

Global Insight

Weekly

U.S. ELECTIONS & MARKET MATTERS

The “but what if” factor

Kelly Bogdanova – San Francisco

We all know the market hates uncertainty. So what happens if November 3 comes and goes and we don't know who the next president is? We explain why we think the market should be able to stomach this disconcerting scenario.

Increasingly, investors are asking about a range of atypical U.S. presidential election scenarios and, specifically, how these could potentially impact the stock market.

The most common questions asked are: What if the election is contested and/or what if there isn't a clear winner on Election Day?

Postal routes

The expected surge in mail-in ballots due to COVID-19 restrictions and related health concerns has increased the possibility that election results could be delayed. Some states and courts have established new vote-counting rules that would push back official certification of results.

For example, in Wisconsin and North Carolina, both considered swing states by political analysts, mail-in ballots will be accepted up to six and nine days, respectively, after the November 3 Election Day as long as they are postmarked by that date.

If the overall race is tight, and if the vote count is close in such states on the night of the election, the delays could generate some uncertainty for the market. But we think the market is largely prepared for this as it is being well telegraphed.

Flashback to 2000

What if the election is contested? This is a separate issue entirely. This could involve a close race in one or more states—close enough to trigger an automatic recount. (Each state has its own rules and procedures for recounts.) Or, a contested election could occur if other types of issues trigger litigation,

such as evidence of election irregularities that could impact Electoral College votes.

One thing is for sure: If there is a contested election we should expect litigation, litigation, and more litigation in the courts, and we should expect a media and social media feeding frenzy.

There is only one example of a contested presidential election in the modern era, back in 2000 when the vote count between George W. Bush and Al Gore was tight in Florida, a swing state rich in electoral votes.

The close Florida results triggered an automatic statewide machine recount. At one point, Bush's lead had shrunk to only 327 votes. As events unfolded, the Bush and Gore teams fought in state and federal court, with multiple lawsuits and appeals, about whether manual vote recounts should be conducted (remember the “hanging chads”?).

Two cases ultimately made their way to the U.S. Supreme Court, and its rulings favored the Bush team. The decisive case

Market pulse

- 3 Fed's low rate policy a huge boon
- 3 Canadian housing surprisingly fairly resilient
- 4 Europe's expansion continues, unemployment edges up
- 4 Tough sledding for the Hang Seng

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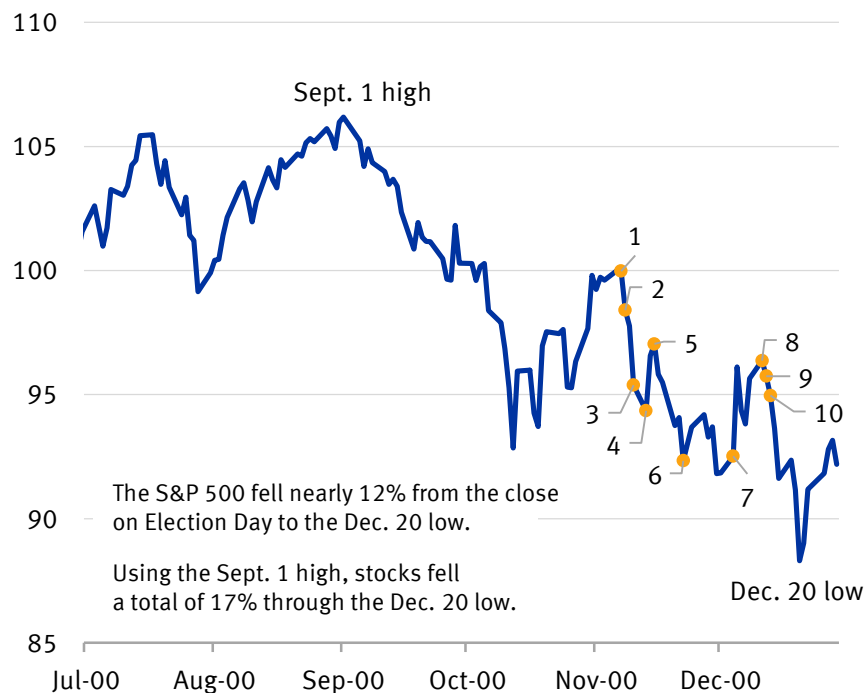
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Management

