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How Will Markets React to the 2020 U.S. Election?

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With the U.S. presidential election nearing, market volatility has increased as the unprecedented level of absentee ballots or postal votes suggests it could take days or even weeks to announce the final outcome. In this report, J.P. Morgan Global Research examines the implications of a range of potential 2020 U.S. presidential and congressional election scenarios that include the status quo, a “blue wave” or a Biden/split Congress, across a wide range of asset classes and sectors.

Presidential Polls and Policies: Trump vs. Biden

Democratic presidential candidate Joe Biden maintains a lead in major polls, but the margin has narrowed compared to the pre-Democratic convention peak in July of around 10 percentage points according to RealClearPolitics. The first safe harbor deadline at the state-level on December 8 is critical, as counting and certification must be completed prior to that day. Each state has unique laws and regulations governing voting across 8,000+ local jurisdictions. After two-thirds of the 50 states and the District of Columbia expanded voter access to mail-in ballots and election officials expecting record volumes, especially from states that historically had low mail-in rates, the overall processing time is likely to increase.

"The predictive powers of polls are strongest after mid-October, but investors should be prepared for election week(s), as a clear winner may not be announced on election night. The election outcome could once again come down to a few key swing states," said Joyce Chang, Chair of Global Research at J.P. Morgan.

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> **Joyce Chang**
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> **J.P. Morgan**

"A blue wave or Democratic control of the House, Senate, and White House would produce the largest changes in policy, but if Republicans retain the Senate or White House, limited new federal policies, fiscal or otherwise are expected until at least the 2022 Congressional elections," added Mike Feroli, Chief U.S. Economist at J.P. Morgan.

Irrespective of the electoral outcome, the use of executive orders to dictate policy is here to stay given the rising level of polarization and stalemate over the past 20 years as most legislation requires a supermajority of 60 votes in the U.S. Senate for passage, which is unlikely to be achieved by either Democrats or Republicans.

Policy Proposals of Democratic Presidential Nominee Biden vs. President Trump's Current Policies

POLICY	BIDEN	TRUMP
Corporate taxes	Raise corporate rate to 28%, create minimum tax rate of 15% on book income	Lowered corporate tax rate from 35% to 21%
Personal income taxes	Restore top rate to 39.6%; raise capital gains tax to ordinary rate for those earning more than $1 million; wealth tax (details unspecified)	Lowered federal rates from 10% to 39.6%; brackets to 10% to 37%

POLICY	BIDEN	TRUMP
Trade	Enlist U.S. allies to challenge China on trade; advocates enforcing existing trade laws while writing new rules that protect workers, the environment and labor standards	America first policy involving withdrawal from TPP, renegotiation of NAFTA, trade/tech/investment war against China and early-stage trade war with EU
Healthcare	Improve Affordable Care Act (Obamacare) by adding public insurance option, Medicare to negotiate drug prices, link domestic to international prices	Failed attempt to repeal Obamacare in 2017
Energy	Ban new leases for drilling offshore and on federal land; partially supports Green New Deal end fossil fuel subsidies; supports carbon tax; end fossil fuel subsidies; 100% clean energy by 2050	Opened more federal land to drilling; Reduced Iran/Venezuela output through sanctions
Tech and Comms	Supports using anti-trust legislation to investigate anti-competitive practices	No significant sector-specific policies, though DoJ, FTC & FCC investigations ongoing
Finance	Support a financial transactions tax	No signature legislation, but more finance-lenient interpretation of Dodd-Frank
Infrastructure	$1.3 trillion plan, including green proposals	No signature legislation
Immigration	End family separation; protect DACA; create a pathway to citizenship; give more resources to better leadership/ training within ICE; don't decriminalize crossing the border	Border wall; record contraction in legal immigration through visa limits
Monetary Policy	No public comments	Favors lower rates; two board seats remain open

POLICY	BIDEN	TRUMP
Minimum Wage	Raise minimum wage to $15/hr	Federal minimum wage unchanged at Other $7.25/hr

Source: J.P. Morgan, campaign websites and public statements

How Will the 2020 U.S. Presidential Election Affect Stock Markets?

