The U.S. Election Playbook

The U.S. presidential election is always a highly anticipated event. The pandemic, social unrest, and the possibility of a contested election result make this year's election even more intriguing. The question for investors is, what are the implications of the election on the investment markets? During the third quarter, global markets continued to rally though July and August, but seasonal volatility returned in September. Perhaps markets were simply due for a pullback after a strong recovery in the months prior. On the other hand, the lead up to the election may be partly responsible for stock market weakness in September. The current stalemate over additional fiscal stimulus, along with rising COVID-19 cases were also factors. Still, considering impact of the pandemic on the economy, stock markets have done well, with Canada's TSX now down -3%, and the U.S S&P 500 up +3% year to date for 2020.

The current administration has long boasted a strong economy, and has been primarily focused on pro-growth policies. Yet the antagonistic approach to foreign trade relations has yielded little real benefit. Although the messaging to the electorate is that the U.S. is winning these foreign trade battles, the reality is that little has been gained. The poor government response to the pandemic, and the resulting economic damage, puts the Trump administration at a clear disadvantage. The election will, in part, be a referendum on President Trump.

There are numerous issues at stake. Biden favours an increase in tax rates for corporations and high income earners, whereas Trump will likely opt for a new round of tax cuts. Some regulations that have eased under the Trump administration will probably be tightened again under Biden. In other candidate specific differences, Trump favours the use of fossil fuels, tariffs, and more restrictions on China. Biden favours the use of alternative energy, increasing regulation of banks, big-tech break ups. Both may use trade for geopolitical reasons. For both, infrastructure spending could be a key tool to stimulate economic and job growth.

Stock markets reward predictability, and disfavour uncertainty. A re-election of Trump might be cheered initially. Markets would prefer more of the same tax cuts and de-regulation. However, beyond these short term celebrations, there could be greater unpredictability under Trump than under Biden. The next president will need to be mindful of the impact of any actions on an economy that is still reeling from the pandemic. Although the ideologies between the two parties are at opposite ends of the spectrum, it is the path of COVID-19 and health of the economy that will dictate the pace of any change. While Biden will be less sensitive to what happens in the stock market, a rising market is more beneficial to the economy than one that is in decline.

Regardless of who wins the election, the direction of the economy and the Federal Reserve (the Fed), and its interest rate policy, will be what matters most. The commitment by the Fed to hold interest rates steady for years, until the economy and job market fully recovers from the impact of COVID-19, essentially forces

investors into stocks. The current outlook means years of negligible returns in bonds. Essentially, *there is no alternative* to assuming stock market risk to make decent returns in the coming years. The same holds true globally, as it is highly unlikely that the Bank of Canada, the European Central Bank, or the Bank of Japan would move in a different direction from the U.S. Fed. Although stocks are expensive by historical standards, bonds are even more so. The ten year Government of Canada bond yield is 0.55%.

The U.S. president is often regarded as the most important person in the world, but within the investment world, that title belongs to Jerome Powell, the head of the U.S. Fed. As we write, President Trump has tested positive for COVID-19 and has been hospitalized for treatment. This adds greater uncertainty and possibly more market volatility in the short term as the election is a mere month away. We view periods of market weakness due to the election as an opportunity to add to stock exposure. It is the direction of the economy and the actions of the Fed that will dictate the investment path. We see both being supportive of higher equity prices in 2021.

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