WILLIAM BLAIR

Election Special: Ten Initial Observations From the U.S. Results So Far

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C20-16925 | 11/2020 | EXP 11/30/2021

William Blair

Equity Research
Economics

5 November 2020

Richard de Chazal, CFA
rdechazal@williamblair.com
+44 20 7868 4489

Election Special

Ten Initial Observations From the U.S. Results So Far…

At this point, with the race not yet over, financial markets are clearly pointing to a scenario whereby Joe Biden wins the White House, while the Senate remains in the hands of the Republicans and the House is retained by the Democrats. Against such an assumed outcome, it might be worth offering 10 observations about the elections and this scenario:

1. Partial redemption for the pollsters and financial markets as predictors of election outcomes

While we have yet to see the final tally, we can certainly say that the vote was much closer than the surveys and the financial and betting markets predicted, i.e., one where a blue wave was the highest probability outcome.

Such an outcome was the pre-election message given to us by the pollsters as well as through the betting markets, the futures market, and the stock and bond markets. In a world of big data analytics and when the pollsters had supposedly greatly improved their algorithms, not to mention the huge leaps forward in connectivity, it shows there are still some very wide gaps in the framework.

Yet, perhaps in their favor, the gulf this time around was much less. For example, in 2016, Nate Silver's FiveThirtyEight election forecast gave Hillary Clinton a 71.4% probability of winning (Trump 28.6%), while *The Economist* gave her a 96% chance, and the *New York Times* 92%. This time around, FiveThirtyEight gave Biden an 89% probability of winning, and *The Economist* provided odds of 97% in favor of Biden—probabilities that currently look to be on target.

2. This is still a very divided nation

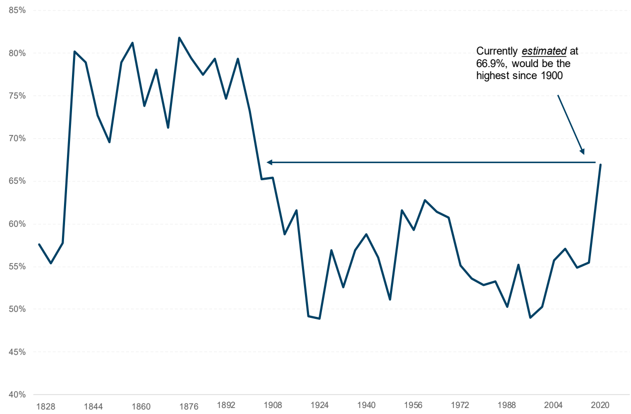
The huge increase in voter turnout (as a share of the voting age population) for this year's election is possibly the highest since 1900—it is currently being estimated at 66.9% (chart 1). In addition to the closeness of the race, it is a testament to both the divisive nature of politics today and the very differing opinions as to which direction the nation should be heading.

In 2016 turnout was 59.2%, whereas the highest in history was 81.8% in 1876. The lowest turnout ever recorded was 1996's Bill Clinton vs Bob Dole election classic, which saw a turnout of just 49%.

This was not an election that has reunited the nation.

Chart 1.

Voter Turnout as a % of Voting Age Population



Source: Wikipedia, Vox, William Blair Equity Research

3. This was not a repudiation of the Republican Party or its ideals, nor were voters enthusiastically embracing those of the Democrats

The fact that the Democrats only took one seat (so far) in the Senate, and lost five in the House, in no way suggests that Americans have completely lost faith in the ideals of the Republican Party and have adopted those of the Democratic Party.

Rather, this election seemed in many ways to be a referendum on President Trump himself, and even then, as we can now see, this potential Biden victory is still a very close call. For a candidate who ran a seemingly very low energy/low charisma campaign, on a platform of raising taxes and increasing regulation, he seems to be lucky to have (potentially) won.

4. Many voters did not blame Trump for the COVID crisis

One of the biggest questions during this election campaign was whether or not voters would give President Trump credit for the exceptionally strong pre-COVID economy, or drop the crisis on his front doorstep and blame him for both not doing enough to keep people safe, and not providing enough economic support to those adversely impacted.

