tavistock WEALTH
REVOLUTIONARY THINKING

CANARY IN THE VOL-MINE

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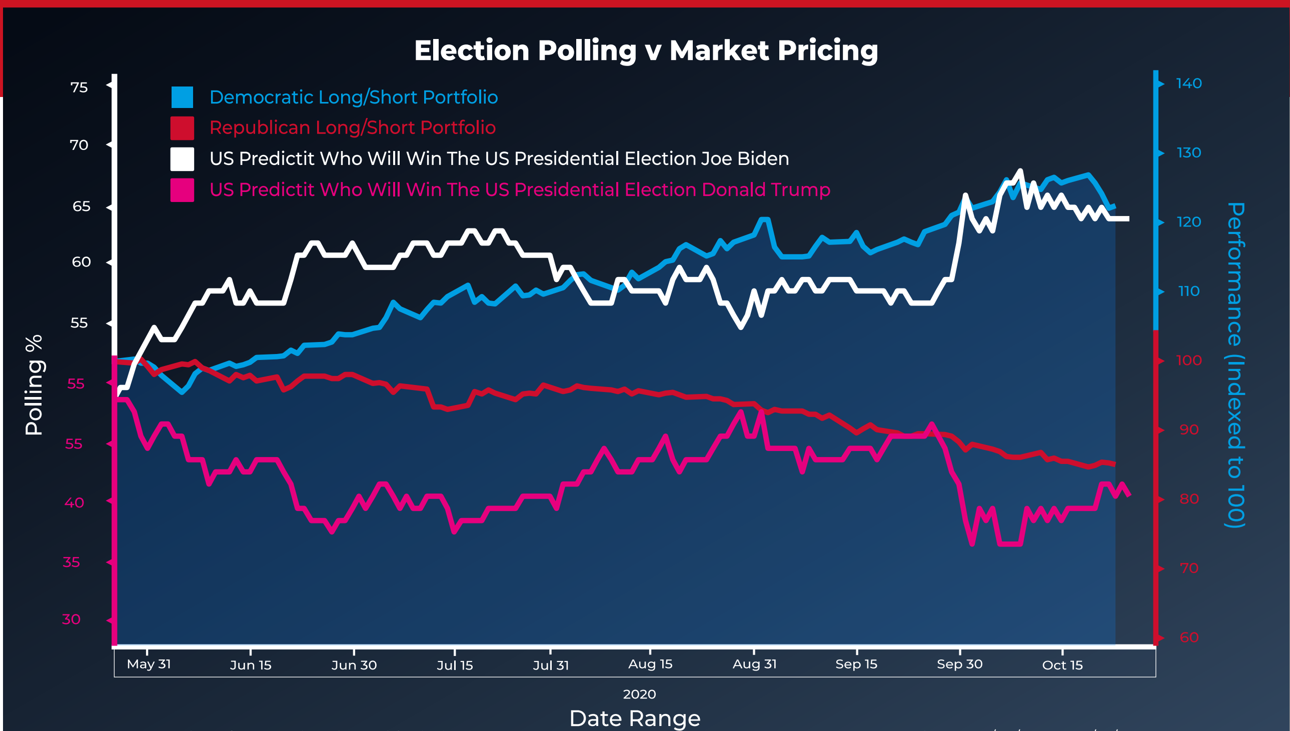
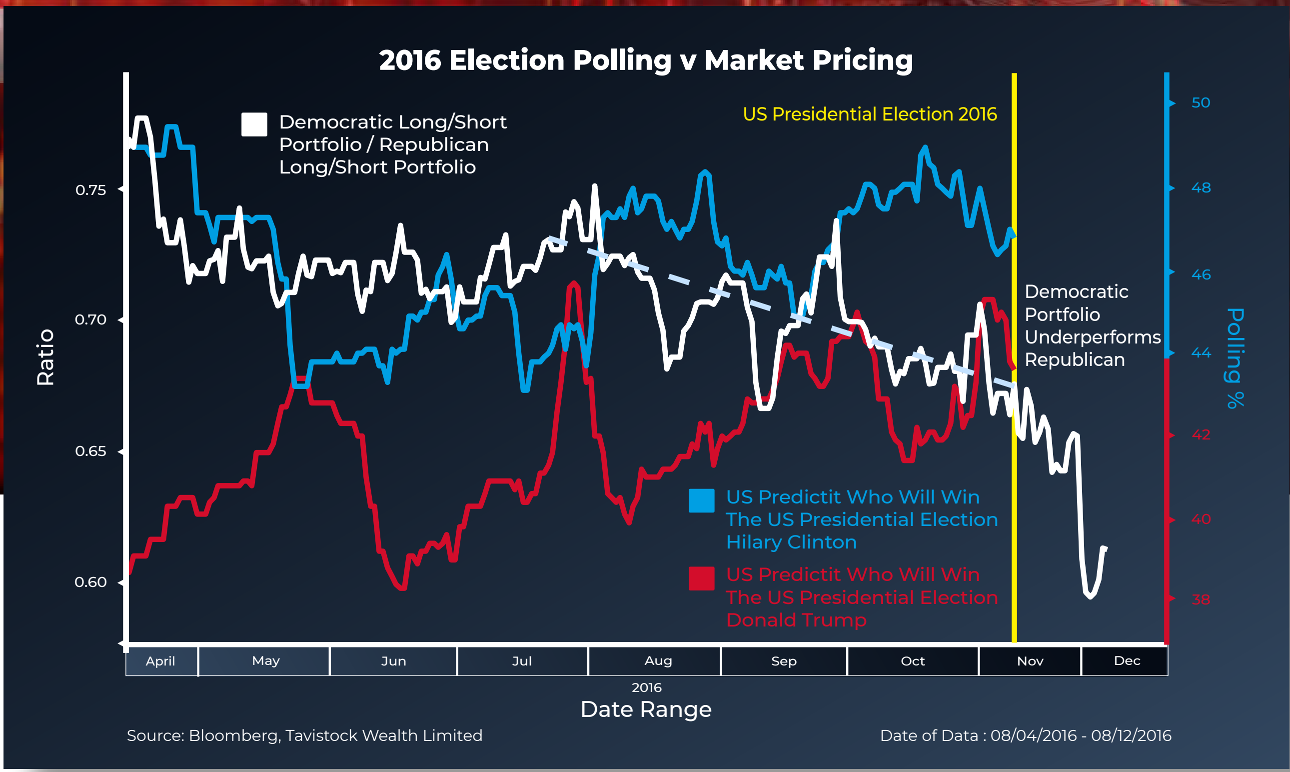
With the US election just 8 days away, financial markets are following the polls and pricing in a Biden win. The prospect for a Democratic clean sweep has contributed to the rising 'Blue Wave' narrative benefiting those companies that stand to benefit from Democratic party policy. Meanwhile a long/short basket of companies more closely aligned with Republican policy and values has steadily underperformed.



