Final Thoughts Before Election Day

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THE US ELECTION IS JUST DAYS AWAY. Voting has begun in earnest and markets are on tenterhooks. Here are our latest thoughts, including how investors might position for November and beyond.

Who's Afraid of the Big, Bad Blue Wave?

There's been a marked shift in the perception that a blue-wave outcome—where Democrats win the White House and both chambers of Congress—would be the "worst-case scenario" for financial markets. That's because the current impasse in getting another fiscal stimulus package passed would likely be broken with both chambers controlled by Democrats, paving the way for passage of a large stimulus package worth around $2-3 trillion. (See Who's Afraid of the Big, Bad Blue Wave? for additional thoughts.)

How We're Interpreting the Polls

As of this writing, former Vice President Joe Biden retains an Electoral College advantage, with multiple possible paths to the 270 votes needed to win the election (and more states like Texas within his striking distance). However, the four states we are most focused on right now are Florida, Pennsylvania, North Carolina, and Arizona, where polls have recently tightened. For President Donald Trump to win the election, he would likely need to capture all four. He is narrowly trailing by an average of 1.5-2% in each, well within the margin of error.

Of those four states, Florida is the one we will be watching most closely on November 3. It has 29 electoral votes and will be among the first states to report results. Whoever wins Florida could become our next president.

Additionally, the latest polls show Democratic Senate candidates holding leads that are consistent with gaining a 51-49 majority, but 15 states are within single digits. The remaining 4-5% of voters who are still undecided will also be key. Bottom line: Democrats have reason to be cautiously optimistic, but these races are far from over.

What Could Surprise the Markets?

In terms of what's already priced in, a lot of the "known unknowns" are already out there, particularly concerns about mail-in voting, a contested election, inaccurate polls, and potential interference by Russia, China, and Iran. This is reflected in the options markets, which are forecasting elevated volatility over the next three months.

Potential wildcards include: 1) the prospect of a major news revelation, especially anything scandalous; 2) whether or not control of the Senate flips to Democrats; 3) picks for key Cabinet positions such as Treasury Secretary, should Biden win; 3) possible removal of the Senate filibuster[1] in the event of a blue wave; and 4) what might happen in the "lame-duck session" between the election results and Inauguration Day.

[1] The legislative filibuster is a Senate rule that requires most bills to meet a higher threshold of 60 votes out of 100 to pass (rather than a simple majority), better enabling the minority party to block bills that it opposes.

Key Points

- Democrats have reason to be cautiously optimistic, but these 2020 races are far from over.
- Uncertainty may arise from a couple of potential wildcards including: major new stories, the fate of the Senate filibuster, and unexpected happenings during the lame-duck session.
- The market's election-induced moves are likely to be secondary to other catalysts, including COVID-19 developments and fiscal/monetary policy.

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Key Takeaways

- Election-related volatility is already elevated, accounting for the well-advertised risks, so markets may not react dramatically unless the results are close and lead to a contested election.
- Beyond who becomes the next US president, a blue-wave outcome may not be as negative for markets as first assumed, given that additional fiscal stimulus might get through Congress more easily.
- Uncertainty could still arise from a major news story, picks for key Cabinet positions, the fate of the Senate filibuster, and unexpected happenings during the lame-duck session.
- In addition, if another COVID-19 wave were to hit the US, any further lockdowns and/or economic fallout would likely be negative for markets.
- The market's election-induced moves are likely to be secondary to other catalysts, including COVID-19 developments and fiscal/monetary policy over the next 12 months. Substantial liquidity (as evidenced by cash on the sidelines), ongoing support from the US Federal Reserve, and fiscal stimulus (so long as it doesn't fade) should remain key tailwinds for the market.

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