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S&P 500 performance surrounding the Bush vs. Gore Florida recount in 2000*



- 1 - Election Day
- 2 - Initial Florida vote count very close; Bush leads. Gore concedes, then retracts.
- 3 - Mandatory statewide machine recount nearly complete. Bush lead shrinks to 327 votes.
- 4 - Federal judge denies Bush request to stop manual vote recounts.
- 5 - Broward County begins manual recount.
- 6 - Bush asks U.S. Supreme Court to block Florida Supreme Court decision allowing manual recounts. (*Bush v. Palm Beach Co.*)
- 7 - U.S. Supreme Court vacates (throws out) Florida Supreme Court decision; remands it.
- 8 - U.S. Supreme Court halts manual recounts in a separate case, *Bush v. Gore*.
- 9 - U.S. Supreme Court reverses ruling of Florida Supreme Court in *Bush v. Gore*, which ends the recounts. 5-4 decision. This effectively awards Florida's 25 electors to Bush.
- 10 - Gore concedes Bush won the election.

* S&P 500 performance in 2000 indexed to the closing price the day before Election Day (100 = 11/6/00). Past performance is no guarantee of future results. Source - RBC Wealth Management, RBC Capital Markets U.S. Equity Strategy, FactSet, Stanford Law School, Associated Press, The New York Times, Pittsburgh Post Gazette

was a 5-4 ruling that halted the manual recounts altogether. This effectively awarded the state's 25 electoral votes to Bush, making him the 43rd president.

The S&P 500 fell 12 percent from Election Day on November 7 to the market bottom on December 20, which occurred one week after Gore conceded.

Consider that the market was not at all prepared for this election drama, including the multiple court battles or the Supreme Court's intervention. The events came like bolts of lightning out of the blue. There was no precedent. It was a complete surprise, so the major stock indexes had difficulty absorbing it all.

This election cycle, various atypical scenarios are being discussed openly, including by those in power in both parties—by the president, the speaker of the House of Representatives, other elected officials, and many political strategists and pundits. For voters, such scenarios can be disconcerting—at best. But from an investing perspective, the scenarios are not a secret. The market is well aware this may not be a seamless or normal election outcome. We think this knowledge and the events of 2000 make the market better prepared this go-around.

We also think it's important to remember the Bush vs. Gore dispute is just one instance. One historical event does not make a trend for the market.

Furthermore, today's equity fundamentals, economy, and monetary and fiscal policies differ from that period. For example, as the Bush-Gore recount drama was unfolding, the wildly overvalued tech bubble was beginning to burst—in hindsight, a major historical event for the market. As we have [written previously](#), we do not believe Tech stocks are in a bubble phase today like they were back then.

Stick with your plan

Investors should be aware that a market selloff materialized during the 2000 contested election, and that there are short-term volatility and downside risks associated with the current election. But we would not adjust long-term equity allocations based on atypical election risks, especially since such an event would likely be transitory in nature.

If unusual post-Election Day events occur and even if there are multiple lawsuits, the caravan will keep moving on. The major companies listed on U.S. stock exchanges will be there once everything gets sorted out. And the situation will get sorted out. There is just too much at stake for big business, and more importantly for the country, for us to argue otherwise.

Regardless of who is elected president, and which party controls the House and the Senate—and importantly, regardless of whether there is post-Election Day drama—we see scope for at least moderate U.S. economic and earnings growth, and therefore higher stock prices, in the next 12 months.