Source: Bloomberg, Tavistock Wealth Limited

Date of Data: 31/05/2020 - 22/10/2020

This stands in stark contrast with 2016 when investors remained unconvinced that Hilary Clinton's lead in the polls would translate to electoral success. As such the Democratic portfolio steadily underperformed the Republican portfolio in the months leading up to the election and beyond.



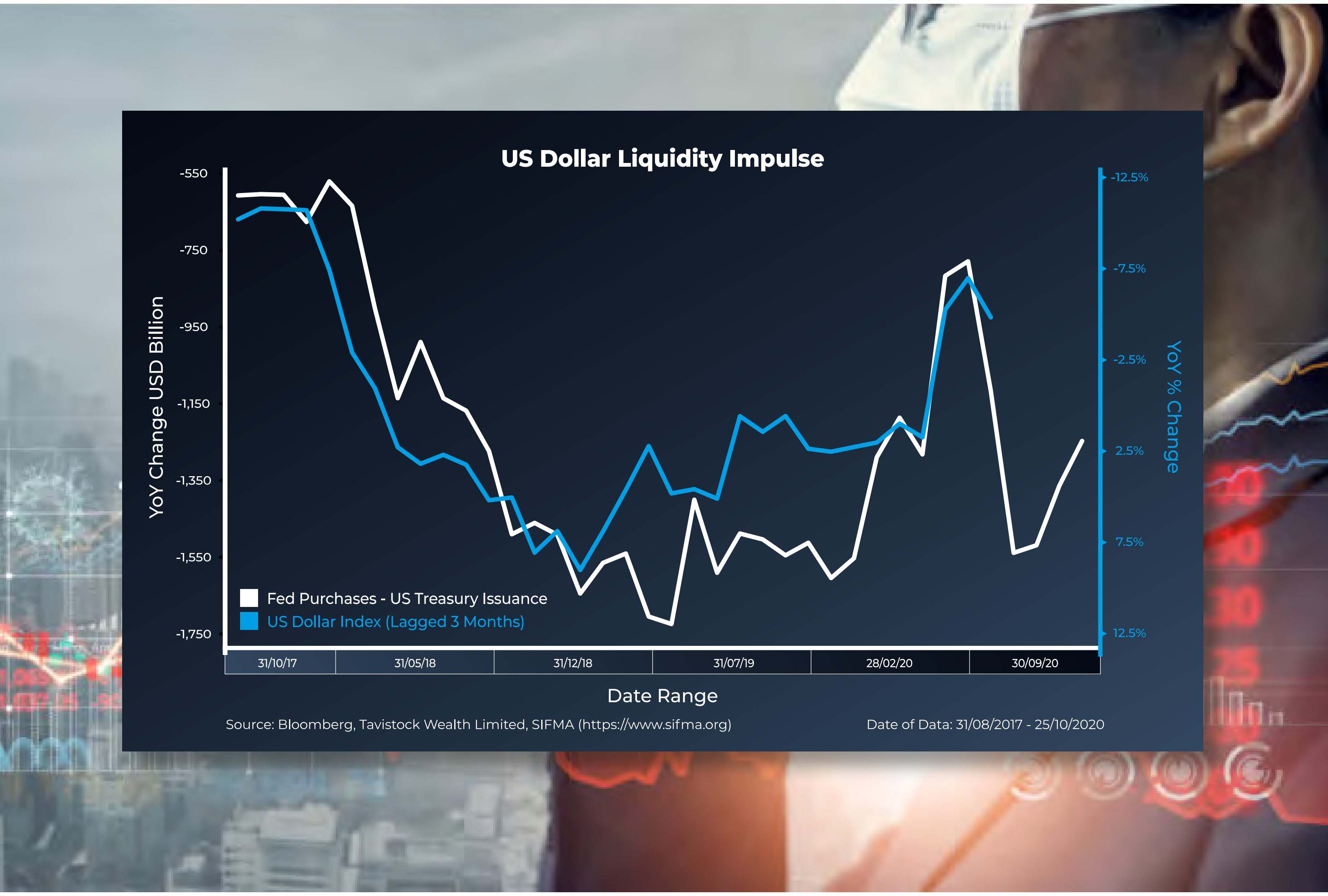
Markets got it right in 2016 and seem very confident about 2020. Whilst a Blue Wave is largely priced-in, conviction is overwhelmingly one-way which could be a cause for concern.

It is interesting to note that despite the prevailing view that a Biden win would be good for risk appetite, and recent dollar weakness, US equities are trading around two-week lows.

This could be a consequence of the recent tightening in the polls, with Trump's support hitting six-month highs in several swing states needed for victory in the electoral college. One key moment can change the course of an election and that moment could have come during the second debate when Joe Biden was forced to deny he would end fracking but clarified he would transition the economy away from oil. That statement could hurt his chances in certain energy producing states, like Pennsylvania, as well as the agricultural vote given corn is an input in the ethanol production process.