As we pointed out in last week's *Economics Weekly*, consumer confidence levels pre-COVID were extremely high and far higher than they were at the start of his term in 2017—in fact, they were the highest since 2001. With confidence having collapsed following the pandemic, they key question was naturally to what extent Trump would get the blame for that weakness. The answer is clearly that not as many voters blamed the president as the Biden campaign had hoped, but possibly just enough to scratch out a win.

5. Many voters did credit Trump for a strong economy and the lowest unemployment rate since the 1950s

Early reads on the voting statistics through exit polling from Edison Research shows that the Trump campaign managed to win over more women, African American, Hispanic, and other voters than in 2016, in fact, the only cohort where he lost voters was white males.

Black and Hispanic voters were presumptuously assumed to be automatically voting for Joe Biden (as Biden alluded to earlier in the campaign). Yet heavy campaigning, particularly in states such as Florida and Texas, seems to have paid off for the Republicans, with Trump winning over many of these voters—quite an impressive feat given his very strong anti-immigration rhetoric.

It was surely very significant that the unemployment rates for African Americans and Hispanics in the lead up to the pandemic were the lowest since at least the 1970s.

6. Despite the market's increase yesterday, renewed gridlock was not the first-best outcome for the equity market this time around

Historically, it has almost always been the case that financial markets have preferred gridlock to a unified government.

Why? Because investors felt more comfortable when policymakers' hands were tied. Gridlock, it is believed, helps keep inflation in check and prevents politicians from giving in to their worst tendencies—making spending decisions that are driven by politically biased motives, rather than what might be considered the most economically rational decision for the good of the nation. Under such a scenario, it also means that management of the economy effectively devolves to an independent Federal Reserve, whose reaction function over the years has become relatively well known to financial market participants and whose outcomes are more easily forecast than those more nuanced political outcomes emanating from Congress.

However, with interest rates once again at the effective lower bound and asset purchases having an increasingly questionable impact, Chairman Powell has been forced to beg Congress to take on more of the stimulus burden.

Hence, from this perspective, either a red wave or a blue wave would have been viewed as a more favorable outcome, to provide a smooth policy glide path, against what is once again expected to be more partisan bickering and horse trading. The fact that Joe Biden is also being seen as a one-term—and therefore lame duck—president also will not help in this regard.

For an economy that will be more dependent on fiscal support, this lack of clarity will only increase volatility and risk premiums, as markets try to price in the various outcomes in what is still a very divided nation.

7. Less near-term COVID-related fiscal stimulus

As mentioned above, financial markets were looking for greater policy clarity, and from this perspective they will be disappointed with the outcome of this election. While the renewed surge in the COVID pandemic may force policymakers' hands ahead of the inauguration, markets were hoping for a more decisive victory on either side that might both increase the size of the next stimulus package and possibly also bring it forward in time. While it is still early days, this result now makes both of these outcomes less likely.

A Republican win in the Senate also makes it less likely we will see much in the way of support for state and local governments, which has been a key sticking point in negotiations, and raises the prospect of more layoffs in this area and more stress in the municipal bond market.

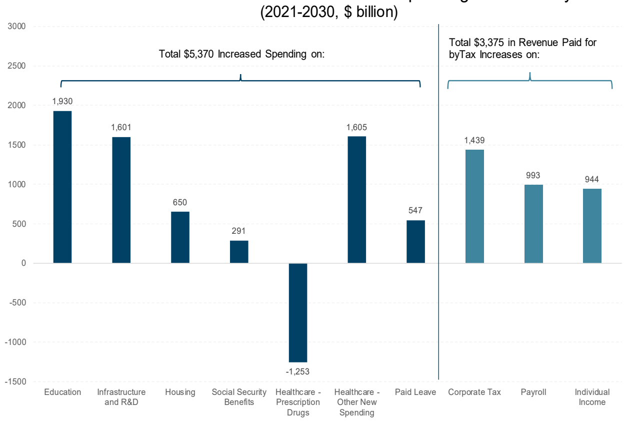
8. Taxes are unlikely to increase, but there is also less chance of a major longer-term stimulus package (and increased debt load)

Without the support of a Democratic Senate, the tax increases which Team Biden has been campaigning for (capital gains, households, and the corporate sector) now look very unlikely.