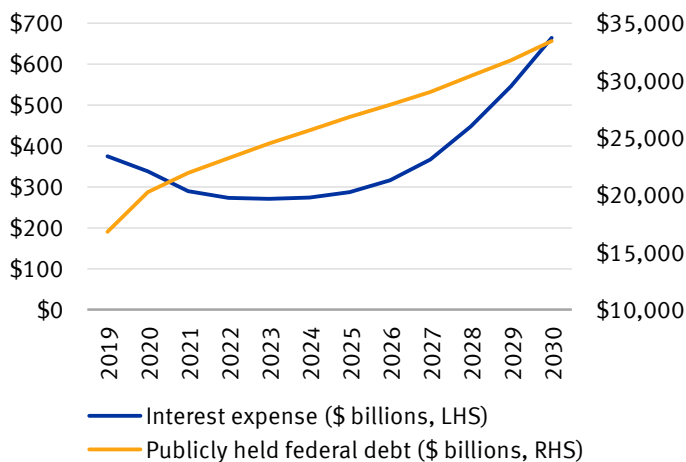
United States

Atul Bhatia, CFA – Minneapolis

- **Fed funds policy fixed ...** Consensus has been growing that the Fed will not be raising rates for at least three years, with Fed Chair Jerome Powell's recent testimony to Congress underscoring the fragility of the recovery and comments from Philadelphia Fed President Patrick Harker that it will likely be 2023 before employment recovers to pre-pandemic levels. The Fed's low rate policy has been a huge boon to the federal budget as well; despite a spike in the federal debt load—which is now poised to exceed annual GDP—government debt service costs have declined due to low rates. We expect both the strength of the recovery and government financing needs to keep the Fed sidelined for at least three years.
- **... and so is the yield curve.** It is difficult for yields to rise on Treasury bonds maturing in the next five years when the Fed is expected to keep funding costs at zero over most or all of the bonds' lifespan. This effective cap on these shorter maturities also acts as an anchor on Treasury maturities as far out as 10 years. One result is the low Treasury volatility seen since the announcement of the Fed's inflation averaging framework. With Fed policy moves essentially detached from routine economic reports, we believe we are likely to see fewer, but potentially larger, shifts in the yield curve driven by events such as the election and COVID-19.
- **Main Street pain.** The Fed has been undeniably successful in supporting bond issuers but it has failed to replicate that success with businesses that rely on bank borrowing. The Fed's Main Street facility, designed to help these borrowers,

Keeping the U.S. federal debt manageable

Fed policies allow interest expenses to decrease while total debt mounts



Source - Congressional Budget Office, RBC Wealth Management

has funded less than 1% of capacity and almost half of that came from a single Florida bank. Main Street issues are focused on solvency, not liquidity, and require a fiscal response. There have been positive signals on that front from Washington this week, but no concrete action so far.



Canada

Richard Tan, CFA & Arete Zafiriou – Toronto

- **Canadian real GDP growth decelerated on a month-over-month basis to a rate of 3.0% in July** from 6.5% in June. July's gain marked the **third consecutive month of positive growth** after economic activity contracted at the steepest rate on record in March and April. Overall economic activity remains below February's pre-pandemic levels, and **the recovery has been uneven across industries**. The retail sector was the first to see activity rebound to pre-pandemic levels in June. The agriculture, utilities, finance and insurance, and real estate rental and leasing sectors surpassed their February levels in July. The hardest-hit sectors are still meaningfully below pre-pandemic levels of output, despite significant increases in July, the most recently reported month. Output in the accommodation and food services sectors jumped 20.1% m/m collectively in July, but remains down 43% and 29% from February, respectively. Statistics Canada expects **GDP growth to moderate** going forward, with a preliminary estimate of August's real GDP growth rate at 1%.
- In the midst of a global pandemic, **it would probably surprise most readers to learn that Canadian housing has remained fairly resilient** and that many key geographies (e.g., Toronto, Montreal, and Vancouver) have appreciated in value on a year-over-year basis. What's equally surprising, in our view, is that despite the massive disruption in the labour market, housing affordability on average improved during Q2, according to RBC Economics. One driver of the strength in the real estate market can be attributed to the **low interest rate environment**, which lowers the cost of financing a mortgage. However, RBC Economics believes the key driver is the **increase in household disposable income**. During Q2, Canadian households lost an aggregate of about CA\$23 billion in wages and salaries, but this was more than offset by government aid programs, which resulted in an inflow of approximately CA\$56 billion. Overall, we think **the improvement in housing affordability could be short-lived if support programs are phased out** or adjusted lower.



Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- Observers continue to scrutinise Europe to gauge the intensity of its recovery. **The European Commission's economic sentiment indicator for the eurozone increased from 87.7 in August to 91.1 in September, suggesting the expansion continues, albeit at a slower pace.**

Encouragingly, the IHS Markit Eurozone Manufacturing Purchasing Managers' Index (PMI) for September confirmed this and was firmly in expansion territory, reaching 53.7, up from 51.7 in August. Italy, France, and Germany all posted better readings than in the previous month. Consensus expectations for the Euro Area Services PMI, to be released later this month, are more subdued, as tightened social distancing measures with the advent of the second COVID-19 wave are anticipated to have a greater impact on the sectors it encompasses.

