus. Technology stocks have performed well too.
- Whatever the outcome, it is clear that uncertainty and division will be the ultimate winner – expect further market volatility and continued low yields.



The US election result remains too close to call – we expect a divided government

In another surprising outcome, the projected results in the US election so far have been much closer than the hundreds of opinion polls have been indicating for many months.

So far, the Republicans have picked up the key swing state of Florida and the traditional bellwether state of Ohio. As is so often mentioned in the media, Ohio has picked the overall election winner in each election since 1900 apart from 1944 and 1960. But it is not yet clear if Ohio's record will continue as

attention has now turned to a collection of other swing states, namely Wisconsin, Michigan and Pennsylvania. In each case, the large number of early and mail-in votes will likely delay their results for days, although Wisconsin and Michigan have projected for Joe Biden overnight. At the same time, we expect that the close races – Wisconsin and Michigan, for example – will trigger requests for recounts and legal challenges that could take several weeks. Pennsylvania's count may well continue until Friday, November 6th, 2020. What is clear, however, is that the Republicans have greatly outperformed expectations in many states. At the time of writing Joe Biden has 264 electoral college votes and President Donald Trump has 214, with 60 crucial electoral college votes remaining on the table.

Market data sourced from Factset.

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Importantly, the close race extends to the Senate and it looks likely it will remain under Republican control. This is an important development and indicates that the US government will remain divided, making future legislation just as difficult to agree upon as it has been in the past 2 years. Democrats needed to flip a net of 4 seats to regain control of the Senate, at the time of writing, their net gain is 1 seat.

Our working assumption is that Joe Biden will win the Presidency, with Congress split between a Democratic House of Representatives and a Republican Senate. There is much to be decided, however, and late swings in the counting process can still alter the picture.

Market reaction is volatile as the Blue Wave scenario fades

Treasury yields have fallen since the polls have closed, with the 10-year yield falling by around 22bps between 7pm November 3rd to 4am November 5th EST. Meanwhile, the US dollar has fallen back by 0.2% in choppy trading by 2am EST on November 5th, according to the DXY US dollar index. Equity market reaction so far has been positive too – the S&P 500 was up around 2.2% by the close on November 4th. One of the biggest gainers has been technology with the S&P sector up over 3.8% yesterday.

Treasury yields have fallen back since the polls closed



Source: Bloomberg, data as at 4am EST, November 5th 2020

Given that the biggest reactions have been in the technology sector and the bond market, we can assume that investors have started to form a view on the outlook for economic stimulus and changes in tax policy. We believe this is currently focused on a smaller stimulus package than was expected or the increased difficulty to pass any near-term stimulus, and fewer of the sweeping tax reforms proposed by Democrats being enacted, which would have hurt the major technology companies. We would caution that these are initial market reactions and a firmer picture will emerge over the coming days.

Our view

There is still plenty to be decided and we cannot expect a definitive result today. We think it quite possible that legal challenges are on the way and the outcome may not be known this week. The upshot is that we believe markets will remain volatile and, more importantly, the trajectory of the pandemic and expectations of economic stimulus will continue to be the key near-term driver of returns.

However, even at this early stage, we can begin to draw some important conclusions with some degree of conviction. Namely:

- A divided government is increasingly likely, which will make it challenging to reach any agreement on a further stimulus package in the coming weeks.
- This scenario would also mean that Joe Biden's tax rise plans will be very difficult to introduce, assuming he becomes President. This would remove some of the concerns of those companies who were facing an increased corporation tax rate, particularly in the communication and technology sectors.

Overall, we continue to believe that economic and pandemic developments will be the most important drivers of market performance over the medium-term. But the prospect of a gridlocked US government is likely to create some headwinds for equity markets and risky asset classes in general, after the initial positive reactions. Furthermore, the probable difficulty of passing new stimulus legislation in the near-term convinces us that bond yields will remain low over the coming year, as the outlook for economic growth will be more moderate. Of course, again, if and when a vaccine is approved, the picture will change quickly and would swamp the impact of the election result.

We continue to recommend moderate caution with regards to equity positioning, whilst emphasising diversification through well-selected alternative asset classes.

Appendix: Index Definitions

S&P 500 Index – The market-cap-weighted index includes 500 leading companies and captures approximately 80% of available market capitalization.

Contacts

Global Asset Allocation

Aon

Retirement and Investment

Global Asset Allocation Team

+44 (0)20 7086 9605

Koray.yesildag@aon.com

Aon's Global Asset Allocation Team

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Aon plc/Aon Solutions UK Limited
Registered office
The Aon Center
The Leadenhall Building
122 Leadenhall Street
London
EC3V 4AN

Aon Investments USA, Inc.
200 E. Randolph Street
Suite 700
Chicago, IL 60601
USA

Aon Hewitt Inc./Aon Investments Canada Inc.
20 Bay Street, Suite 2300
Toronto, ON
M5J 2N9
Canada

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