U.S. equities, credit and rates are priced consistent with elevated volatility well after Election Day, potentially due to a delayed or contested result. Despite the recent uptick in market volatility, the outlook for U.S. equity and credit markets is constructive. J.P. Morgan Research U.S. equity strategists now expect the S&P 500 to reach new highs of 3,600 by the end of this year. With fundamentals and balance sheet trends continuing to see improvement, S&P 500 earnings per share of $136 for 2020 and $170 for 2021 are also expected.

"The consensus view is that a Democrat victory in November will be a negative for equities. However, we see this outcome as neutral to slighty positive," said Dubravko Lakos, Head of U.S. Equity and Quantitative Strategy at J.P. Morgan.

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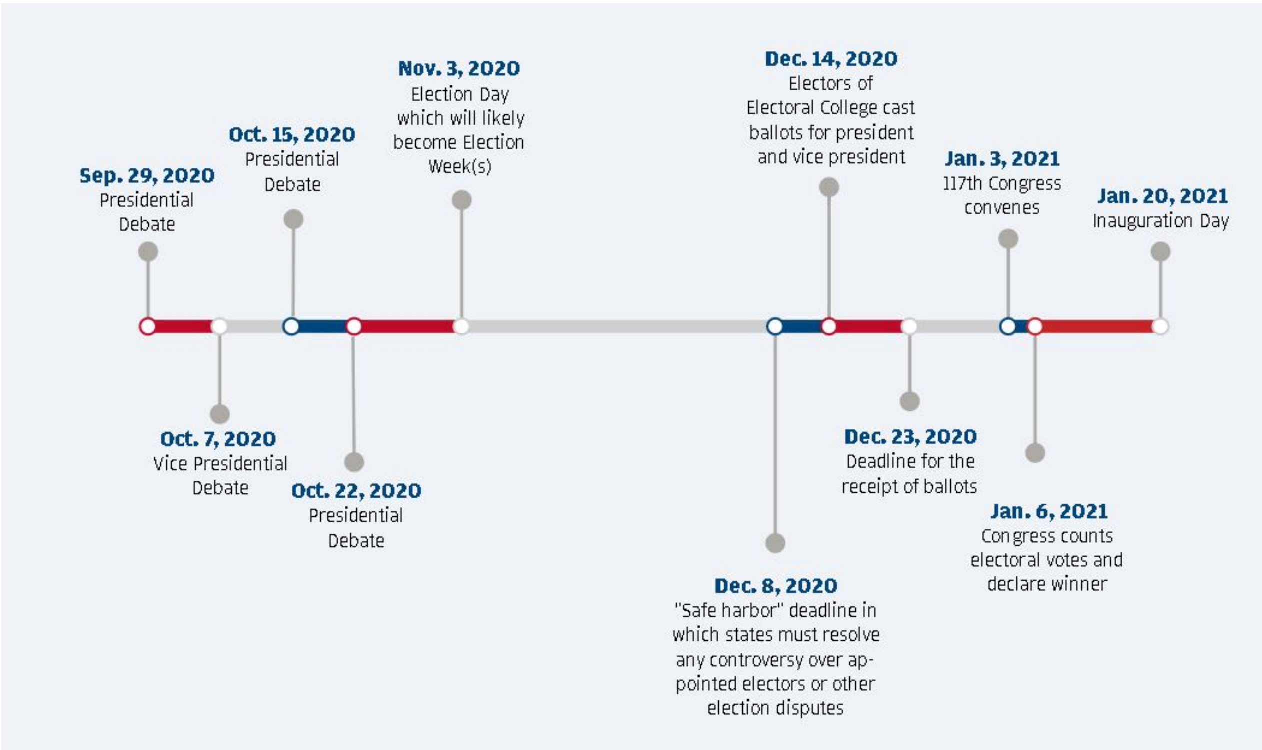
Central bank liquidity has helped enable a record $1.3 trillion in capital market activity year-to-date ($1.2 trillion debt issuance and $96 billion equity issuance), which has significantly lowered credit risk and allowed equity risk premia to compress in the midst of a recession.

