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US election: no winner yet, markets moving from a Blue Wave to a possible Trump trade

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"Whoever wins we know already that Trump did well. Hence, the market has started to change the narrative from a blue wave to a possible Trump victory."

- *US election outcome:* At the time of writing, the result remains unclear and prudence is needed as **the race is close Biden 238 - Trump 213 (270 to win)**. **We expect an 85% likelihood of knowing the winner within ten days**. The winner of the election is likely to be determined sometimes during the next few days as three battleground states, Michigan, Pennsylvania (6 November: deadline for mail-in ballots to be received in Pennsylvania) and Wisconsin, complete the long process of counting large numbers of ballots that were sent by mail as a result of Covid-19. There are possible paths to victory for both Trump and Biden. So far, the electoral college map is looking much like the 2016 race. Trump's deft use of nationalism appears to have resonated with white voters as well as some minority working-class voters. His message during the closing days of the campaign warned of rising socialism and higher taxes, and he touted his efforts to bring jobs back to the United States. Trade tariffs were an important part of his agenda. A very high turnout did not favour largely the Democrats.

- *The Democrats are likely to maintain control over the House of Representatives but it is too soon to determine the make-up of the Senate.*

- *Initial market reaction:* Over the last few days, given high market expectations for a Biden sweep, the reflation trade gathered momentum ahead of the election results, with global equities rallying strongly, sovereign yields rising, and the dollar selling off sharply. Against the uncertain outcome of the results, the market reaction has given rise to volatility and a flight to quality with ten-year US Treasury yields plunging to around 0.8%, and the dollar is up. This morning the market has started to change the narrative from a blue wave to a possible Trump trade. Therefore, some winners over the past few weeks such as green deal and infrastructure related stocks are now trading more weakly, while more Trump-related sectors such as healthcare and tech are recovering.

- *We anticipate that uncertainty over the timing of an election decision and the resulting short-term political instability will keep markets under heightened volatility and could weigh on equity markets.*

- *What to look out for next:* After the elections, we would expect markets to refocus soon on the **healthcare situation** and we expect more volatility in the coming months, as this is a key topic on Biden's agenda (should he win). **The ability to quickly implement a fiscal stimulus is the single most important factor with implications for the economy and financial markets, especially on cyclicals, commodities and energy**. If Biden wins in the context of a divided congress, it will be difficult for the incoming democratic administration to pass any major reforms. If Trump wins, there will be continuity and likely faster fiscal support in implementation.

- *In a divided-power scenario or a contested outcome, the rising volatility should push appetite for the US dollar higher in the short term*, while expectations for higher deficit should recede sharply. Investors' focus should shift back to the Covid-19 situation in Europe and its impact on growth. On EM the dollar trend is key: a weaker dollar is supportive for EM assets. On China, the tough rhetoric will likely remain, whatever the scenario.

- *The great rotation towards the Biden trade (including the value cyclical equity rotation and the steepening of the US curve) is now on hold. Overall we remain cautious and balanced.*

Election result: the winner is... unclear!
Arguably, the longest Presidential election in US history continues. This is not surprising, since we expected only a 40% probability of knowing the winner on election night.

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Still, we expect an 85% likelihood of knowing the winner within 10 days. However, **market expectations were for a Biden sweep with a high likelihood of finding out a winner on Election Day. This has not turned to be the case.** In fact, the winner of the election will likely be determined sometime during the next few days as three battleground states, Michigan, Pennsylvania and Wisconsin, complete the long process of counting large numbers of ballots that were sent by mail as a result of Covid-19. And the race is close. There are possible paths to victory for both Trump and Biden.

At the time of writing, there were no major change in states won by Democrats and Republicans in the 2016 election. In the Southeast, Trump performed more strongly than expected in the battleground states of Florida, Georgia and North Carolina. On the West Coast Biden performed well, as expected, and was leading in Arizona, which Trump won in 2016. Early exit polls revealed Trump had notable strength among Latino voters, mainly Cuban.

In June 2020, the Transition Integrity Project convened a bipartisan group of over 100 current and former senior government and campaign leaders and other experts in a series of 2020 election crisis scenario planning exercises. In a nutshell, **their conclusion was that if the race was too close, we may face lawsuits and attempts to stop the vote count. There is a real possibility that the elections will be contested until January, including the Senate**. At the end of the day, this is likely to be the start of a political battle, not just a media battle. Media narrative will be crucial. This environment is conducive to volatility and a retreat towards safe havens.