However, this also means that the roughly $4 trillion-$5 trillion in new longer-term stimulus that makes up the bulk of the Biden platform, and which the tax increases were going to be used to pay for, now also looks unlikely (chart 2).

Chart 2.

Where Biden Administration Wants to Increase Spending & How to Pay for It (2021-2030, $ billion)



Source: Penn Wharton Budget Model, William Blair Equity Research

This agenda included a major infrastructure spending plan and support for green initiatives, such as more funding for renewable energy and the electrification of the public transportation system.

Biden has, however, proposed leaning on the major pharmaceutical companies through negotiated drug prices—which is something that has plenty of bipartisan support and is a move that should also help significantly reduce the nation's healthcare costs. These cost savings, in turn, can still be used to pay for his other healthcare initiatives, including the expansion of the ACA and a lowering of the age for Medicare qualification from 65 to 60 years old. Hence, we expect to see some further policy shifts in this direction.

It is worth remembering that legislation can still be passed without a filibuster-proof majority of 60, though it needs to be pushed through using both executive orders and the Budget Reconciliation process. The latter was the chosen strategy, for example, that was used by Presidents Trump (to pass his 2017 tax cuts), Obama (to pass the ACA), and Bush (to pass his 2001 and 2003 tax cuts).

9. Regulation is likely to increase

While a possible President Biden many be hemmed by a GOP Senate, where he does have a free hand and does not need Congressional support is with regard to regulation.

He has made it one of his campaign pledges to increase regulation in many of the same areas where President Trump has been successful in rolling it back. Sectors more likely to be adversely impacted here include the financials and non-renewable energy sectors, in addition to the smaller-cap stocks, where regulation has been used by the larger-caps as an effective barrier to increased competition.

10. Easing of geopolitical tensions

The second major area where the president is given free rein without the need for Congressional oversight is with regard to foreign policy and trade negotiations (new trade deals of course eventually have to be ratified in Congress).

President Trump has clearly used this to his advantage during his term in office, with his love for tariffs and ramping up tensions with political allies at G20 meeting.

A possible President Biden has stated that he would seek to ease most of these tensions—with the exception of China, where there is bipartisan support for an aggressive stance.

Biden has been vocal about taking a more multilateral approach to resolving trade disputes, which could possibly include re-joining the Trans-Pacific Partnership. His election will also be seen as good news for the WHO—which President Trump has vowed to quit; possibly for the Iranian nuclear deal; and for the 2015 Paris Climate Agreement—which President Trump has also withdrawn the United States from.

In the United Kingdom, a Biden victory would be viewed with disappointment by the ruling conservative party, where it was hoped that a Brexit-backing President Trump would help to give the U.K. a stronger negotiating hand in its final round of talks with the EU. Such an outcome has not been lost of the sterling/euro exchange rate, which has fluctuated accordingly as the probability of a Trump victory has waxed and waned.

While a Biden victory would still be dollar bearish, that dollar weakness is unlikely to be as great as might have been the case under a blue wave scenario.

A reduction in geopolitical tensions should help provide some greater certainty on the foreign trade front—of benefit to the industrials and materials sectors—though the absence of a blue wave reduces the scope for the major reflation trade the market was hoping for, in addition to even more negative real interest rates.

Reduced geopolitical tensions and protectionism, along with a slightly weaker dollar, are once again factors that should be of relative benefit to the larger-cap stocks compared to the small.

Conclusion and Market Implications

While it may turn out to be too early for any definitive conclusion to be drawn with regard to the election to the White House, what is already apparent is that there will be a divided government in the United States and the blue wave that financial market participants were already starting to price in will not be the end result. While gridlock has historically been the desired outcome for financial markets, at a time when monetary policy is close to reaching its limits, this was not the best outcome the equity markets were looking for, though it will please bond investors concerned about a soaring debt burden.

