How Should Investors Think About the 2020 U.S. Election?

The day after election night, Senior Wealth Consultant and Partner, Jeff Otis, interviewed Evergreen investment committee members Louis Gave, CEO and Co-Founder of Gavekal Research, and Jeff Eulberg, Managing Director at Evergreen Gavekal, to get their take on how the results of the US election will impact markets. Since the US election is still on everyone's mind, we wanted to share their thoughts and insights as the situation unfolds.

The interview originally took place on Wednesday, November 4th and can be heard on Apple Podcasts, Spotify, Stitchr, and via the plug-in below. We've also transcribed the interview for those who would rather read the text.

Jeff Otis: As we evaluate the market's reaction to the election, what do you see as the biggest surprise?

Jeff Eulberg: When I went to sleep on election night after President Trump's "victory speech", I thought I'd wake up seeing headlines about the worst fear coming to fruition: a contested election. My biggest surprise is how calm markets have been. If you look through all of the data, it's not a sure thing yet and is still a toss-up. I would have anticipated markets would be scared by that, which is clearly what everyone was talking about as the scariest environment. We're there, but the market is seeing through it and thinking Biden's actually going to win Georgia, Pennsylvania, and it won't be as close when they finally count all the votes. At this point, seeing the market up over 2 1/2 % - and, specifically, tech – seems a little overdone. The other thing I would add that I think is surprising is the move in interest rates (editor's note: treasury rates fell sharply on Wednesday morning). That could be because bond markets are smarter than equity markets and they anticipate a contested election, but the talking point coming out of the election is that physical stimulus might be off the table now, which I think is misguided. Even if Biden wins, I think that Republicans will want to pass a stimulus bill because the politics behind it are no longer as pressing. As a result, interest rates should move up as anticipated with increased fiscal spending.

Jeff Otis: Louis, anything to add?

Louis-Vincent Gave: First, to Jeff's point, if you spoke with investors before the election, most people said "I don't care who wins, I just want it to be over with, and want someone to win definitively." The nightmare scenario was where we didn't have a clear winner after election night, where it came down to disputed ballots, and where the election was going to end up in courts and drag on. We're there. Whatever happens – even if Georgia and North Carolina are called for Biden – we know this is going to end up in the courts and drag on. So, it's an interesting question; why are markets so unphased? I think there are a few different explanations. First, maybe the biggest fear for the markets was actually a massive blue wave that would see tax hikes, a big increase in regulations, and Biden become a hostage to the left of his party. The fact that it looks like we will end up with a divided Congress, maybe the market is concluding that we are going to see more of the same. Markets did fine with a divided government for six out of the eight Obama years, and most of the Trump years. Its perhaps especially good for US tech, which has thrived in a divided government. The biggest threat to tech is a government that goes after it. But a divided government is probably less likely to do that than a unified government. The biggest threat to tech would have been a massive blue wave or a huge Trump win. Neither happened. As a result, tech is rallying. In recent years, tech has been the anti-fragile asset of choice. Historically, that has been bonds. The problem is when bond yields are at zero, they don't protect a portfolio like you'd want them to. Today's natural reflex amongst investors is to buy big tech during uncertain times – and I'm not saying whether that's right or wrong, it just is, because they're the new anti-fragile class. We saw this again after the election. Markets are facing uncertainty, and investors are piling into Big Tech.

Jeff Otis: I think you're touching on this a little already, but if you believe the current odds, and Biden is elected with a split Congress, what are the investment implications? Broadly speaking, who are the winners?

Louis-Vincent Gave: I think one big fear coming into the election is that a massive blue wave would have pushed Joe Biden to nationalize the US healthcare system or have a single-payer system. With a divided government, I think that possibility is out the window. The first obvious winner is healthcare. Another big fear was regulation against tech. I think the odds of that are also dramatically reduced. I think a third fear was a united government that would go hard against China, and I think that's probably also not going to happen.

Jeff Eulberg: The only thing I would add to that is other industries that will also benefit from a divided government, such as energy. Without a blue wave, there won't be as much legislation that gets through Congress for the next two years, so anyone that was exposed to a blue wave outcome is going to be a big winner. I agree that the biggest winner is tech. Beyond the risk of increased regulation, without a blue wave, we probably won't see taxes – especially capital gain taxes – go up significantly. I spoke with several clients leading up to the election, and that was a very big fear. Now, people don't have to sell the tech names they love and rotate into value out of fears around higher capital gains taxes.

Louis-Vincent Gave: I'd add one more thing. It's very tempting to focus entirely on the US election right now because it's a big deal and that's all the media is talking about. But a couple of other things happened last week that are very important. The first is that Europe has gone back to confinement, which I think is a policy error of epic proportion. They are worried that hospitals will be overwhelmed and, frankly, nothing has been done over the past six months to prepare for a second wave. This policy error will likely mean that Europe will have a second recession, and the populist vote in Europe is likely to go through the roof. You could say "the polls aren't showing that yet" but after last night, forget the polls. You cannot deploy capital on the back of polls. Combined, the failure of the polls in the United States and the second wave of lockdown in Europe means that Europe is no longer investible. You could say, there's still Asia (and I remain a bull on Asia and China), but with the pulling of the Ant IPO, if you're a China skeptic, it plays perfectly into that narrative. If you're starting point is we live in a world of zero interest rates, so staying in cash is not an option, Europe has become not investible, China just shot itself in the foot in the short-term, so the United States once again looks like the best option.

