US Election Result: Markets Rally on Biden Victory

Fullerton Market Updates
November 2020

FULLERTON FUND MANAGEMENT

Executive summary

- Biden has won the US presidential race, with the Democrats holding the House, and the Republicans likely to retain the Senate. Risk-assets have reacted positively to this Biden led 'divided-government' outcome.
- Equities should potentially do well under President Biden, as US fiscal support over time will likely be significant. Historically, a Democrat President with split legislative power, can result in a fiscal-stimulus 'sweet-spot' that is great for equity market performance.
- Asian equities could also benefit if a more dovish US foreign policy results in US-China relations stabilising and potentially improving over time.
- Pressures are likely to continue to build over time for US 10y yields to slowly drift higher, from stronger macro data, higher equities, and rising inflation expectations.
- US dollar strength is likely to fade over time as the wider US current account deficit drives the dollar down.

Author

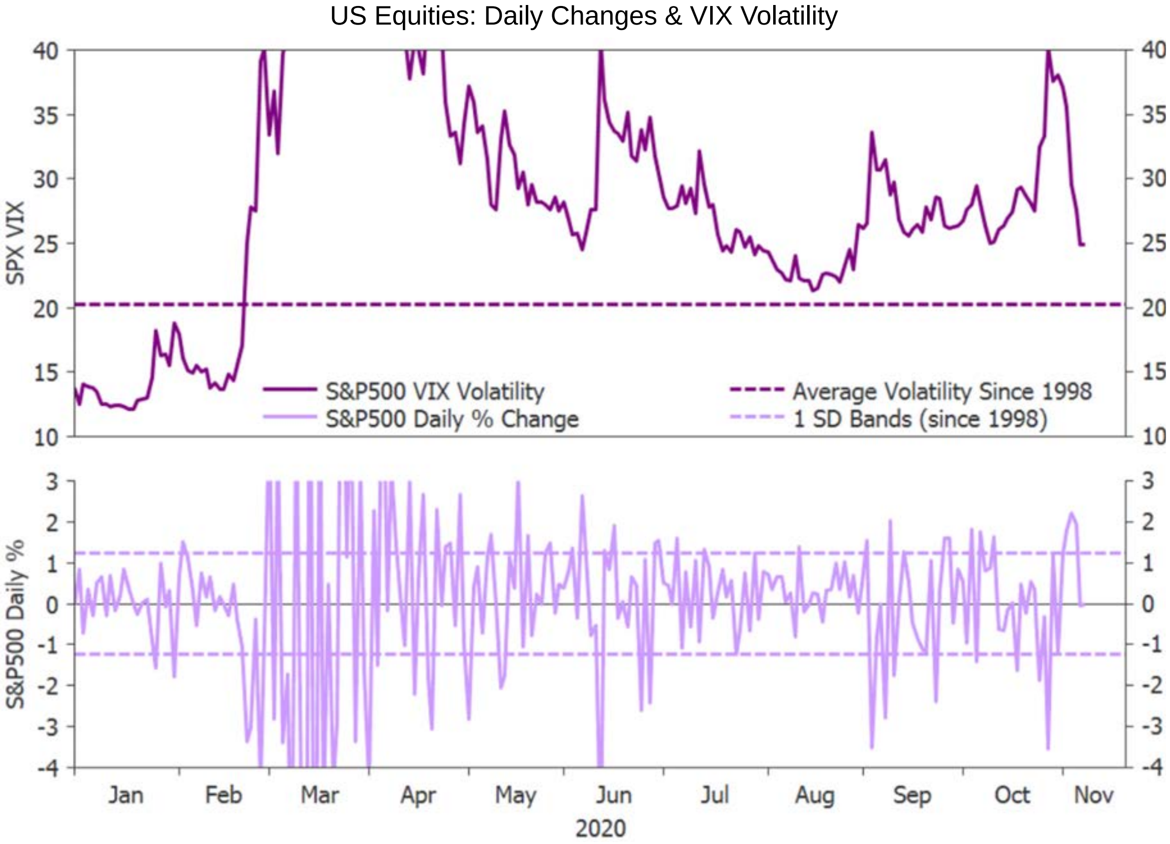
Robert St Clair
Strategist
Fullerton Fund Management

Market actions largely as expected

Despite taking longer than anticipated to get clarity on the US elections, and with the threat of legal action by President Trump still hanging over the results, markets have responded positively as expected since Biden's win was confirmed.

