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U.S. ELECTION UPDATE

Final thoughts as we approach election day

Luc de la Durantaye, Chief Investment Strategist

While elections are usually important elements of the economic outlook, the two candidates for this year's contest have divergent views on many important aspects of economic policy. As a result, assessing the potential political scenarios has become more important and more difficult at the same time. National and State polls, polling-based models and betting markets all continue to show Joe Biden with a stable lead to win the Presidency, with less than two weeks left before the election. While polls have faded from their peaks, national polling averages show around +9pts favouring Biden, a comfortable lead two weeks before an election by historical standards.

The Senate race, while closer, is also tilted towards a Democrat win—the most likely outcome is leaning towards a Blue Wave. While this doesn't mean a sure win, it may require an unforecastable event to change this outcome in such a short period of time. Still, knowing the actors involved, surprises remain possible. An obvious risk is for the polls to be wrong, somewhat like the 2016 experience. While possible, pollsters have adjusted their methodologies to reduce this risk.

Another risk is the unprecedented amount of vote-by-mail in this election, which poses a specific risk to the Democrats as they represent a larger share of this voting method. In a tight election contest, a higher percentage of discarded votes could swing results in certain States, leading to a swing of power back to Republicans. The Senate race will also hold our attention, as the U.S. fiscal policy path likely hinges on its outcome. If Biden wins the Presidency, control of the Senate will mean the difference between substantial fiscal expansion, in the case of a so-called Blue Sweep, or fiscal gridlock if Republicans retain the Senate. So far, polls and betting markets give a slight advantage to the Democrats to win the Senate. There is also the risk of a contested election. The more the race depends on the outcome of the few States allowing extended mail-in ballot counting deadlines after November 3 (mainly Michigan, Pennsylvania and Wisconsin) the more "election night" could turn into "election week". This would raise the risk of Trump contesting the election results more aggressively.

Financial market implications

The capital markets implications are also meaningfully divergent under the two most probable scenarios. A Blue Sweep, where President Biden is also supported by a Democratic Senate, would likely represent the largest fiscal stimulus to the economy. Such a scenario could translate into further non-U.S. equity market gains (due to the U.S. corporate tax increase and increased U.S. regulations) and higher long-term bond yields, due to higher economic activity and higher fiscal deficits. It could also potentially mean a degree of sector rotation, with industrial and material companies doing better with the prospects of growing infrastructure projects.

The second most likely scenario—a Biden win and a Republican Senate—could be the most negative growth scenario. Fiscal stimulus is likely to be more marginal and other key elements of the Biden agenda that could be implemented through executive orders could be negative for near-term growth prospects. Under such a scenario, equity markets could experience a correction, growth stocks could continue their outperformance relative to value stocks and interest rates would likely decline, anticipating slower growth. Such an uncertain outcome will require a degree of flexibility and portfolio diversification to preserve capital while seeking growth.