

QUICK TAKES ON A CLOSE (AND YET TO BE DECIDED) ELECTION

We are hearing from a lot of clients as to our opinion on the market reaction regarding this historic election. I'll attempt to frame it with the information we currently have, but as we all know, this is an extremely fluid situation.

Based on the recent trend of mail-in votes in key states, it looks like Biden has a **slight** edge; the Senate and House likely maintaining Republican and Democratic majorities respectively.

Our opinion is that markets *had* been pricing in a Biden win and *potential* for a Dem majority based on polling. The recent weakness in stocks, which began October 13, bottomed last Friday and has since rallied about 5% into last night's vote. Interestingly, the top graph shows the technology sector (purple) was weaker than the broader market (blue) and much weaker than value stocks (orange) into last Friday's trading session. The bottom shows financials (orange) notably stronger than Tech and the broader market



Last night saw huge swings in the equity futures markets. To put it in perspective: those overnight markets got weak as the race seemed tighter than polling had suggested, and at one point were down over 1%. Then as Trump gained momentum, they started to show strength. Here's the key: we believe

that once it looked like the Senate would remain in Republican hands, those markets rallied hard, at one point up over 4%. To put it in terms of the Dow Jones, it would be like an intraday swing of going down 300 points to going up 1100 points. A massive swing by any measure.

At the same time, the betting markets (yes, there are sites where you can gamble on elections... www.predictit.org being the most liquid it seems), swung from favoring Biden, to hugely favoring Trump. This all occurred while you were *hopefully* sleeping.

So, the betting markets pricing in a Trump win while the equity futures markets rally. Seemed a republican sweep was being assumed by these prognosticators, which conventional wisdom suggest is good for the economy, good for stocks, etc. etc. We won't get into the economic or market analysis by party but that is another assumption.

Here's the twist: the technology sector, as illustrated by the Nasdaq look incredibly strong as the market opens, much stronger than the broader market or other sectors, while financials are selling off. The betting markets have swung largely in Biden's favor.

What's the conclusion, in our opinion, with a split government?

- Trend described above is reversing this morning
- No appetite for a breakup of big tech (Apple, Google) or legislation to reign in social media companies (Facebook, Twitter). Hence, strength in Nasdaq futures.
- Financials are very weak due to the rally in bonds and lower interest rates (bad for banks) but we think likely benefit longer term, again, with less threat of stiffer regulations, at a time when that industry trades at low valuation historically
- Healthcare, also may benefit, with difficulty pushing through a repeal of ACA and lower drug prices, with that segment also rallying this morning

Those three sectors represent 50% of the market. Hard to handicap industrials with Airlines needing stimulus and an unclear picture on defense spending, although under the Trump administration both sectors have been huge underperformers (defense stocks down nearly 5% in past three years)ⁱ.

Look, just like the election we can only go based on information that is rapidly changing. And it could drag on for a while. We still feel a contested election means greater volatility in the near term. Markets do tend to have knee-jerk reactions and then reverse. There are many, many other factors, such as interest rates, the strength of the dollar, trade with China, and so forth. For now, we want everyone to take a deep breath. We don't construct portfolios for points in time, we construct portfolios to withstand and persevere through all points in time. But we look at the data closely and want to keep you informed of our best thinking.

Please call or email with any questions or comments.

Jeff

ⁱ Dow Jones US Defense Index, Y Charts data