

Election reaction: Quick takes on the market

With votes still to be counted in key swing states with razor-thin margins, it looks like things are just beginning to get sorted out. But the equity market has been taking things in stride so far, and we explain why investors should do the same.

As if 2020 hadn't delivered enough drama and angst, more was piled on with the delayed U.S. presidential election results and the potential for recounts and court battles for one or more swing states.

As of this writing, there are narrow vote margins between Donald Trump and Joe Biden in Wisconsin, Michigan, and Nevada. There are also potential legal disputes brewing in Pennsylvania and Arizona.

The equity market, however, is taking this in stride—at least so far. The S&P 500 and Dow Jones Industrial Average futures fluctuated moderately overnight and both indexes are up in early trading on Wednesday; volatility has been muted.

The election uncertainties were initially not a shock to the market's system because institutional investors had mulled over various post-election scenarios well ahead of Election Day. Unlike the surprise Bush v. Gore Florida nail-biter in 2000, the delay in the 2020 election results did not come out of thin air. Leaders on both sides of the political aisle, including the president and speaker of the House of Representatives, had openly discussed various unorthodox election scenarios.

But market volatility may pick up if the results are not sorted out soon. In this case, the path forward could involve twists and turns regarding vote recounts, court battles about the recounts and/or the legality of certain ballots, and then the multistep constitutional process for finalizing results in the Electoral College.

Bush v. Gore: An imperfect analog

The extremely close race in 2000 between George W. Bush and Al Gore in Florida is the only comparable situation in the modern era.

As the Florida vote recount and ballot controversies raged and multiple lawsuits were filed by the Bush and Gore teams in state and federal courts, the S&P 500 fell 12 percent from Election Day to mid-December, shortly after Gore conceded.

While it's useful to review this episode, the market may not repeat this performance of 20 years ago. Back then, there were other factors that magnified the Bush v. Gore selloff. The Tech bubble was beginning to burst in 2000—in hindsight, a significant historical event for the market. Also, the very tight Bush/Gore Florida race occurred out of the blue, so investors were unprepared. We think this shock generated additional volatility and pushed the index into correction territory. In our view, the market is more prepared for election uncertainty this go around.

There's good and bad gridlock

Regardless of which candidate is elected president, preliminary results are pointing to a status quo Congress with the Republicans maintaining control of the Senate, albeit by a slim margin again, and Democrats controlling the House of Representatives. Divided government would result in further legislative gridlock.

For starters, we think this would keep the Trump tax cuts of 2017 largely in place—even if Biden becomes president—

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for individuals and corporations for at least the next two years of this legislative session.

While the equity market typically prefers gridlock, this isn't always the case. Market participants have been clamoring for another large COVID-19 fiscal stimulus package, and have also begun to get their hopes up for an infrastructure spending package. These bills would probably be more modest in size and scope with a divided Congress. Fiscal stimulus could be delayed until after the inauguration, and an infrastructure package is no guarantee.

But we think gridlock would be perceived positively for certain sectors. For example, it would mean that far-reaching fossil fuel, health care, and financial industry regulations would be much less likely. We also doubt the Tech and Communication Services sectors at large would face serious regulatory challenges, although select companies could continue to face scrutiny in the near term.

The political outlook ≠ the economic outlook

While a contested election could bring forth volatility, we do not believe it would be a game-changer for the market—no matter who ends up in the Oval Office.

The train is already moving forward. The economy and corporate profits have substantially improved since the COVID-19-induced recessionary lows last spring, and we think they have scope to grow further in the next 12 months, despite the fact that infection rates are rising again. Health officials have a better handle on how to treat those who are sick. More effective treatment regimens are being implemented, new therapeutics are coming, and vaccine progress seems likely, according to medical experts. Also, the public has become more accustomed to managing the logistical challenges that come with COVID-19 risks and restrictions.

We would stick with long-term investment plans, even in the face of election-related volatility. The U.S. economy should reach its pre-pandemic level by 2022 and return to its prior growth trajectory in 2023—a much shorter time frame than it took following the global financial crisis.

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