The financial markets are seemingly already assuming a scenario of a Biden victory coupled with a GOP Senate and Democratic House, which we can see in the form of a flatter yield curve, a weaker dollar, and the relative outperformance of the larger-cap growth stocks compared to the smaller cap stocks. These smaller-cap stocks may find themselves under more pressure from increased regulation and less protectionism, without the benefit of the offsetting stimulus and stronger dollar to support them.

S&P 500 Sector Performance

Global Industry Classification System	Current Weight* 04-Nov-20	Day Ago 03-Nov-20	Month Ago 02-Oct-20	Qtr-to-Date 30-Sep-20	Year-to-Date 31-Dec-19
S&P 500 Index	**100.00**	**2.20**	**2.84**	**2.39**	**6.58**
S&P400 MidCap Index		**0.06**	**4.15**	**6.47**	**-3.94**
S&P600 SmallCap Index		**-1.02**	**3.76**	**6.35**	**-10.93**
Dow Jones Industrials		**1.34**	**0.60**	**0.24**	**-2.42**
Nasdaq Composite		**3.85**	**4.66**	**3.79**	**29.18**
Communication Services	**11.33**	**4.25**	**7.09**	**6.39**	**14.51**
Advertising	0.06	-3.55	-0.95	2.99	-33.22
Alternate Carriers	0.03	-3.41	-12.27	-12.78	-33.39
Broadcasting	0.14	-2.87	-1.61	-1.64	-31.81
Cable & Satellite	1.12	3.92	-1.63	-3.46	5.24
Integrated Telecommunication Services	1.44	-1.19	-4.45	-4.42	-19.44
Interactive Home Entertainment	0.39	3.82	0.13	-2.41	27.77
Interactive Media & Services	6.11	6.85	15.45	14.71	34.17
Movies & Entertainment	1.53	1.43	0.41	0.12	9.31
Publishing & Printing	0.03	0.21	-4.96	-3.64	-5.12
Wireless Telecommunication Svcs	0.48	4.41	2.30	1.45	47.95
Consumer Discretionary	**12.16**	**3.14**	**1.97**	**2.43**	**25.42**
Apparel Retail	0.38	-0.64	-5.24	-1.83	-11.15
Apparel & Accessories & Luxury Goods	0.18	-1.82	4.41	8.16	-29.20
Auto Parts & Equipment	0.12	-2.22	2.02	3.90	-1.67
Automobile Manufacturers	0.27	-1.43	13.71	17.29	-9.94
Automobile Retail	0.29	-0.61	-2.01	-1.44	0.40
Casinos & Gaming	0.19	0.98	4.59	4.35	-34.60
Computer & Electronics Retail	0.10	0.87	6.62	7.70	36.51
Consumer Electronics	0.07	0.58	17.20	17.29	14.04
Distributors	0.13	-0.65	9.77	11.38	-5.64
Footwear	0.53	2.21	0.55	1.43	25.69
General Merchandise Stores	0.52	0.56	0.65	1.42	23.62
Home Furnishings	0.05	0.68	6.92	11.38	-15.53
Home Improvement Retail	1.44	2.00	1.17	1.69	32.52
Homebuilding	0.26	6.27	-3.26	-0.56	30.75
Hotels, Resorts & Cruise Lines	0.28	1.09	-0.75	1.40	-44.46
Household Appliances	0.04	-1.70	5.53	5.72	31.77
Housewares & Specialties	0.03	-3.23	8.57	9.97	-1.82
Internet Retail	5.89	5.87	3.31	2.67	64.22
Leisure Products	0.04	-2.75	-0.71	-0.41	-21.99
Restaurants	1.20	0.98	-0.83	0.67	7.00
Specialty Stores	0.15	-0.08	0.98	0.92	6.69
Consumer Staples	**7.56**	**0.06**	**0.36**	**0.25**	**2.13**
Agricultural Products	0.09	-2.90	-0.49	0.04	0.35
Brewers	0.03	-3.59	9.55	11.11	-30.82
Distillers & Vintners	0.18	-1.15	-2.51	-3.80	-0.82
Drug Retail	0.11	-2.88	1.47	1.04	-38.44
Food Distributors	0.10	0.81	-3.85	-2.38	-28.99
Food Retail	0.08	-1.99	-5.81	-5.37	10.69
Household Products	1.73	-0.12	1.52	0.97	13.98
Hypermarkets & Supercentres	1.90	0.20	3.23	3.47	23.21
Packaged Foods & Meats	1.07	0.15	-1.79	-1.51	-1.86
Personal Products	0.17	1.32	4.11	4.35	4.79
Soft Drinks	1.49	0.40	0.04	-0.21	-3.48
Tobacco	0.61	0.47	-3.29	-3.40	-19.13
Energy	**1.91**	**0.16**	**0.40**	**-1.78**	**-51.05**
Integrated Oil & Gas	0.96	-0.21	0.76	-1.81	-49.10
Oil & Gas Equipment & Services	0.17	-0.24	8.13	5.45	-56.02
Oil & Gas Exploration & Production	0.36	2.07	-3.27	-4.40	-54.33
Oil & Gas Refining & Marketing & Transportation	0.20	-0.36	0.02	-3.36	-54.91
Oil & Gas Storage & Transportation	0.21	-0.54	-0.03	-0.83	-42.69