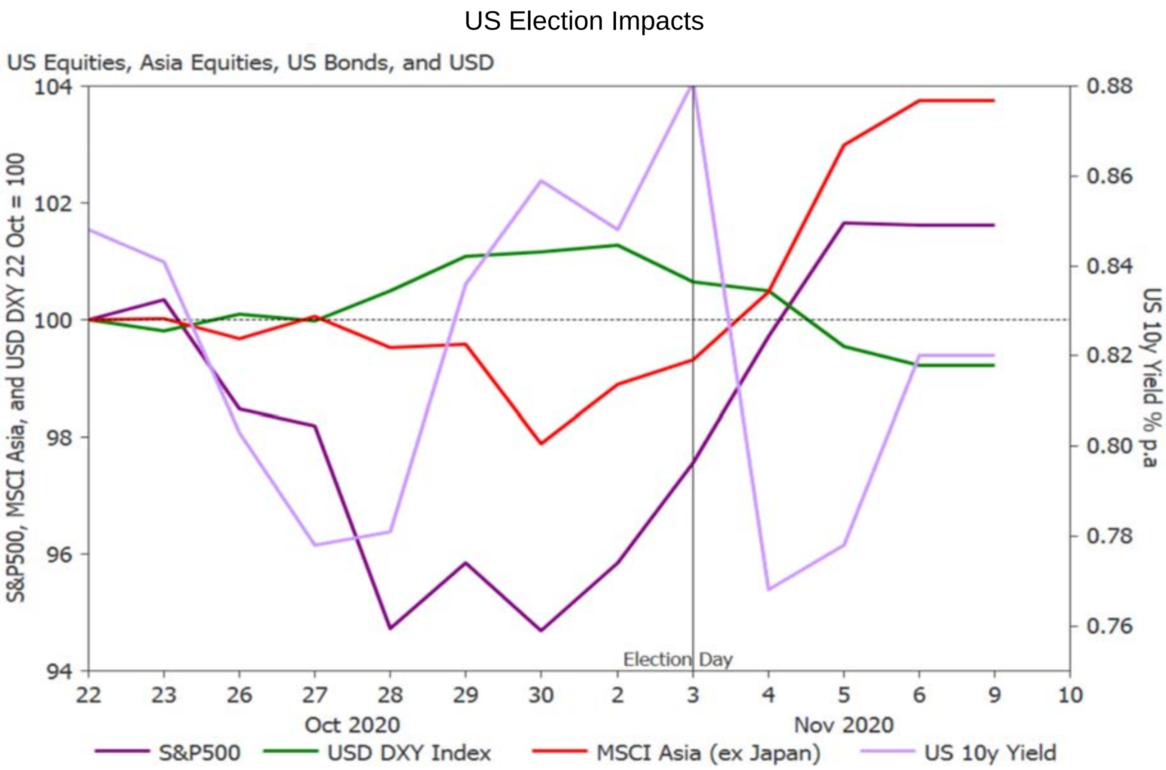
As at 8 November 2020, US equity market volatility has fallen back significantly, from a peak of 2 times average volatility to 1.25 times average volatility (Figure 1). US equities are up by about 4% (Figure 2). Meanwhile US 10-year yields (Figure 2) initially fell sharply, then rebounded. The USD was holding-up, but has started to slip again (Figure 2). Reflecting the prospect of a more dovish US foreign policy, and thus better US-China relations over time, Asian equities (Figure 2) have moved higher, during this period.

Figure 1: US equity volatility



Source: Refinitiv Datastream, 8 Nov 2020

Figure 2: US election impacts across equities, bonds, and USD



Source: Refinitiv Datastream, 8 Nov 2020

US election outcomes are potentially bullish for US equities, Asian equities, but bearish for bonds and the USD

President-elect Joe Biden spoke of his intent to “restore the soul of America” during his victory speech as he urged the US to come together after “one of the most divisive periods in US history”. A key priority is to provide as much stimulus as is required, to make sure the US economy does not stall in its recovery from the COVID-19 driven recession.