- **Euro area unemployment crept up to 8.1% in August** from 8.0% in the previous month and a cycle low of 7.2% in February 2020. Furlough and part-time subsidy schemes have helped cap the increase in unemployment so far. Spain has followed in the footsteps of France and Germany and is seeking to extend its furlough scheme. With Spain accounting for more than a quarter of all unemployed in the eurozone, such an extension could help contain the rise in unemployment. **Yet with the recovery losing some steam, we believe unemployment will likely edge up in the months to come.**
- **Energy major Royal Dutch Shell announced it plans to cut 7,000 to 9,000 jobs** as part of its "Project Re-Shape," which the company estimates will **help achieve its \$3-\$4 billion operational expenditure savings target by the end of 2021.** The group also provided an overview of its efforts to transform itself for a low-carbon energy future. The CEO stated that the group's upstream business "will be run to ensure a strong flow of cash to Shell," describing it as "critical" to having "the financial strength to invest further in ... lower-carbon products." Moreover, Shell plans to grow its liquefied natural gas (LNG) business through the energy transition, while its refining footprint will continue to shrink.



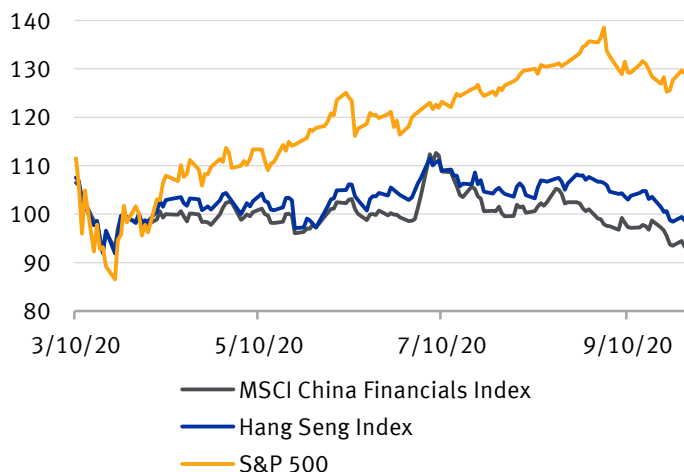
Asia Pacific

Jasmine Duan – Hong Kong & Nicholas Gwee, CFA – Singapore

- **China and Hong Kong markets have a short trading week due to China's National Day holiday.** China's national holiday week will run from Oct. 1 to Oct. 8.

Hong Kong equities lag U.S. counterparts

Chinese financials' underperformance weighs



Source - Bloomberg, RBC Wealth Management; data range 3/10/20–9/30/20, normalized to 3/31/20 = 100

- **The Hong Kong market underperformed other major Asian indexes in September**, with the Hang Seng Index (HSI) down by 7.7% during the month. **HSBC (5 HK), the third most heavily weighted stock in the HSI, underperformed the index in September.** Recently, negative news flow including accounts of the leaked documents widely reported by Reuters and others, that have raised concerns of money laundering and potential sanctions by the Trump administration due to U.S.-China tensions sent HSBC's share price tumbling to a 25-year low.
- **China banking stocks are also among the worst performers in the index.** The banks have been asked by the authorities in Beijing to sacrifice profits to ease the financial difficulties of smaller companies by lowering interest rates and extending loans. As such, the sector reported the **worst Q2 results in a decade due to a surge in loan-loss provisions.**
- **Sentiment towards the Chinese property sector has been weak in the past month**, chiefly due to the new rules to regulate the leverage ratio of property developers. However, investor concerns this week regarding the liquidity of China Evergrande (3333 HK), one of the most highly leveraged Chinese developers, further dragged down share prices across the sector.
- **Chinese economic data continue to show signs of a solid recovery.** China's industrial profits rose 19.1% y/y in August after a 19.6% rise in July. Meanwhile, the Manufacturing Purchasing Managers' Index rose to 51.5 in September from 51 a month earlier. The increase reflects an ongoing recovery in production, easing factory-gate price deflation, and stronger exports. In addition, consumption also picked up as more restrictions were lifted on traveling and visiting entertainment venues.



