Philequity Corner (November 9, 2020)
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Blue Red Blue

Based on the latest electoral count and projections, it appears that the US election will result in a Blue Red Blue government. Though the Senate race still hangs on the balance due to runoff elections in Georgia, investors cheered the possibility of a Biden presidency (Blue) combined with a Republican Senate (Red) and a Democratic House (Blue). Big mega-tech stocks led the rally as the Nasdaq soared 9% last week. The Nasdaq Index jumped 3.9% last Wednesday, its biggest single-day post-election return. For the week, the Dow and S&P 500 posted returns of 6.9% and 7.3%, respectively. This was the biggest election week gain for the S&P since 1932. The US is the largest market in the world and its post-election rally lifted global stock markets higher. Last week, the Euro Stoxx 50 jumped 8.2% while the Nikkei gained 4.9%. Emerging Markets ETF (EEM) and the PSEi rose 7.2% and 5.7%, respectively.

Georgia runoff may result in Blue Wave

Though odds are in favor of Republicans keeping control of the Senate, elections in Georgia have resulted in a runoff for two sets of senatorial candidates. According to state rules, a runoff election will be held on January 5 to decide the winners since there was no candidate that secured 50% of the votes. If both Democratic candidates win, the Senate count will be tied at 50-50 for the Blues and the Reds. However, rules state that in case of a tie, the Vice President will cast the deciding vote, and consequently hand the Democrats control of the Senate.

Potential gridlock government

Depending on the outcome of the runoff elections in Georgia, the US may end up with either a Blue Red Blue government or a Blue Wave (Democratic sweep). A Blue Red Blue government may implement a smaller fiscal stimulus, but threats of higher taxes and more regulations may be checked and policed by a Republican Senate. On the other hand, a Blue Wave may result in a massive fiscal stimulus and higher infrastructure spending, but accompanied by potentially higher taxes and increasing regulations in tech and healthcare. Based on the move last Friday, it seems that investors are looking at the bright side and the market is ready to welcome a Biden presidency whether the Senate ends up being Blue or Red.

Lower for longer

With a potentially smaller fiscal stimulus from a constrained Biden government, the Fed would have to do more to lift the American economy from the coronavirus-induced recession. Investors expect the Fed to keep policy rates at near-zero levels for a longer period to stimulate credit activity. The Fed has also ensured an abundant supply of US dollars to prevent a potential credit crunch amid difficult global macroeconomic conditions. Bonds rallied and the US dollar weakened with expectations that interest rates will stay lower for longer. This favors companies that can still deliver growth in a low interest rate environment. This can also be a boon to emerging markets and Asian countries that may see their currencies strengthening due to the broad-based weakness of the US dollar and low interest rates in the US. Continued monetary easing by the Fed and a weak US dollar have given global central banks ample leeway to keep their policy rates low without stoking currency weakness.

Less acrimonious US-China relations

Trade relations with China may stop deteriorating with a Biden administration. At the very least, investors expect Biden to adopt a more predictable and less combative approach to China. This will be in stark contrast to Trump's belligerent, capricious, and whimsical stance on China. The destructive tariffs implemented by the Trump government may be reduced, and this can enhance trade between the two biggest economies in the world. This outcome is positive for US corporates that operate in China and companies that sell their products to the vast Chinese market. Economic relations with other American trading partners may also become more cordial with Biden leading the way. This benefits the whole world, including emerging markets and Asian countries such as the Philippines that have strong trade relations with both the US and China.

Election risks still abound

Though markets rallied strongly on the possibility of a Biden presidency, there are election risks that need to be monitored. The threat of a drawn-out and contested election still exists as Trump prepares to instigate legal battles in specific states that he claims to have won. However, varying state laws and election rules may hinder the Trump campaign from mounting a credible legal case that can overturn the poll results. Moreover, the election runoff in Georgia bears close watching as it may result in a Blue Wave or Democratic sweep.

From election race to vaccine race

With election fever subsiding, attention may shift back to the rapid spread of COVID-19 in Northern Hemisphere countries which are experiencing cold weather. Excitement regarding the election may have masked the fact that the US reported more than 120,000 new coronavirus cases in a single day, the biggest on record so far. Public health experts commented that lockdowns may have to be reinstated if the high infection rate in the US is sustained. Despite these risks, financial markets rallied strongly as investors remain optimistic with a Biden presidency, a less acrimonious US-China relationship, and continued global monetary easing led by the Fed. Remarkable progress made by vaccine makers such as Sinovac, Moderna, and Pfizer gives us hope that a coronavirus vaccine will be created soon and can be made available globally by mid next year.

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