Jeff Eulberg: We completely agree. We've been rotating out of Europe and looking at tech names in Asia that are far less expensive than US tech names. Yesterday, when the Ant IPO got pulled, I started thinking that the election might not actually be the most important event of 2020; it might turn out to be that the Ant IPO fell apart.

Jeff Otis: Are there any obvious losers from a Biden victory and a split Congress?

Jeff Eulberg: Financials could be hurt but, overall, I think the outcome that is playing out is the perfect market scenario for the United States.

Louis-Vincent Gave: Aside from pollsters being losers and lawyers being winners, I would make one quick point. Paradoxically, I think both parties had their world rocked on election night. The Democratic party has increasingly become a coalition of special interests, which is not that healthy. You want a party that represents everybody. What was extremely bullish about the election, is that President Trump did better among black Americans and Hispanic Americans than any other Republican before him and broke through a lot of trends that were very unexpected. In a healthy Democracy, a country shouldn’t vote completely across racial lines. That started to unfold yesterday, and is a positive move for America, even if it’s problematic for the Democratic party. On the Republican side, I think the negative development for them is that President Trump is not going to walk into the sunset if he loses the election to Biden. He will claim himself as the natural leader of the Republican party and will likely run for President again in 2024. Usually, when you lose an election in America, you move on. I don’t think President Trump will move on from this, which will create problems for the Republican party moving forward.

Jeff Eulberg: I completely agree. I think there is a 0% chance that President Trump moves on if he ends up losing the election to Joe Biden. It will be interesting to see what the Republican party does with Trump because he’ll be 78 years old come the next election cycle. I think it will be really telling to see how the Republican party treats Trump moving forward.

Jeff Otis: Because of the swings over the past 24 hours, what happens if things swing back towards President Trump and he is elected? What would be the investment implications in that scenario?

Louis-Vincent Gave: I think you’d probably see a bigger rally in energy and a selloff in bonds. If Trump is elected, he would unleash a massive stimulus package, funded by central bank printing. If Biden is elected, the Senate will be far more adversarial, and won’t spend as much money as Biden wants. So, in that scenario, you’d see a marginally stronger dollar and flatter yield curve.

Jeff Eulberg: I’d say basically the same thing. If Trump wins the presidency and is elected for the next four years, equities will rally, financials will do well, and the 10-year will sell off.

Jeff Otis: What investment opportunities are flying below the radar that people should be following?

Jeff Eulberg: It’s been a good couple of days for industries that are being legalized. In every state where the gaming industry was on the ballot, online gaming and the expansion of gambling was approved. In the cannabis space, every single ballot on the state level was approved. One reason why the space is selling off right now is because the industry was expecting the Senate to flip, which would have resulted in Federal regulations that were more beneficial. Both of those areas had good nights last night and are trending in the right direction.

Louis-Vincent Gave: For me, the quandary remains, how do you build your offensive line when real rates (editor’s note: interest rates after inflation) across the western world are between -.5% and -2.5%? I think the only options left for investors are Asian bonds, which are the only bonds that offer low volatility, rising currencies, and positive real interest rates. If you look at China, which started opening its bond market to foreigners about ten years ago, flows are now rushing in. This is leading to a stronger renminbi and as the renminbi goes up, the government is left wondering if it should let the renminbi go up faster, or if it should try to push some of the money out. That's my starting point. If you're the Chinese government, you have a record Chinese trade surplus, and at the same time you have money pouring in. What do you do with all of that money? Either you let asset prices go through the roof, or you try to push the money back out. I think they're starting to push it back out. How do you do that? By buying gold, copper, and reopening Macau. The opportunity set for me is in Asian fixed income, which offers a risk-reward that is simply unavailable anywhere else in the world. This leads me to be bullish on Macau, Chinese tech, and other assets around the region.

Jeff Otis: Coming into election night, we didn't expect to see such a strong rally in US equities if there was a contested election. Should investors think about selling into this rally? Conversely, if we do see a pullback, is that something to be buying into?

Jeff Eulberg: We knew there was going to be volatility around the election. We're looking to buy into weakness. We think there will be a stimulus bill in the next few months. We think there will be an approved vaccine relatively soon. Once that happens, we think the market will really be forward-looking in 2021 and that will be good for equities.

Louis-Vincent Gave: To me, today's news is not that exciting. I'm still concerned about the looming court cases, the divided country we're bound to see. I'd rather wait to see the market rally and reach new highs to confirm that we're back in bull market mode. We have increasing volatility in the market, and I don't think we're going anywhere.