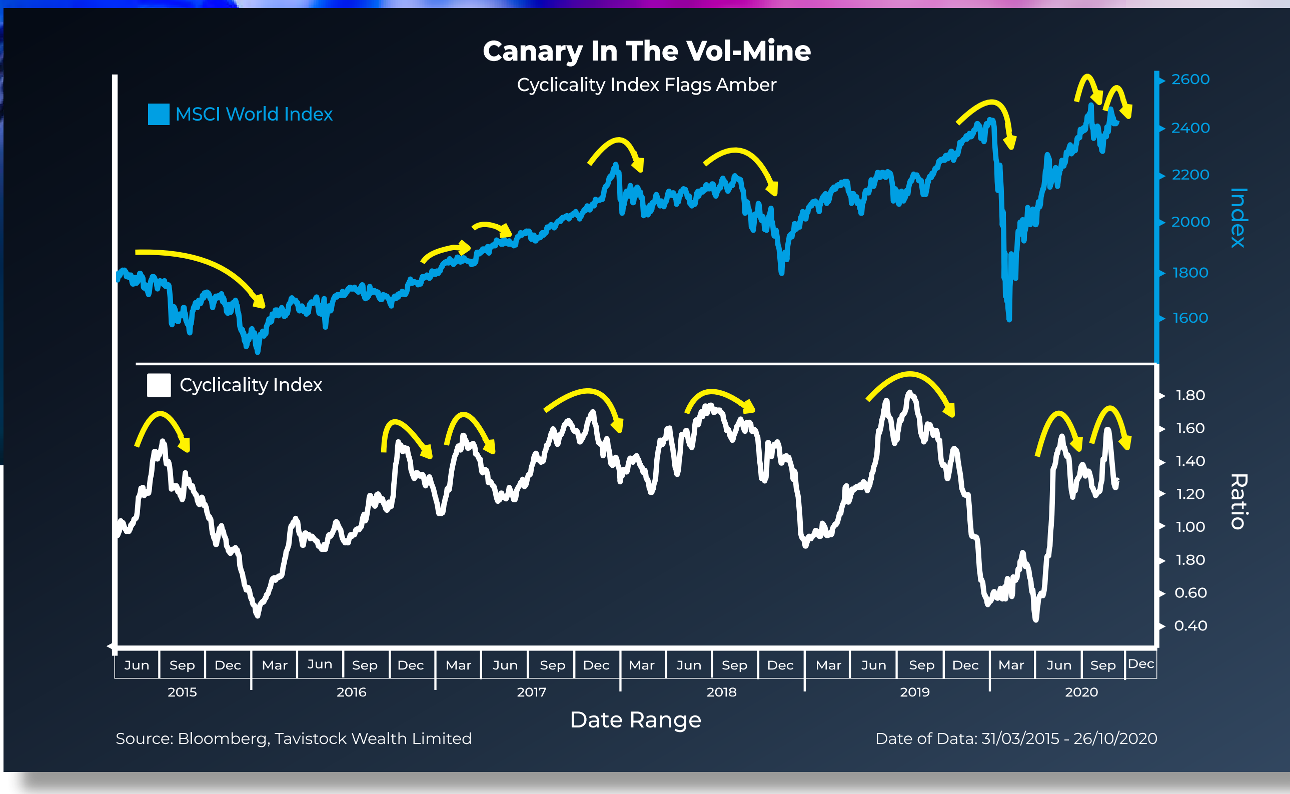
The deteriorating likelihood of a fiscal relief package being agreed before the November election is also impacting risk sentiment. House Speaker Nancy Pelosi saw her Tuesday deadline for a pre-election deal come and go last week and Trump moved the goal posts by suggesting an even bigger stimulus than the Democrats' $2.2 trillion proposal. Trump's facetious gesture infers intent as the biggest political loser from a no-deal scenario is Pelosi. However, failure to provide additional stimulus also risks stalling the economy, and there are clear signs the economic recovery is losing steam. Monthly job gains have slowed alongside factory output and consumer spending growth, which will continue to struggle as unemployment benefits expire for a growing number of claimants.

Failure to agree to a stimulus package means the cash mountain sitting at the Treasury (prefunded by Steve Mnuchin) has nowhere to go, acting as a drag on liquidity. The US dollar index tends to track the liquidity impulse (difference between Fed Purchases and US Treasury issuance) with a lag of 3 months or so, and this liquidity drain could translate into a stronger US dollar, and therefore weaker risk appetite. Whilst we believe a deal will ultimately be reached and retain our medium-term outlook for a weaker dollar, it may be that this isn't the time to express such trades in the portfolio.



Finally, coronavirus cases are surging, with the US reporting almost 84,000 new cases on Saturday, just below the single-day record set one day prior.

With market positioning stretched, a deteriorating outlook for public health, mounting political crisis, tightening liquidity and fiscal stimulus shortfall we think now is the time to remain cautious. This outlook is consistent with our in-house cyclicality index which is flagging a potential pick-up in volatility.



We believe an election surprise is more likely than currently perceived or priced-into markets. Should the prevailing narrative falter, resulting in a Trump win or a split-ticket, leading to political gridlock, this could dent risk appetite over the short term. We are positioned for this via our preference for quality anti-fragile assets. Beyond that, we continue to believe a deal will eventually be struck, supported by the Fed, leading to rising investor sentiment and an improving economic outlook which will continue to benefit risk assets into 2021 and beyond.

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