Comments from Joe Terranova, Chief Market Strategist, Virtus Investment Partners
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"Overall, $90 trillion in global liquidity and an investable asset supply-demand imbalance supersedes the presidential election outcome in importance for long-term investors."
– Joe Terranova

Two tailwinds for investors

- While an important U.S. presidential election is on the horizon, the outcome is not likely to negate the strong tailwinds of the mosaic of coordination and the investable asset supply-demand imbalance.
- To date, there has been $2.9 trillion worth of fiscal stimulus, the equivalent of 15% of U.S. gross domestic product (GDP). The U.S. Federal Reserve (the Fed) has grown its balance sheet by 70% in 2020 to $7.1 trillion, which represents 33.5% of GDP.
- Overall, $90 trillion worth of global liquidity continues to search for a home, and is offering a supportive hand under global risk assets.
- The mosaic of coordination to date has been the catalyst for a V-shaped economic and capital market recovery.

Global Liquidity

Source: Bloomberg

Federal Reserve Balance Sheet

Source: Bloomberg

A supply-demand imbalance in the availability of investable assets

- We have not seen viable investment vehicles introduced that offer compelling performance and strong liquidity. Neither commodities nor hedge funds have lived up to expectations over the past 10 years or so.
- The number of publicly traded companies in the U.S., according to Credit Suisse, fell from 7,300 to 3,600 in the 20 years from 1996 to 2016.
- The diminishing supply of and rising demand for investable assets is illustrated anecdotally by the excitement surrounding bitcoin and cannabis as potential new opportunities. (This is not meant to take a position on the fundamental viability of either.)
- Investing has no boundaries. It is global in nature. Investors around the globe through ever-improving personal wealth have a growing ability to invest in the capital markets.
- In addition, we are in the early innings of what could be a powerful transfer of wealth from an older generation to a younger generation.
- There are 75-80 million millennials who are realizing that they need to invest. We certainly saw their desire to participate in the markets this summer as Robinhood traders. And behind them are another 75-80 million members of Generation Z who will soon enter their investing years.

The election: Plan for four potential outcomes, but do not act yet

- A narrative exists that the outcome of the election will have a dramatic impact on reshaping the U.S. as a society and as an economy.
- However, there is insufficient evidence that a particular outcome will impact the capital markets in a way that should deter long-term investors from continuing to seek multi-asset portfolio solutions.
- A look back at the market under the 13 presidents dating back to 1945 shows inconsistent results. The six top-performing presidents are split equally – three Republicans and three Democrats.
- The S&P 500® Index posted its best return under Bill Clinton (D) – a cumulative gain of 210%.
- The second-best return – 181% – occurred when Barack Obama (D) was president, and came off a deep and violent global recession during the great financial crisis.
- Under Eisenhower (R), the S&P 500® Index was up 129%. During Reagan's (R) term, it returned 118%. The Truman (D) presidency saw an 81% gain. And, under George H. W. Bush (R), the market rose 52%.
- The two presidents under whom the market posted negative returns were Nixon (R) and George W. Bush (R).
- Clearly, there is no consistent link between market returns and the president's party, and no evidence to suggest that long-term investors should reduce their holdings in a meaningful way.

President	Party	Years in Office	S&P 500® Index Price Return
William J. Clinton	D	1993-2001	210%
Barack H. Obama	D	2009-2017	181%
Dwight D. Eisenhower	R	1953-1961	129%
Ronald W. Reagan	R	1981-1989	118%
Harry S. Truman	D	1945-1953	81%[1]
George H.W. Bush	R	1989-1993	52%
Donald J. Trump	R	2017-	47%
Lyndon B. Johnson	D	1963-1969	47%
Jimmy E. Carter	D	1977-1981	30%
John F. Kennedy	D	1961-1963	20%
Gerald R. Ford	R	1974-1977	9%
Richard M. Nixon	R	1969-1974	-6%
George W. Bush	R	2001-2009	-37%

Past performance is not indicative of future returns.

