PALOS

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Weekly Commentary

Issue **No. 44** | **OCTOBER 26, 2020**

Macro View

By Hubert Marleau

Don't Count Your Chicken Before They Hatch!

Submitted October 25, 2020

What Happened In the Week Ended October 23, 2020:

The S&P 500 finished the week registering a drop of 0.5%, amid a severe surge in the number of coronavirus cases. Since the start of October, the rise in cases has been steady and inexorable. Moreover, the index was weighed down by Intel and American Express who reported big misses. Stock price reactions to earnings haven't been strong--yet both revenue and earnings have been exceeding analyst forecasts at a much better than average pace, and while forward guidance has been very positive.

It could have been worse if it had not been for favourable economic prints. Jobless claims fell by a lot more than consensus while leading indicators like housing activities, money supply and PMI handily beat expectations. Output growth regained momentum in October, as business activity rose at the fastest rate in 20 months and business optimism improved markedly. IHS Markit, the producer of the PMI index, said "the recent upturn was largely driven by service providers, though manufacturing firms also reported a solid increase in production". We all know that the GDP mechanically soared at the annual rate of 35% in the third quarter; and we now have proof that the US economy has started the December quarter on a strong footing. Another double-digit growth in Q/4 is a real possibility. Money is being spent. The Wolf Street website points to a tightening transport market. The ships are 100% full, the containers are 100% full and US ports are operating near full capacity. FedEx and UPS have told their customers that most of their capacity is already spoken for. Shipping costs are rising. U.S, intermodal rail transport is 7.0% higher than last year.

The Election: Blue Wave or Red Upset?

Biden's betting odds to win are now just over 60%. At this point in 2016, Clinton's chances to win were at 83%. She lost. It begs the question: Is a "Blue Wave" coming or shall we get a "Red Upset". Predictions say that 150 million Americans will vote in 2020 compared to 136 million in 2016. Of these numbers, about 50

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million have already voted. Assuming that the split is 55% to 45% in favour of Biden, Trump will have to win big with those who have not yet cast their vote. The baseline reality is that some 90% of the electorate are already committed to either Trump or Biden---so victory depends on who is going to bring the 15 million undecided voters to their side.

The arithmetic should not be taken too precisely but it does show that if Biden did indeed get 55% of those who already voted, he's currently ahead by about 5 million votes. Thus and if the remaining 85 million of decided votes which have not been cast are evenly divided, Trump would need to get two-thirds of the undecided votes--10.0 million. That is what happened in 2016. In this regard, there are three essential elements to consider.

First, the fact that they disapprove of Trump's handling of the coronavirus pandemic. Second, the apparent belief that they are reluctant to absorb four more years of Trump's persona. Third, the fact that they generally approve of Trump's economic policies. If the third cancels the first, it's a simple binary referendum on Trump's personality.

Going into the final week, Biden has a 7.9% margin versus 4.6% for Clinton at this stage of the game. Understanding that the electoral college bias gives Trump a +5.0% tilt, the voting advantage that Biden seems to have may not be sufficient to shift the tipping point in crucial battlegrounds. I do not know whether the latest presidential debate has changed the overall dynamics of the campaign. Trump did score points. But perhaps it's just too late. Going back to basics, a president at 43% approval one week before the election and who has been underwater virtually his entire presidency, has a steep hill to climb. This is why the supercasters are only giving Trump a 13% chance of winning. Nevertheless, if something can happen more than one out of ten throws, the chance of Trump reversal cannot be discounted.

The thing is that people are getting as sick with the election as they are with the coronavirus. According to Nielsen, the TV rating provider, about 10 million less people watched the final presidential debate than the first one a month ago. A sign that there are not as many voters up for grabs as many believe. That is a 14% drop compared with the first event and 13% below the final debate of the 2016 campaign. According to several pundits of various leanings, the poll numbers are suggesting fewer people are undecided at this point in the campaign than it did at the same time in 2016.

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What Elections Tell Us About the Market:

Paul Vigna, a journalist with the WSJ, argued in a recent article that figuring election outcomes is tantamount to a waste of time. It's a useless intellectual exercise. He pointed out that stocks tend to go up regardless of which party controls Washington. He wrote: “From 1929 through 2019, one party controlled both chambers of Congress and the Presidency in 45 of those years. The S&P 500 on average rose 7.45% during those years. The index was up 30 times and down 15 times. In the 46 years when there was a split government, the index climbed 7.26% on average, rising 29 times, falling 16 times and remaining unchanged once.” The bottom line is that Election Day and Inauguration Day have been uneventful for the stock market and postelection selloffs have also been rare.

What Should Investors Do?

Based on the aforementioned observation, it’s probably the wrong time to do anything heroic. Morgan Stanley says that investors should buy stocks if there’s an election plunge. I agree. I don't think that anyone would want to miss out on a “Blue Wave Plus Vaccine'' scenario that could be combined with a huge fiscal package and an easing monetary stance at a time when the economy is already in full expansion. It spells REFLATION. This is the narrative that has brought about rising bond yields, higher copper prices and a wider yield curve. Stimulating a consumer-driven economy from the demand when an economy is operating below potential and when a manufactured income boost is aimed toward those who have the highest marginal propensity to consume should overwhelm any drags from higher taxes.

An analysis by Moody’s Analytics finds that:
1) If Biden wins and the Democrats win a majority in both chambers, average annual economic growth would be 2.9% through 2030.
2) If Trump wins and the Republicans win the majority in both chambers, average annual for the next ten years would average 2.4%.
3) If Congress maintains its split majority, the economic outcome would be better with a Biden win than with a Trump win, ranging from 2.8% (Biden) to 2.5% (Trump).

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Upcoming Special Event:

The Department of Economics and the Faculty of Social Sciences at the University of Ottawa invite you to the Marleau Lecture Series on Economic and Monetary Policy. Please join our virtual workshop “Digital Currency and Monetary Policy” to discuss the design and consequences of a central bank digital currency. The keynote speaker will be Professor Fernández-Villaverde (University of Pennsylvania, NBER and CEPR). In his presentation, Professor Fernández-Villaverde will build on his recent research, which is featured in *Cryptocurrencies: A Crash Course in Digital Monetary Economics* and *Central Bank Digital Currency: Central Banking for All?*

http://secure.campaigner.com/csb/Public/show/ch5q-2bbbz2--rxk3c-5ke7znj7#

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