"A Biden victory with a split Congressional outcome would be the 'best case' from a markets perspective. In the case of a Democratic sweep, we see better investment opportunities in key sectors that would benefit, such as materials due to infrastructure spending and consumer discretionary due to a higher minimum wage," said John Normand, Head of Cross-Asset Fundamental Strategy at J.P. Morgan.

Apart from U.S. equities, emerging market Asian equities and currencies would also benefit due to a less-impulsive trade policy under a potential Biden administration. In the event of a Democratic sweep, J.P. Morgan Research recommends an overweight to China equities on the potential for stronger policy support, but an underweight to emerging markets elsewhere vs. developed market equities.

In Europe, the Stoxx Europe 600 should remain range bound into year-end, with the U.S. likely to stay the regional outperformer as it continues to benefit from favorable sector tilts and stronger earnings delivery.

Key U.S. Political Events and Electoral Reporting Timeline



Source: J.P. Morgan Strategic Research

How Will the 2020 U.S. Presidential Election Affect Market Volatility?

Macro trades at the level of the index or Treasury yields and the trade-weighted dollar are less compelling given offsetting proposals within the Biden platform, like higher corporate taxes. Investment portfolios should not discount the possibility of a Trump re-election as Biden's lead has narrowed in recent polls and the impact on sectors and factors (momentum vs. value, cyclicals vs. tech, Environmental Social Governance) could be dramatic.

“We think that political and economic convergence of the K-shaped ‘recovery’, i.e. convergence of COVID-19 winners and losers, is ahead of us and some unwind of the new normal lies ahead,” said Marko Kolanovic, Head of Macro and Quantitative Derivatives Strategy at J.P. Morgan.

Election-related event risk is much more expensive in equities and rates options markets compared to foreign exchange markets.

“The tendency of the market to project based on what information is available at the time can, under the right circumstances, lead to significant excess volatility in the weeks following Election Day, particularly in rates and equities. U.S. rates, credit and equities are all pricing elevated risk of a delayed or inconclusive result while most forex pairs are pricing the opposite.”

Josh Younger
Head of U.S. Interest Rate Derivatives Strategy
J.P. Morgan

Despite all the macroeconomic upheaval and aggressive policy easing this year, most major currencies have seen small cumulative moves. The lone standout is the Euro – since the start of the year, it has appreciated 6% in traded-weighted terms and 3.9% against the U.S. Dollar (USD). A blue wave scenario foresees around 2.5% USD weakness, a Trump status quo sees potential for 4.5% strength and a Biden/split congress scenario implies more modest 2.0% USD weakness.

“Our election USD scenario framework suggests a 7-8% potential divergence between the two election outcome scenarios and the weighted probability of those scenarios suggests little justified USD premium associated with November elections at present,” said Dan Hui, Global Foreign Exchange Strategist at J.P. Morgan.

With spreads just over 10% north of the 150 basis point (bps) target for the J.P. Morgan High Grade Credit Index (JULI), a narrow range of outcomes for credit markets is expected between now and year-end. In the municipal bond market, potential trade opportunities under a Republican dominated outcome include AMT (alternative minimum tax) bonds, utilities with higher coal/fossil fuel generation. Should a blue wave emerge, state/cities with large COVID-19 related budget shortfalls, high tax state bonds (New York, California, Connecticut, and Illinois), mass transit systems, community colleges and historically black universities are preferred, according to Peter DeGroot, Head of Municipal Research at J.P. Morgan.

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