

It's not at all unusual for volatility to spike and uncertainty to rise as we enter the final stretch in the lead up to the U.S. election. Frances Donald (Global Chief Economist and Global Head of Macroeconomic Strategy) and Erica Camilleri (Investment Analyst, MultiAsset Solutions Team) remain broadly constructive on risk assets, but they're also vigilant about the risks associated with election cycles.

How should investors approach the upcoming U.S. election?

The outcome of this election will provide important information about the future path relating to U.S. fiscal, trade, and regulatory policy, and it'll give investors the opportunity to implement more nuanced market positions. That said, we continue to believe that several key structural macro themes will remain particularly relevant to investors regardless of the election outcome.

Crucially, while investors might be tempted to head for the exits in view of heightened uncertainty, we'd argue against it. As Nathan W. Thooft, CFA, our global head of asset allocation, has noted previously, historical data suggests that it makes sense for investors with a longer-term investment horizon to stay invested, even when confronted with high levels of uncertainty.

In our view, there are two key factors that'll determine the market's direction in the hours, and possibly days, after the election—the length of time it'll take for the outcome to be finalized and the composition of the U.S. government, which is dependent on not only the outcome of the presidential election, but also the results of the Congressional elections.

When will we know the final outcome?

Given the higher than typical share of mail-in votes, it's entirely possible that a winner may not be declared on November 3. Some U.S. states, such as Florida and Arizona, have preprocessing procedures that enable them to begin counting mail-in ballots in advance; others can only start the counting process on either the

day before or day of the election. Understandably, this isn't what we're used to, and markets have responded by pricing in greater odds of volatility through November *and* December. However, it's also important to remember that the results of the 2000 U.S. presidential election weren't finalized until 36 days after the vote had taken place.¹ In other words, even if we were confronted with a delay this November, it isn't unprecedented.

The composition of government might matter more than who wins the presidency

With the Democrats widely expected to retain their majority in the House of Representatives (as of this writing), the focus shifts to the contest for the Senate. In addition to being a far tighter race, we also believe that the battle for control of the Senate is far more relevant to investors—the outcome could influence future U.S. policy, from trade agreements to fiscal policy.

In our view, if the Republican Party—which typically favors a more conservative approach to fiscal spending—manages to hold on to its majority in the Senate, it's reasonable to assume that U.S. government spending in the next few years could be relatively lower than it would've been otherwise.

At this point, it's just as important to note that the *size* of the majority that a party commands in the Senate could also make a huge difference. The magic number here is 60—if either party manages to win at least 60 seats in the Senate, it'll make it much more difficult for its opponent to invoke the [filibuster](#), thereby making the task of pushing through the majority party's agenda a much easier task.

Interestingly, markets have traditionally fared better when we have a split government where both political parties retain some form of influence over the policymaking process,² as it tends to make it more challenging for the administration to push through significant policy changes. The implication here is that it's more likely for status quo to be maintained. However, given that the economy is likely to remain very fragile in the first half of 2021, a split government could delay any fiscal aid, potentially adding an additional layer of uncertainty to the general environment.

Four scenarios to monitor

History has taught us that polls can be unreliable. Consequently, instead of assigning probabilities to outcomes based on election polls, we believe it's more practical to focus on the four most likely election outcomes and the associated implications for each of them (these scenarios assume that the Democrats retain control of the House of Representatives).

From a macro perspective, fiscal policy, structural regulatory changes to key sectors (particularly those that are relevant to the broader economy), and trade policy are of most interest to investors given their respective impact on growth and inflation outlooks, broad risk sentiment, and the foreign exchange market.

A second term for President Trump

Joe Biden forms a new administration

Republicans retain control of the Senate

Fiscal

A moderate stimulus package is likely, although it could be smaller in size than it would've been had the Democrats won control of the Senate. In this scenario, we'd expect to see a stronger U.S. dollar relative to other election outcomes. Inflationary pressures are also likely to be lower in this scenario when compared with a Democratic sweep.

Fiscal

In our view, this outcome could pave the way to the passage of a moderate stimulus package—possibly the smallest in size relative to the other three outcomes outlined here—as a result of protracted negotiations.

