

US Election: “It ain’t over ‘til it’s over”

Coming into this election, overall we were relatively neutrally positioned to a wide variety of outcomes in terms of country/sector weights and stock selection as we do not believe we have an edge in predicting election outcomes. Given uncertainty around rising COVID cases, Brexit and the US election, the portfolio has had a slightly more defensive tilt in recent times.

Author: Calvin Lim, CA, Portfolio Manager / Analyst, Northcape Capital

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Current views on US election:

Current likely outcome is for a Biden White House but Republican Senate and more Republican seats in the House, though still a Democrat majority in the house.

- It seems clear the Republicans have retained control of the Senate and McConnell will remain as majority leader. This means the end of progressive ideas that Biden wanted to bring in, such as the Green New Deal and increasing corporate tax rates, while there is a majority of Republicans in the senate which could continue until 2024 depending on how the mid-term elections in 2022 go.
 - The strong Republican presence in the Senate and Congress will act as a countervailing force on the radical left such that the Democrats won't be able to put through agendas like packing the Supreme court, free education/healthcare etc.
- Republicans have picked up a few more seats in the House – not a majority, but potentially enough to improve cooperation with the Republican controlled Senate.

So overall, Republicans have strengthened their position in the Congress, such that even if Biden wins the White House, Congress is able to act as a brake on his progressive agenda – all part of the checks and balances of the system.

This election is extremely close as we expected, which was not the consensus view leading up to the election of a blue sweep.

The outcome of the election is only likely to be known in days if not weeks from now.

It is clear Biden will win the popular vote, however that is not the main criteria given the Electoral College system.

Market implications:

Overall we think this outcome is more favourable to US stocks than a blue sweep where stimulus would have been a boost, but then corporate tax rates would be increased, and higher bond yields/risk free rate (on higher stimulus expectations and inflation) would have been headwinds for valuation.

The current likely outcome of a split government could be positive for risk assets given:

- Biden can't push through corporate tax rate increases and a near doubling of the capital gains tax rate for instance.
- Lower risk-free rate for longer should help the long-duration growth stocks (like the tech sector) at the detriment of more cyclical stocks like banks that benefit from a steepening yield curve.
- Less fiscal stimulus should reduce the risk of inflation and hence reduce the risk of Fed rate hikes and potentially result in even more Fed support – indeed we saw the US 10-year treasury yield fall during the day as the odds of a Trump win increased.

Relative winners:

- ✓ **Big tech** - Democrats were more anti-tech and a lower risk-free rate helps to support higher multiples.
- ✓ **Healthcare** – any changes to the regulatory landscape is likely to be more incremental rather than big changes under a Democratic sweep scenario.

Relative losers:

- X **Solar/renewable energy sector** - potentially also some infrastructure and utility stocks.
- X **Financial stocks** such as banks – flattening of yield curve pressures net interest margins.
- X **Cyclical stocks** – less fiscal stimulus outcome.

Election update:

- Overnight the new information was that a key state flipped to Biden being Arizona.
- So 6 swing states remaining.
 - MI - Michigan
 - WI - Wisconsin
 - NV - Nevada
 - PA - Pennsylvania
 - NC – North Carolina
 - GA - Georgia
- From here if Biden gets WI, MI and NV he wins.
- If Trump wins NC; PA; NV; GA he wins.
- As of now the odds of Biden winning have materially increased given WI and MI have been called his way. This then leaves it in the hands of NV to decide the outcome of the election. At this stage it would appear Biden has much higher odds of winning the White House.
- **However the above scenario only applies if there is no fraud or litigation etc.** but given the high level of mail-in ballots this year, expect many legal claims and challenges to come, indeed several have been filed by Trump's legal team over the past 10 hours or so.
- When stuffing the ballot box, this normally comes in towards the end.
- Some legal claims on mail-in ballots in the current swing states include: late receipt; missing postage; late postmarks; missing signatures; illegible ballots; non-matching signatures, etc.
- Even once all ballots are counted – which likely takes days from here, the margin is likely to be very close that Biden/Trump are likely to demand recounts where they are legally entitled based on state law – we saw this in Florida back in 2000. But this year we could see that same scenario play out across the 6 key swing states aforementioned, with the process likely taking weeks to conclude.
- So expect quite a few days if not weeks before we find out the outcome. It is clear Trump will do everything he can to stay in power, hence the potential for some near-term political uncertainty given the fine margins and mail-in ballot situation which is unique to this election due to COVID.
- There are some extreme election scenarios we will explore next.

Some additional thoughts...

I caveat my views that I'm no political analyst/expert and that these views are certainly non-consensus and are my personal views.

How the Republicans could decide the election on its own in a disputed election:

- December 8th is the “safe-harbour” deadline for appointing the 538 individuals who make up the Electoral College. The electors meet 6 days later on December 14th but each state must appoint them by the safe-harbor date to guarantee that Congress will accept their credentials.
- Statute says that if “any controversy or contest” remains after that, then Congress will decide which electors, if any, may cast the state's ballots for president.
- The US normally chooses electors by popular vote, but there is nothing in the Constitution that says it has to be that way.
- Article II provides that each state shall appoint electors “in such Manner as the Legislature thereof may direct” - this is the key part of the constitution which enables state legislature to choose to appoint its own slate of electors to the Electoral College. If this happened in a state where the winner would decide the national election, Congress would then be FORCED to choose which results to accept.
- Since 1892, every state has ceded the decision to its voters/popular vote.
- The Supreme Court affirmed in Bush v. Gore that the state “can take back the power to appoint electors”. That said, how and when a state might do so has not been tested since the 1890s. With confirmation of Barrett there is a conservative majority in the Supreme Court favouring the Republicans (6 to 3) which is why it was important for the Republicans to get Barrett confirmed prior to the election.

Trump could certainly test the above with contingency plans to bypass election results and appoint loyal electors in battleground states where Republicans hold the legislative majority.

- A justification could be based on claims of rampant fraud. Trump would ask state legislators to set aside the popular vote and exercise their power to choose a slate of electors directly.
- In such a scenario the longer the Republicans succeed in keeping the vote count in doubt, the more pressure legislators will feel to act before the safe-harbor deadline expires.

- Republicans control both legislative chambers in the most closely contested battleground states.

Both sides have around 600-700 lawyers on retainer ready to contest the election outcome likely on the mail-in ballot grounds.

Some other points

Period of social unrest ahead:

- It is likely that we will see Antifa trying to create anarchy post November 3rd should it look like the election is going Trump's way, BLM movement, etc.
- If Trump loses then we could see white supremacist groups also come out and incite violence.

Trump win implications:

- Status quo continues and the world gets more of the same. Less regulation in the US; more efforts to curtail China; peace in the Middle East; etc.

Biden win implications:

- Remains to be seen if this is good for the stock market as a whole as capital gains tax will be doubled from 20% to around 40%, anti-trust against big tech etc., but would be more stimulus.
- This outcome would be larger fiscal deficits, good for stimulus but negative for the dollar and positive for Gold. Certain sectors like Renewable energy would benefit from policy etc.

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