MARKET SCORECARD

Data as of October 1, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,380.80	0.5%	4.6%	15.0%	15.6%
Dow Industrials (DJIA)	27,816.90	0.1%	-2.5%	4.7%	4.4%
Nasdaq	11,326.51	1.4%	26.2%	43.2%	40.9%
Russell 2000	1,531.20	1.6%	-8.2%	2.5%	-8.5%
S&P/TSX Comp	16,184.54	0.4%	-5.2%	-1.6%	0.5%
FTSE All-Share	3,290.91	0.3%	-21.6%	-18.5%	-20.2%
STOXX Europe 600	361.80	0.2%	-13.0%	-6.8%	-5.8%
EURO STOXX 50	3,194.09	0.0%	-14.7%	-9.2%	-6.4%
Hang Seng	23,459.05	0.0%	-16.8%	-10.1%	-15.6%
Shanghai Comp	3,218.05	0.0%	5.5%	10.8%	14.1%
Nikkei 225	23,185.12	0.0%	-2.0%	5.9%	-4.4%
India Sensex	38,697.05	1.7%	-6.2%	1.0%	5.9%
Singapore Straits Times	2,500.74	1.4%	-22.4%	-20.5%	-23.2%
Brazil Ibovespa	95,478.50	0.9%	-17.4%	-8.2%	21.4%
Mexican Bolsa IPC	36,626.11	-2.2%	-15.9%	-14.7%	-26.5%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	1,905.62	1.0%	25.6%	28.8%	60.3%
Silver (spot \$/oz)	23.78	2.3%	33.2%	37.9%	64.1%
Copper (\$/metric ton)	6,668.00	0.0%	8.4%	17.9%	6.5%
Oil (WTI spot/bbl)	38.72	-3.7%	-36.6%	-27.8%	-48.6%
Oil (Brent spot/bbl)	40.85	-0.2%	-38.1%	-30.6%	-51.9%
Natural Gas (\$/mmBtu)	2.49	-1.4%	13.8%	9.2%	-19.5%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.677%	-0.7	-124.0	-95.8	-240.6
Canada 10-Yr	0.552%	-0.9	-115.0	-79.8	-195.5
U.K. 10-Yr	0.234%	0.5	-58.8	-23.6	-135.4
Germany 10-Yr	-0.536%	-1.4	-35.1	2.8	-100.7

Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	1.18%	0.0%	6.8%	6.8%	18.1%
U.S. Invest Grade Corp	2.01%	0.0%	6.6%	7.7%	22.0%
U.S. High Yield Corp	5.77%	0.0%	0.6%	3.3%	9.6%

Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	93.7200	-0.2%	-2.8%	-5.5%	-1.7%
CAD/USD	0.7529	0.3%	-2.2%	-0.4%	-3.5%
USD/CAD	1.3283	-0.3%	2.3%	0.5%	3.7%
EUR/USD	1.1746	0.2%	4.8%	7.4%	1.5%
GBP/USD	1.2888	-0.2%	-2.8%	4.8%	-1.2%
AUD/USD	0.7189	0.4%	2.4%	7.2%	-0.5%
USD/JPY	105.5600	0.1%	-2.8%	-2.0%	-7.3%
EUR/JPY	123.9800	0.3%	1.8%	5.3%	-6.0%
EUR/GBP	0.9114	0.5%	7.7%	2.6%	2.7%
EUR/CHF	1.0789	-0.1%	-0.6%	-0.7%	-5.3%
USD/SGD	1.3626	-0.2%	1.2%	-1.6%	-0.7%
USD/CNY	6.7908	0.0%	-2.5%	-5.0%	-1.1%
USD/MXN	21.8286	-1.3%	15.3%	10.1%	16.6%
USD/BRL	5.6529	0.8%	40.3%	49.6%	40.7%

Source - Bloomberg. Note: Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing. Data as of 8:35 pm GMT 10/1/20.

Examples of how to interpret currency data: CAD/USD 0.75 means 1 Canadian dollar will buy 0.75 U.S. dollar. CAD/USD -2.2% return means the Canadian dollar fell 2.2% vs. the U.S. dollar year to date. USD/JPY 105.56 means 1 U.S. dollar will buy 105.56 yen. USD/JPY -2.8% return means the U.S. dollar fell 2.8% vs. the yen year to date.

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