Key takeaways from the electoral night

- So far, the **electoral college map is looking very much like the 2016 race**. The winner of the election will be determined by the battleground states of Wisconsin, Michigan, Pennsylvania, which were also pivotal in 2016.
- The Red fortress of Georgia and Texas softened a bit but were not breached. Trump appears to have gained ground in Florida due in part to Latino voters.
- **GOP (Republican party) tenacity versus the Democrat's cash**. Trump's vigorous campaign rallies during the last two weeks helped fire up his base and turn out voters. Biden's much larger campaign war chest may not to have had a major impact, as of yet.
- **Polls missed the mark again**. One day before the election, national polls showed Biden leading against Trump among likely voters by a comfortable margin of 50% versus 42.4%, according to our own poll of polls. The polls of battleground states were much tighter, with RealClearPolitics, a polling aggregator, showing Biden leading 48.9% to Trump's 46.6%. Biden's lead was within the margin of error.
- **Trump's deft use of nationalism appears to have resonated with white voters as well as some minority working-class voters**. His message during the closing days of the campaign warned of rising socialism and higher taxes, and he touted his efforts to bring jobs back to the US. **Trade tariffs were an important part of his agenda**.
- **Very high turnout did not favor Democrats**. Trump's aggressive campaigning appears to have succeeded in mining new voters to vote for him. The Democrats will likely maintain control over the House of Representatives. It's too soon to determine the makeup of the US Senate. One key race in Georgia may not be decided until January.
- **The Presidential election will hinge on the slow process of counting mail-in ballots in Michigan, Pennsylvania and Wisconsin, which could take several days or longer**. The race remains too close to call. Trump is very much in the running to win re-election, while Biden remains favored to win the popular vote. Unsettlingly, there is a very narrow path to a 270-270 tie in the electoral college vote. This could result in the race being decided by the House of Representatives.
- With Biden winning in Arizona, then the election comes down to Wisconsin, Michigan, and Pennsylvania. Whoever wins two out of three of these states wins the election. **The odds of a Democratic Senate have diminished.**

"The odds of a Democratic Senate has diminished."

Market reaction

Financial markets have proved volatile ahead of the election, with US Treasury volatility hitting a six-month high and the VIX index stood at 35 on election day, well above its long-run average of around 20.

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Given high market expectations for a Biden sweep, the reflation trade gathered momentum ahead of the election results, with global equities rallying strongly, sovereign yields rising, and the USD selling off sharply. On election night 3 November, equity markets have closed up strongly (S&P 500 up 1.8%).

Bond and equity volatility
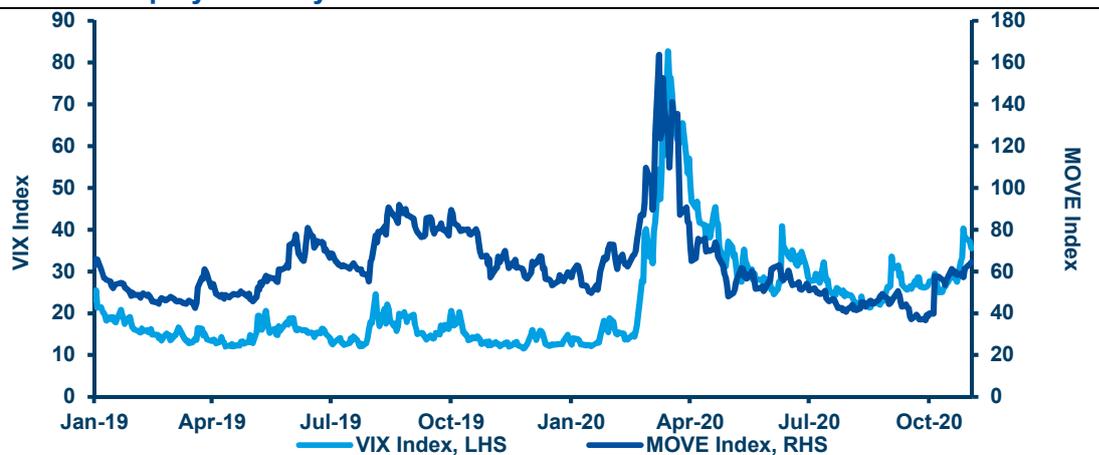
Source: Amundi, Bloomberg. Data as of 4 November 2020.

