

2020 Presidential Elections

Considering that we are approximately 100 days away from election day, we are closely monitoring the presidential campaigns and events that will define the final outcome and results. As we will illustrate in this piece, during the “corona economy”, Biden has led in the polls and in the betting markets. The election that was Trump’s to lose in 2020, became the election for Biden to lose today. With the coronavirus pandemic and the social unrest happening in the country the results are looking harder to predict than ever before.

In this Thinking Man edition, we illustrate that the equity markets effectively have started to price in a Biden win. However, we believe we will not have clear predictions until sometime in August, if not September. Our view is that the debates (or lack thereof) will be a defining factor, making the results difficult to predict at this time. While we believe a Democratic victory with the Republicans keeping the Senate is the most likely outcome at this point in time, our level of conviction is low, as the situation may change. In addition, there is no Street consensus at this time about who will win the presidential election, or the ramifications of a Trump or a Biden win. For this reason, going into the election period, we suggest investors focus on fundamental data (such as economic and earnings data) rather than on anticipation of unpredictable results.

When will equity markets start pricing in the election?

We believe the market has started to discount a potential Biden win. However, in line with Wall Street, we think the final results are still not clear. The four indicators that are starting to reflect a Biden victory are: (1) the polls, (2) the betting markets, (3) stocks of companies levered to a Biden win are currently outperforming stocks of companies that would benefit from a Trump victory (such as Biotechnology stocks), and (4) the relative strength of the Chinese equity market. The Shanghai Shenzhen (SSE) Index is the only major equity index up year-to-date (YTD) along with the Nasdaq. At the time of this writing the SSE is up 26.39% YTD¹. This outperformance could be partly foreshadowing a Democratic victory, since political decoupling will be stronger under Trump: Biden has a pro-globalization agenda, which contrasts with Trump nationalistic approach.

¹ As of 07.20.2020

The Thinking Man’s Approach



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- Even though the market is starting to predict a Biden win we believe equity markets will start to fully price in the election sometime in August.
- Polls are also suggesting a Biden victory. Nevertheless, we believe the debates (or lack thereof) will be defining - any mistake by Biden during these events could tip the election.
- The Street today expects a Democratic victory, with the Republicans keeping the Senate, which we believe will trigger a 5%-10% correction in the stock market. A Democratic Sweep is a large risk for the equity market – we expect a 20% correction if this happens. A contested election is the largest risk to the equity market.
- The main sectors levered to a Biden win are Alternative Energy, Cannabis, and Infrastructure. While a Republican victory mainly favors Defense, Energy, and Pharma.
- For more on how we are positioning our portfolios, please contact your investment advisor or ideas@bigsurpartners.com



All in all, we believe it is still early and we will have a better picture in the month of August. Historically, markets usually start pricing in the results of presidential elections three months prior, after the VPs have been selected and their respective party conventions take place.

The presidential debates could define the elections result

We have been seeing a large decline in Trump's poll results since April. At the time of this writing, Biden is leading with 60.4% in his favor in the betting markets.² At this time, Biden is also taking the lead in the national Presidential Election polls, with 49% in his favor³ and a Financial Times Poll predicts that Biden will win 308 of the electoral college votes, while Trump is expected to win 132 of these votes (270 votes are needed to win the election).⁴ In addition, Trump is predicted to lose in every swing state (AZ, FL, MI, NC, PA, and WI). Nevertheless, it is important to take into account that Trump was polling just as negatively nationally and in the swing states during the 2016 presidential election. However, the environment of the COVID economy and its negative ramifications for the population might make it difficult for Trump to regain popularity.

We believe that the debates could be the defining factor for this election. Biden has had a fragile position as the Democrat nominee, drawing negative press every time he has spoken in public events. As a result, Biden has been maintaining a low-exposure campaign. However, any significant mistake by Biden in one of the three upcoming presidential debates taking place between September 29th and October 22nd, could tip the election. Another possibility is that debates do not take place. For example, Thomas Friedman, a Democratic thought leader, published an opinion piece suggesting that Biden should demand the following conditions to participate in the debates: that Trump releases his tax returns for 2016-2018 and a "real-time fact-checking team approved by both candidates"⁵. His argument is that Trump will not accept these conditions. If Biden takes this approach, it is possible that the debates will not take place. With no historic precedent in this regard, we will have to wait and see.

The consensus is for a Democratic Victory: What are the risks for the stock market?

We believe the most likely outcome today is a Biden win and a Republican Senate. A Strategas survey predicts that Republicans will control the Senate with a 58.3% chance.⁶ We believe a Democratic sweep is not impossible but, most likely improbable. A Democratic sweep would mean a large risk to the equity market in our view, which we believe could trigger a correction of approximately 20%. On the other hand, we believe a Democratic victory, and the Republicans keeping control of the Senate at the highest probability, could potentially trigger a 5%-10% correction in the market.