President Trump has threatened legal action over some of the outcomes across key battle-ground states, but it seems that such actions don’t have a strong basis and may only result in verifying procedures, and possible re-counts, rather than invalidating any outcomes. The final makeup of the Senate will not be known until 5 January 2021 - at present the Republicans have 2 more seats than the Democrats.

In our recent US Election Preview we summarised the policy actions that are the most important to the Democrats. Risk-asset markets have reacted very positively so far, on the prospect that:

- US foreign policy could become more dovish - which can support the performance of US multinationals, as well as global equities, and especially Asian equities, if US-China relations stabilise and improve.
- US government spending will be stronger than otherwise over the next four years, and any potential increases in tax may be modest (or postponed until the economy is stronger).
- Any new legislation impacting the operating environment for US tech firms is likely to be more positive than otherwise (as pro-business Republicans will push for that from the Senate).
- There will be more fiscal stimulus if the US struggles again with potential COVID-19 related lockdowns.

US bond yields also started to rise again once Biden’s win was confirmed. Pressures are likely to continue to build for US 10y yields to slowly drift higher over time, from stronger US macro data, higher equities, and rising inflation expectations.

Election uncertainties were helping to support the US dollar, but US dollar strength should now fade over time as the wider US current account deficit drives the dollar down (read more in our Q4 2020 Fullerton Investment Views which outlines in more detail our expectations for the performance of risk assets).

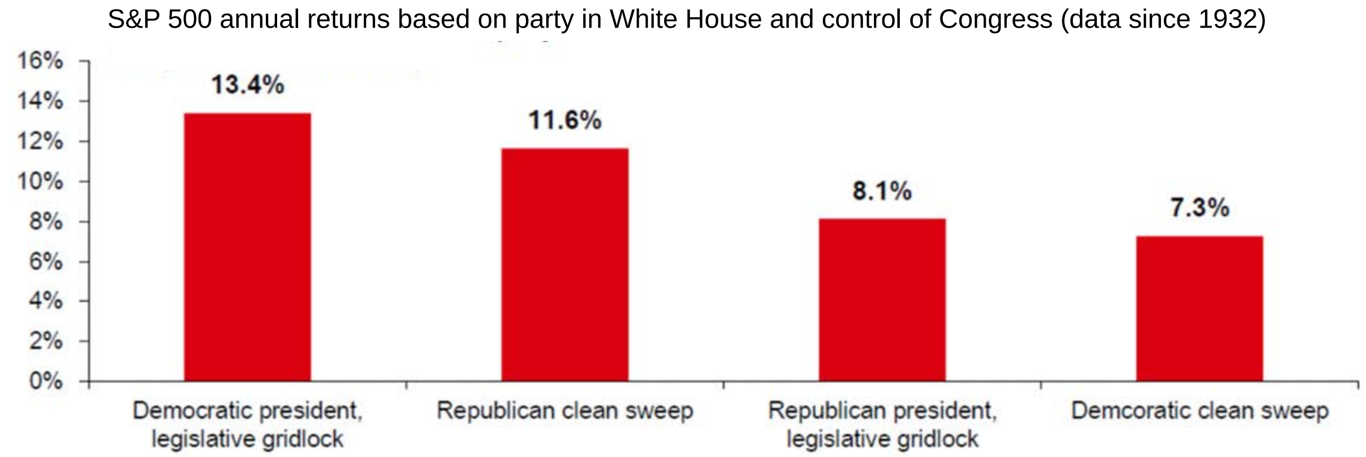
A Democrat 'divided-government' can potentially result in strong performing equities over time

Because fundamentals are solid, the Biden victory can be potentially supportive to equities because of his bias toward fiscal stimulus and a potentially more dovish approach to US foreign policy.

Historically, a Democrat President with split legislative power has correlated with strong performing US equities (see Figure 3) – perhaps because of the Democrat bias toward more fiscal stimulus that is kept 'in-check' by Republicans (so as not to become excessively inflationary).

In other words, a Democrat 'legislative gridlock' outcome can result in a fiscal-stimulus 'sweet-spot' that is great for equity market performance. The most obvious risk to this positive outlook is if President Biden's policy actions prove to be less stimulatory than expected over time (or worse – the risk that fiscal austerity is eventually pursued given the divided government).

Figure 3: Historical US equity returns (% p.a.) based on White House and Congressional control



Source: Bloomberg, HSBC, As at 7 October 2020