Source: YCharts. Price returns reflected. Terms run from 1/20 of the year starting the term through 1/19 of the year at the end of the term. Figure for Trump is through 10/2/20. [1]Figure for Truman reflect the Dow Jones Industrial Average.

The four potential outcomes of the election

Outcome # 1 – A contested election or delayed result

- If the country is unable to declare the winner of the presidential election, and potentially certain critical Senate and House races, on November 3, we could see a macro-oriented knee-jerk reaction in which correlations and volatility rise, and safe-haven Treasury buying prevails in the short term.
- The markets in September began to price in this outcome, because the significant increase in mail-in voting may make it difficult to count all the ballots on election night.
- The rules about when mail-in ballots can be processed differ from state to state. In many states, ballots cannot be counted until Election Day, making it a difficult task to get results in a timely manner. For example:
    - In Pennsylvania and Wisconsin – both presidential swing states – counting cannot begin until Election Day.
    - Iowa, Michigan, and New Hampshire cannot start counting until less than a week before Election Day.
    - Florida, Arizona, Ohio, and Texas can start one week before the election.
    - In Georgia, Montana, North Carolina, and Nevada, ballots can be processed upon receipt.
- This could also affect states with a potentially critical impact on the Senate majority, such as South Carolina, Alabama, and Mississippi. Those three states cannot count mail-in ballots until Election Day.
- During the Pennsylvania presidential Democratic primary, it took a week to count all the mail-in ballots. This kind of delay in the presidential election or a critical Senate election will elevate volatility.
- A contested election would increase safe-haven U.S. Treasury purchases, potentially pricing yields lower toward the March 9^{th} 10-year Treasury low of 0.31%.

Outcome # 2 – A red wave

- If the Republicans keep the Senate and the White House, and take the majority in the House, we can expect to see an acceleration of existing policies.
- This would include the fiscal tailwinds of an easier regulatory environment and continued favorable tax policy. Nationalism and the accompanying tariffs would act as a mild negative offset.
- In the case of either a red or a blue wave, we can expect increased fiscal spending. If either party cements a majority, they are likely to spend more money, particularly on infrastructure. This would have a positive impact on industrial stocks.

Outcome # 3 – Continued gridlock

- If one party holds the Senate and the other holds the House after the election, the president will be limited in his ability to enact any impactful legislation.
- A divided Congress is the most bullish scenario for risk assets.

- During gridlocked governments, Treasury yields tend to price consistently with the current monetary policy condition. Therefore, in a gridlocked scenario, investors should not expect a fixed income environment that is much different than the current one.
- When there is a wave, either red or blue, it tends to correlate with an increase in fiscal spending that may temporarily lead to a rise in yields which is somewhat inconsistent with current monetary policy.
- Investors may be able to use such a rising yield scenario as an opportunity to shorten duration.

Outcome # 4 – A blue wave

- If the Democrats win the presidential election and take the Senate majority while retaining the House, it will likely result in higher personal and corporate tax rates, with potentially higher rates on capital gains and dividends, as well.
- But investors need to be careful about extrapolating an overall negative scenario for risk assets if a blue wave occurs.
- While potentially higher taxes would contract corporate margins and consumer spending, a reintroduction of globalization, and thus lower tariffs, could offer a potential offset.
- Regulatory tightening could have a somewhat longer-lasting negative impact, but that would be a micro condition that would only impact certain sectors, not the capital markets overall.
- In a blue wave, energy stocks would likely face increased regulation. In fact, the energy sector declined 15% in the month of September, pricing in a potential blue wave.
- Money center banks could be negatively impacted by financial regulation that would force them to hoard cash on their balance sheet and be vulnerable to financial transaction taxes.
- Industrials could be positively impacted by fiscal infrastructure spending.
- Municipal bonds may experience some dislocations as select states and municipalities may or may not receive federal aid.
- In the event of a blue wave, it will be important to outsource to seasoned active managers who have experience mining for opportunities while avoiding the risks that are created by tightening regulation.