Financials	**9.23**	**-1.27**	**0.85**	**1.78**	**-20.33**
Asset Management & Custody Banks	0.79	0.60	7.29	8.58	-3.20
Consumer Finance	0.50	-1.03	-1.12	1.89	-23.73
Diversified Banks	2.50	-3.20	-0.80	0.63	-37.96
Financial Exchanges & Data	1.11	3.66	-1.19	-0.64	10.45
Insurance Brokers	0.48	2.33	-6.62	-6.64	-4.11
Investment Banking & Brokerage	0.83	-1.20	4.73	5.31	-7.95
Life & Health Insurance	0.39	-2.94	1.40	2.89	-29.16
Multi-line Insurance	0.16	-3.23	7.27	9.62	-34.40
Multi-Sector Holdings	0.97	-0.23	-2.37	-3.19	-8.98
Property & Casualty Insurance	0.70	-0.96	5.88	5.80	-7.40
Reinsurance	0.03	-1.86	6.52	7.13	-23.55
Regional Banks	0.78	-6.27	5.93	9.23	-26.09
Health Care	**14.04**	**4.45**	**5.24**	**3.79**	**7.53**
Biotechnology	1.99	7.75	1.52	-0.72	5.25
Health Care Distributors	0.24	2.38	9.56	8.02	10.42
Health Care Equipment	3.62	1.42	3.29	1.69	9.98
Health Care Facilities	0.18	-3.53	3.56	5.55	-13.25
Health Care Services	0.69	5.94	13.58	12.47	-3.53
Health Care Supplies	0.29	3.37	20.40	18.55	23.95
Health Care Technology	0.07	-0.48	1.29	-0.26	-1.76
Life Sciences Tools & Services	1.28	3.58	12.76	11.69	33.13
Managed Health Care	1.72	9.23	13.61	14.12	17.34
Pharmaceuticals	3.95	4.25	1.04	-0.77	-1.30
Industrials	**8.28**	**-0.99**	**2.31**	**3.12**	**-2.42**
Aerospace & Defense	1.57	0.73	-2.07	-0.84	-28.64
Agricultural & Farm Machinery	0.24	-2.78	3.79	5.27	34.65
Air Freight & Logistics	0.72	-1.00	-0.92	-0.54	44.43
Airlines	0.21	-1.06	-3.85	-0.27	-46.86
Building Products	0.47	-1.78	6.64	8.32	18.50
Construction & Engineering	0.07	-5.99	6.65	9.49	22.50
Construction Machinery & Heavy Trucks	0.53	-5.85	3.81	4.05	7.47
Diversified Support Svcs	0.21	3.15	6.03	7.38	28.94
Electrical Components & Equipment	0.45	-3.35	4.76	5.46	4.25
Environmental & Facilities Services	0.33	1.53	2.74	3.19	8.44
Human Resource & Employment Services	0.02	-2.72	-6.25	-3.36	-18.98
Industrial Conglomerates	1.10	-0.82	6.95	7.75	-9.26
Industrial Machinery	0.84	-2.08	3.65	4.41	3.70
Railroads	0.88	0.13	0.49	0.08	9.46
Research & Consulting Svcs	0.30	2.80	5.10	4.81	14.12
Trading Companies & Distributors	0.20	-2.13	2.63	3.69	16.61
Trucking	0.12	-0.05	4.91	6.58	35.71