Key sector watch

We expect firms in the technology space to benefit on a relative basis when compared with other outcomes, as they'd be less likely to face the prospect of a possible tax hike, for now.

Key sector watch

In this scenario, it could be challenging for the new administration to introduce major reforms. Sectors that are likely to benefit from a status quo scenario (for instance, healthcare) could experience relief as perceived risks arising from regulatory changes recede; however, sectors that had benefited from growing expectations of a large stimulus package could give back recent gains.

Global trade

In this scenario, we largely expect the status quo to remain, although an escalation in geopolitical tensions—which could lead to the creation of new trade barriers—cannot be ruled out. If that were to happen, the U.S. dollar could strengthen on the back of its perceived safe haven status.

Global trade

The new administration is likely to adopt a comparatively less hawkish approach to global trade and foreign policy relative to its predecessor. While we expect tensions to persist, they'd likely be moderated to some extent.

A second term for President Trump

Democrats win control of the Senate

Fiscal

We expect a sizable fiscal stimulus package to be passed in short order in view of President Trump's recent comments relating to the subject. In this scenario, we expect the U.S. dollar to remain rangebound as the prospect of a larger fiscal deficit (which typically leads to a weaker greenback) is offset by its safe haven status in the face of rising geopolitical uncertainty.

Key sector watch

We believe the energy patch could experience some relief as the prospects of stricter climate regulations are less likely to be passed into law, for now.

Global trade

In this scenario, we expect the administration to maintain its hawkish approach toward global trade and foreign policy. That said, we expect trade rhetoric to be slightly less aggressive than in a scenario where the Republicans had retained control of the Senate.

Joe Biden forms a new administration

Fiscal

Of the four scenarios outlined here, we believe this outcome would lead to the passage of the largest fiscal stimulus package to support the U.S. economy. We expect the package to be financed by the U.S. Federal Reserve (Fed) and, over the course of several years, higher corporate taxes.

Key sector watch

It's likely that the technology and healthcare sectors could come under pressure as the administration moves to implement proposals he had outlined during the campaign, specifically the global intangible low-taxed income plan and the additional tax on worldwide book income. On the other hand, the industrials sector and other industries that are likely to receive direct or indirect support from the expected ramp up in fiscal spending could benefit.

Global trade

From a trade policy perspective, we believe this is likely to be the least hawkish outcome; however, we continue to believe that global trade tensions and the movement toward deglobalization will persist, even in this scenario.

Three long-term themes that matter regardless of the outcome

The upcoming U.S. election is no doubt important, but we believe investors should also pay attention to emerging macro themes that are likely to play an important role in shaping global financial markets.

1. We continue to expect interest rates to remain extraordinarily low in developed markets. We don't expect any major central bank to raise interest rates in the coming five years—rather, we think there's a likelihood that policy rates could be cut further, taking rates into negative territory (in some cases, *further* into negative territory). A return to a lower-for-longer interest-rate environment, combined with the Fed's shift toward average inflation targeting and the abundance of

remarkably large quantitative easing programs, could mean that global yields will remain suppressed for some time—particularly in the front end of the yield curve, up to the 10-year maturity. Where investors are concerned, this means the search for yield becomes a more challenging task, likely pushing them further out on the risk spectrum and forcing them to embrace assets with less desirable risk/return profiles.

2. In some ways, the COVID-19 outbreak has rewritten the rule book for how we look at fiscal balances. We expect debt-to-GDP ratios in most developed economies to remain near historically high levels in the coming years. By the same logic, we also expect government debt issuance—specifically, long-dated debt—to rise, which would

create downward pressure on the very long end of the yield curve.

3. Finally, regardless of the outcome of the U.S. election, we expect geopolitical tensions to remain elevated for some time. The ongoing health crisis and its associated impact on the global economy will no doubt add to a growing sense of uncertainty, as will the emergence of trade tariffs as the gradual movement to unwind decades of globalization takes shape, along with its various implications for the global supply chain.

¹ ["The Bush-Gore Recount is an Omen for 2020,"](#) *The Atlantic*, August 17, 2020. ² "Blue Wave Breaches the Red Wall," Bank of America Merrill Lynch, November 8, 2018.

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