Initial market reaction has been mixed (negative European equities at opening, and flat on Dow Jones futures and up +2% on Nasdaq futures benefitting from a potential Trump trade).
The 10y US Treasury yield is plunging to around 0.8%, and the USD is up. We anticipate that uncertainty over the timing of an election decision and the resulting **short-term political instability will keep markets under heightened volatility and could weigh on equity markets**. **The value cyclical rotation is now on hold, as well as the steeping of the US curve.**

What to look out for next
It is important to consider that this US electionsis held in the extraordinary context of a Covid-19 second wave at a global level and high uncertainty for the economy in Q4, after a very strong rebound in Q3.
After the elections, we would expect markets to refocus quickly on the healthcare situation and to be heading towards more volatility in the coming months. Recent epidemiological simulations are alarming and call for renewed partial restrictions, with impact on economic forecasts for the next couple of quarters.

The ability to quickly implement a fiscal stimulus is the single most important factor with implications for the economy and financial markets, especially on cyclicals, commodities and energy and this will depend on the winner and the Congress composition. The more that is done in this respect, the better the benefit to the pro-cyclical trade. At the margin, trade war, taxes and regulation will also have an influence.
A Biden win would bring a fiscal package, that would be smaller and more controversial in a divided-Congress scenario.
Gold should be the natural hedge for a contested electoral result or on likely higher volatility in the markets, should the uncertainty last for long.

In **the most likely divided-power scenario** or a **contested outcome,** the **rising volatility** would push appetite for the **Dollar higher** in the short term, while expectations for higher deficit should recede sharply.
Dollar trends are the key element to watch with respect to EM assets, which will be very sensitive to the greenback reaction to the election result. In this respect, the worst-case scenario is a one of persistent Dollar strengthening, putting EM central banks under pressure to tighten and leading to higher volatility on EM currencies. The Fed will probably try to offset

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such a strength but short-term damage can still have impact. **No big change is expected on the US-China** relationship. Biden is somewhat less volatile and aggressive in his rhetoric than Trump, with a clear focus on the technology sector. Overall, from both sides, the 'tough-on-China' stance will remain.

S&P 500 and trade-weighted US dollar
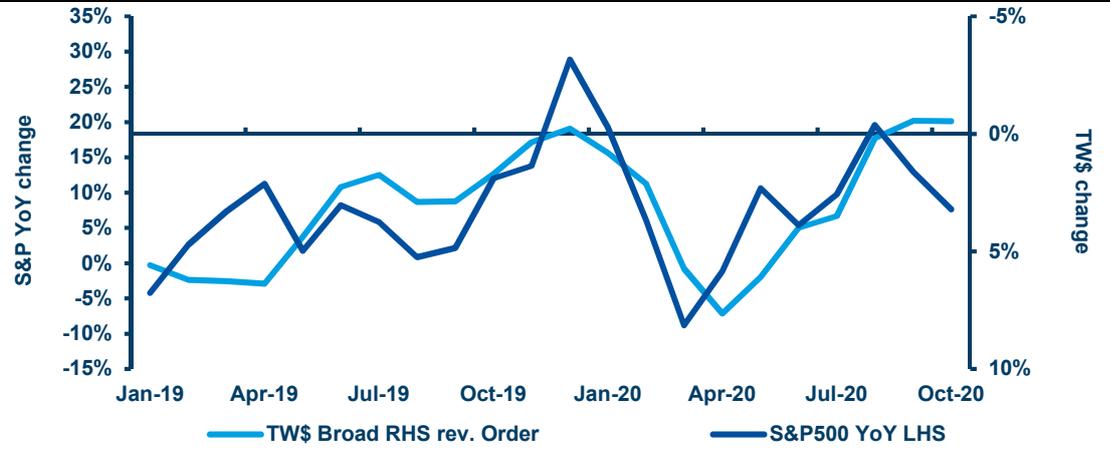
Source: Amundi, Bloomberg. Data as of 4 November 2020.

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Definitions

- **Curve steepening:** A steepening yield curve may be a result of long-term interest rates rising more than short-term interest rates or short-term rates dropping more than long-term rates.
- **FDI:** Foreign direct investments.
- **FX:** FX markets refer to the foreign exchange markets where participants are able to buy and sell currencies.
- **GOP:** Grand Old Party, the US Republican political Party.
- **Spread:** The difference between two prices or interest rates.
- **Volatility:** A statistical measure of the dispersion of returns for a given security or market index. Usually, the higher the volatility, the riskier the security/market.

Important information

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