Information Technology	**27.20**	**3.83**	**2.25**	**0.60**	**28.28**
Application Software	2.53	5.53	3.87	2.26	45.90
Communications Equipment	0.72	-0.61	-1.67	-3.89	-18.38
Data Processing & Outsourced Services	4.08	3.70	-2.80	-3.23	8.78
Electronic Components	0.20	-0.43	4.39	5.54	10.46
Electronic Equipment & Instruments	0.16	0.88	14.91	15.52	6.69
Electronic Manufacturing Services	0.15	-0.45	4.88	5.33	9.63
Internet Software & Services	0.13	5.15	-3.63	-5.09	9.43
IT Consulting & Services	1.05	0.18	0.00	-1.02	-2.86
Semiconductor Equipment	0.55	4.23	14.52	12.95	18.61
Semiconductors	4.29	3.96	3.53	1.59	28.08
Systems Software	6.49	4.57	4.31	2.49	36.33
Technology Distributors	0.06	2.40	8.39	11.98	-6.29
Technology Hardware, Storage & Peripherals	6.79	3.84	1.61	-0.76	49.89
Materials	**2.57**	**-1.65**	**3.06**	**2.45**	**6.21**
Commodity Chemicals	0.19	-4.63	-2.47	-1.29	-19.34
Construction Materials	0.11	-8.69	2.31	3.85	-7.20
Copper	0.09	-4.10	12.93	15.09	37.20
Diversified Chemicals	0.04	-2.03	6.06	6.13	4.60
Fertilizers & Agricultural Chemicals	0.17	-0.63	2.78	3.00	-6.03
Gold	0.18	-2.39	4.48	2.57	49.78
Industrial Gases	0.63	0.37	0.08	-1.77	14.49
Metal & Glass Containers	0.10	0.38	13.84	13.22	45.52
Paper Packaging	0.25	-2.07	8.04	7.84	1.21
Specialty Chemicals	0.77	-0.99	2.77	2.01	2.50
Steel	0.05	-6.20	1.97	4.65	-16.58

Real Estate	2.54	0.28	-2.16	0.93	-8.05
Health Care REITs	0.18	-2.38	-2.64	2.67	-26.53
Hotel & Resort REITs	0.03	-3.43	-2.65	1.86	-40.76
Industrial REITs	0.31	1.41	2.29	6.05	18.65
Office REITs	0.14	-1.90	-7.86	-3.61	-32.66
Real Estate Service	0.06	0.12	8.15	10.69	-15.17
Residential REITs	0.28	-1.34	-3.01	3.24	-27.56
Retail REITs	0.19	-3.03	-8.85	-3.84	-45.16
Specialized REITs	1.36	1.52	-1.75	-0.18	12.60
Utilities	**3.12**	**-1.59**	**4.89**	**7.16**	**-1.49**
Electric Utilities	2.14	-1.85	5.07	7.84	-0.88
Gas Utilities	0.04	-2.09	-0.45	0.00	-14.55
Independent Power Producers & Energy Traders	0.04	-1.63	7.55	10.10	-0.07
Water Utilities	0.09	-1.08	4.33	7.27	26.50
Multi-Utilities	0.93	-1.12	4.71	5.99	-3.78

*Current Weight is market cap based, based on calculations by William Blair Intl. Ltd.

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