MARKET UPDATE: WHAT TO MAKE OF THE US PRESIDENTIAL ELECTION?

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With less than a month to go until the ballot opens, investor attention is increasingly focused on the US presidential election. With two very different characters running for the White House, and with US politics deeply divided along political lines, interest in the outcome is understandable. However, we suspect that – for the most part – voting on 3rd November will have much greater significance politically and socially than it will from an investment perspective.

While there is much to differentiate the policies of Republican Donald Trump and Joe Biden, his Democratic challenger, there are also a number of similarities. From a cold-hearted investor's perspective, one particularly important common agenda is the intention of both candidates to unleash additional government spending to support the US economy. True, the scale and shape of this support differs – Trump's plans emphasise business-friendly tax cuts while Biden's focus on social security – but the objectives are the same: to cement and accelerate the economy's recovery from its Covid-induced recession.

Undoubtedly, of course, there is devil in the detail. Four more years under President Trump, with his low tax agenda and anti-regulatory instincts, would likely be welcomed by Wall Street. Furthermore, though his first term has been marked by unpredictability and opportunism, a second term for Trump nonetheless represents continuity, a condition investors tend to prefer over change. On the other hand, while the scale of Biden's proposed economic stimulus should be welcomed by stock market investors, the prospect of tighter regulatory standards and higher corporate taxes may mean a Democratic victory is initially met with a degree of wariness.

Beneath the headlines, the election outcome may have a material impact on specific sectors of the economy. As ever, healthcare is set to be a key battleground. While Trump wishes to dismantle the Affordable Care Act – a cornerstone of Barack Obama's legacy – Biden supports its expansion. The fortunes of healthcare providers, insurers and drug manufacturers are heavily dependent on which approach wins out. The same might also be said of industrial sectors, particularly car manufacturers. While climate concerns hold little sway with Trump, Biden's industrial agenda has a pronounced green tint to it.

Meanwhile, the technology sector has been coming under increasing scrutiny for the monopolistic traits of a number of high profile companies. Trump has enjoyed a love-hate relationship with technology since his election four years ago and it is difficult to predict how he would treat the sector should he win a further term in office. Under Biden, it is likely that large technology companies would come under greater scrutiny over the low proportion of their revenues that is paid in tax is turned over to the tax collector.

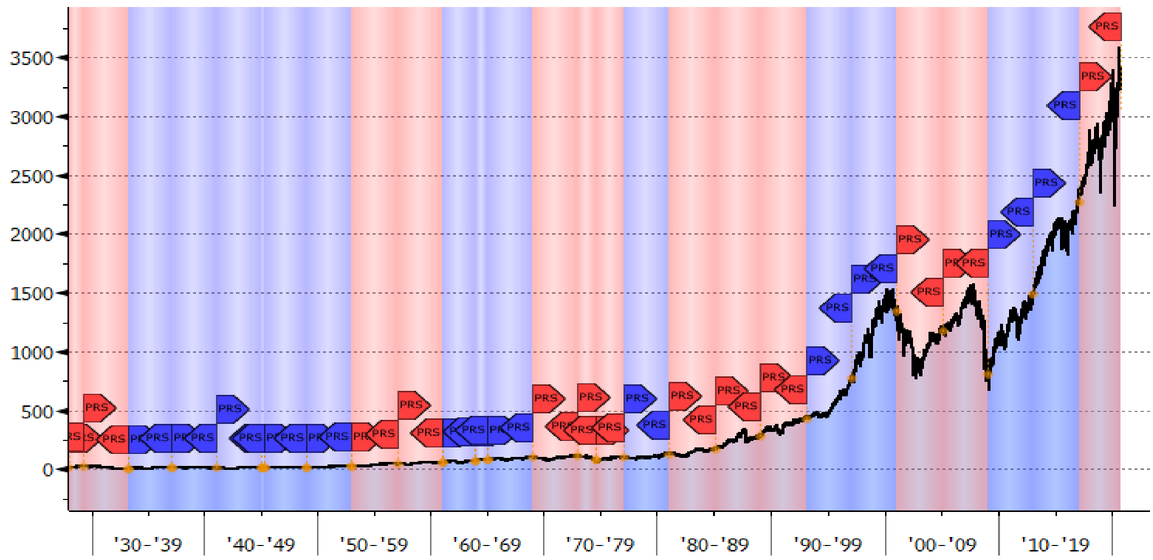
At this point, it is worth remembering that it is not only the presidency that is up for grabs on 3rd November. Among many other state and regional positions, Americans will also be voting on all 435 seats in the House of Representatives (the lower house of the US Congress) and 33 seats in the Senate (the upper house). After their strong showing in the 2018 mid-term elections, the Democrats' control of the House of Representatives is thought to be fairly secure. However, the battle for control of the Senate will be closely fought. At present, the Republican party enjoys a slim majority in the Senate, but polls suggest the Democrats have a chance to overturn this.

Should either party emerge with a clean sweep, winning the presidency, the House and the Senate, it will be in a position to implement policies that are further from the political centre ground. On the other hand, should the three pillars of government be divided among the two main parties, compromise will be required to pass legislation. While this means domestic policy is unlikely to lurch either to the left or the right, hostilities between the parties would likely mean a continuation of the political brinksmanship – with key decisions delayed until the very last minute – that has been at least partly responsible for some of the turbulence we have seen in financial markets in recent years.

There is therefore a range of possible outcomes from November's elections and, as the experience of recent years has taught us, elections (and referendums) are difficult to predict. However, as investment managers we must weigh the relative probabilities, analyse potential future scenarios, and ensure portfolios are able to both benefit from our highest conviction predictions, and be robust in the face of unexpected outcomes.

The reason for this, at least in part, is that while the president of the United States is undeniably important on a global scale, long-term investment outcomes are determined by a multitude of other factors, each of which is unrelated to the current occupant of the Oval Office. Republicans may enjoy a 'business friendly' reputation while Democrats are held to prioritise 'Main Street' over 'Wall Street', but the influence of these unrelated factors ensures there is no identifiable pattern to historic stock market returns under presidents from one camp or the other (see Figure 1).

Figure 1: The S&P 500 index of US stocks under Republican (red) and Democrat (blue) presidents since 1925



Source: Bloomberg

Of these factors, monetary policy is perhaps the most important. Overseen by the Federal Reserve – the politically independent US central bank – monetary policy (interest rates and other market operations such as the programme of asset purchases known as "quantitative easing") is set to remain exceptionally supportive for several years yet to come, regardless of who wins in November. Given the importance of the US dollar to the world economy, this is welcome news for investors, globally, in both stocks and bonds.

Against this, the US stock market currently appears very expensive relative to stock markets elsewhere. Our analysis highlights valuations as a critical determinant of future investment returns. On this basis, we might expect non-US stocks to outperform US stocks over the coming years, regardless of whether the US president is in favour of 'America first' or a more collaborative international approach.

Our key message for investors is to recognise the importance of the US presidential election, but not to be consumed by it. From a social and political perspective, there is a great deal to distinguish between Donald Trump and Joe Biden and the character of the United States they wish to preside over. From a cold-hearted investment perspective, these differences are likely to cause some turmoil beneath the surface: we believe an active approach to stock selection is best placed to deal with the associated risk and opportunities. However, the commitment of both candidates to large scale government spending is likely to set the tone at the headline level. More than this, we believe long-term investment returns are heavily influenced by a number of factors over which the sitting US president has little or no influence, including monetary policy and valuations. As ever, we would encourage investors to focus on the long-term.

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