The largest risk we have been considering is a contested election. Biden is polling higher than Trump in the eight key swing states. But this could quickly change – not many voters would need to change their minds to make it a close victory, or even flip the election. The extreme polarization, combined with candidates with weak popularity on both sides increases the probability of a contested win. The victory might be achieved by a

² As of 07.20.2020 (https://www.realcLEARpolitics.com/elections/betting_odds/2020_president/)

³ As of 07.20.2020 (https://www.realcLEARpolitics.com/epolls/latest_polls/national_president/)

⁴ As of 07.20.2020 (<https://ig.ft.com/us-election-2020/?emailId=5f0e685edf938300040045b8&segmentId=22011ee7-896a-8c4c-22a0-7603348b7f22>)

⁵ <https://www.nytimes.com/2020/07/07/opinion/biden-trump-debate.html?searchResultPosition=1>

⁶ Strategas

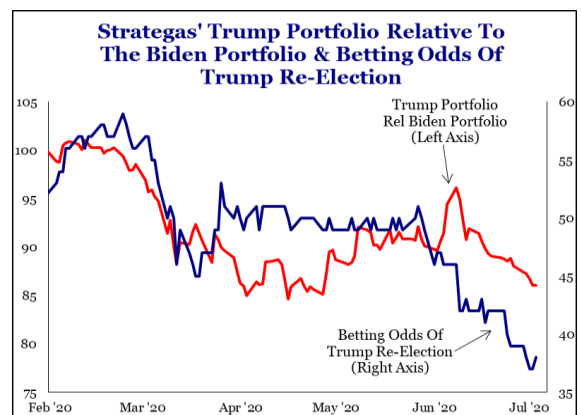


small amount of votes, or a recount triggered by allegations of unfair restrictions on voting. This would be a very bad scenario for the equity market in our view as we would estimate a 10%-30% correction in this case. As a reference, during the 2000 contested presidential election between Bush and Gore, the United States Supreme Court settled a recount dispute in Florida. On December 9th, 2000, the Court had preliminarily halted the Florida recount that was occurring. The Electoral College met on December 18th, 2000, to decide the election. The S&P500 lost between 8-9% during those days of uncertainty. As we consider the environment of polarization to be much worse in 2020 than in 2000, we would expect a larger equity market correction in 2020 in a scenario of a contested election.

As Ian Bremmer from the Eurasia Group reports, Trump is already ramping up a drumbeat of “the opposition is trying to rig the election” as part of his campaign, particularly focusing on the need to oppose vote by mail. The key difference with the 2016 election is that then-candidate Trump had no instruments of power to help him change the electoral process and/or contest the outcome in his favor. Today Trump runs as President, which not only means that he counts with the benefits of incumbency, but also with every lever that can be deployed by a sitting President with a loyal cabinet, a Republican Senate, and the Administration’s domestic and foreign policy influence to support him. In addition, this will be a national election unusually vulnerable to interference and de-legitimization, with a flare-up in the status of social media platforms (which make disinformation far easier to distribute), together with a polarized electorate (already inclined to only consume one side of politicized news), and a pandemic that itself is disruptive to the electoral process, leading to changes in rules that make disenfranchisement of voters both easier and more likely. On that latter front, legal fights are underway across the country, with 142 suits already filed related to rules for voting in a pandemic. Putting these two features together—a particularly delegitimized election, coupled with a President greatly interested in interference—the upcoming November elections are shaping up to be a perfect storm.

Sectors that are levered to a Democratic Sweep vs. a Republican Sweep

The market has started to price in a Biden win in our view. This is being reflected in the outperformance of stocks levered to a Republican Sweep compared to stocks levered to a Democratic Sweep, as is seen in the graph. The Strategas Republican Sweep Portfolio has stocks of companies operating in the following sectors: Energy, Healthcare, Defense & Aerospace, Financials, For-Profit Prisons, For-Profit Education, Materials, Labor & Tech Regulation, and Tax Reform. The Strategas Democratic Sweep Portfolio has stocks of companies in the following sectors: Infrastructure, Renewable Energy, Trade Policy, Healthcare, Marijuana Legalization, State Budgets, Consumer Staples and Safety Net, and Immigration and Guns. The companies in the latter sectors are outperforming the former.



Source: Strategas

Republicans keeping the senate would reduce the probability of a tax increase. On the other hand, a Biden win would mean a bullish environment for infrastructure as well as for the marijuana industry, but would also mean increased financial regulation and headwinds for defense stocks. There are sectors such as Technology which will be affected in different ways depending on each specific company. For example, we believe a Biden win



would be very positive for Tesla (TSLA), since it would benefit from potential environmental subsidies that Biden would roll out as part of his climate change plan. However, we believe a company like Facebook (FB) would benefit from a Trump win, since he will likely favor less regulation.

Conclusion

We believe it is too early to change the current positioning of portfolios based on the predictions for the elections. We do believe the market has started to price-in a potential Biden win, mainly via relative sector and stock performance (like Biotech stocks or the stock of Tesla). In our view, the largest risk to the equity market is a contested election, since it is unusually vulnerable to de-legitimization and the President seems to be prone to interfering. However, we think it's still too early to call and that two main events will shape the results: Biden's Vice President pick and the debates (or lack thereof). In the meantime, aggressive monetary and fiscal policies will continue to support risk assets.



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