



Recounting the Election

October/November 2020 - as of 11/12/20

- Record voter turnout resulted in a divided federal government, pending Georgia Senate runoff.
- Divided government tends to be viewed more favorably by equity markets and should reassure markets that there likely won't be a major tax policy overhaul.
- The Pfizer-BioNTech vaccine news sparked a spectacular reversal of the growth/value trend, but it's unclear if this will last, especially given the record numbers of new Covid-19 cases and the protracted ramp-up before the vaccine is widely available.

Overview

"We are not enemies, but friends. We must not be enemies. Though passion may have strained, it must not break our bonds of affection. The mystic chords of memory, stretching from every battlefield and patriot grave to every living heart and hearthstone all over this broad land, will yet swell the chorus of the Union, when again touched, as surely they will be, by the better angels of our nature."

– Abraham Lincoln, First Inaugural Address, 1861

The 2020 election will have generated both the highest absentee ballot count in history at 65.2 million and the highest voter turnout – roughly 160 million people or 70% of eligible voters – in 120 years.²

The printing presses ran almost nonstop for months and churned out millions of ballots in anticipation of historically high voter engagement. The incumbent claimed that this election would be "the most important in the history of our country," and the challenger described it as "life-changing."¹ Voters agreed. As the final count draws near, the election will have generated both the highest absentee ballot count in history at 65.2 million and the highest voter turnout – roughly 160 million people or 70% of eligible voters – in 120 years.² Most media outlets have called the results in favor of Joe Biden. Despite the presumed win for the Democratic Party, Republicans made inroads "down-ballot" – picking up at least five seats in the House of Representatives and retaining control of the Senate, although the final result will depend on an early January runoff election in Georgia.

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The Trump administration is actively pursuing recounts in at least three states, but recounts seldom reverse election outcomes. According to an analysis by FairVote, there have only been 31 recounts in 5,778 statewide elections since 2000, and only three of those altered the results.³ A Republican-controlled Senate will likely constrain the Biden-Harris administration from making sweeping policy changes. Statehood for Puerto Rico and Washington D.C., an end to the Senate filibuster rule, and the Green New Deal are probably off the table for at least the next two years. Betting markets, which may have solidified their superiority to polls over the past few weeks, currently expect a 67% chance of this outcome.⁴

It may be premature to glean anything from this election, but the results have shone a light on at least two realities. The first is just how competitive many key races were. Indeed, in an almost mirror image of 2016, the results of the 2020 election were ostensibly decided by a relatively small group of voters in just three states – Wisconsin, Michigan, and

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Divided election outcomes have been viewed more favorably by markets than single-party sweeps.

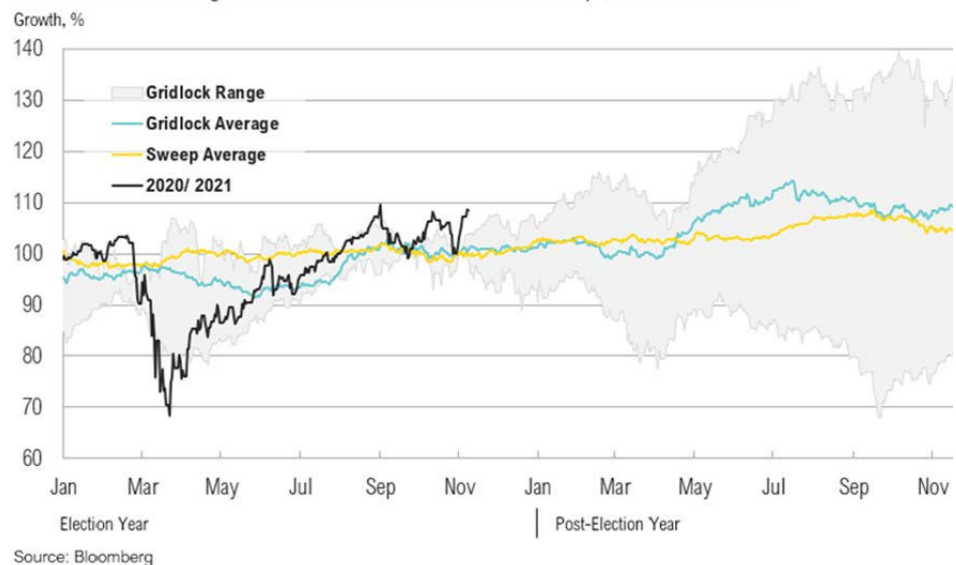
While significant challenges face the incoming administration, relief may be found in improved therapeutics and a recently announced vaccine.

Pennsylvania – who between them hold 46 electoral college votes. The second is the immense challenge of forecasting, especially during a period of widescale social and technological upheaval. For example, popular forecaster FiveThirtyEight assigned a one-in-ten chance of a Trump win with an almost three-in-four chance of a “Blue Sweep.”⁵ Several other professional forecasters predicted landslide victories for the Democratic party akin to Reagan’s sweep of Carter in the 1980 election.⁶ To be fair to FiveThirtyEight, their forecasted margin for the popular vote may turn out to be relatively close to the final numbers, but the state-level polls they relied on missed final results by nearly eight percentage points in Wisconsin, Iowa, and Ohio and five points in Florida.⁵ These polls tended to significantly underestimate Trump’s performance in “swing” states that could have been pivotal to the final outcome.⁵ Trump won more votes relative to the total population of eligible voters than Reagan did in his conclusive win in 1980 (an estimated 29.9% for Trump versus 26.8% for Reagan), and he still lost the popular vote by a not trivial 3.3% (and counting).⁷ Biden, who received 75 million votes or 32% of the eligible vote, will claim the title of receiving more votes than any other presidential candidate in history.⁷

Historically, markets have viewed divided election outcomes more favorably than single-party sweeps, and we expect this could be the case for 2020, especially because it likely eliminates the chance of a tax policy overhaul. In the 24 elections since 1928, markets have averaged a return of 7.7% from November 1 of the election year to the end of the first year of the next presidential term. The average over that period for divided governments was 10.6%, over 5% higher than the average for single-party sweeps, which generate an average of 5.5%. The 8.6% return of the S&P 500 in the nine days since November 1 is higher than any similar post-election stretch in history.⁸

Gridlock Historically Better for Markets than Sweeps

S&P 500 Returns During Post-Election Years with Gridlock vs. Sweeps, 1/1/1928 - 11/9/2020



There are significant challenges facing the incoming administration, but challenges can also present opportunities. New Covid-19 cases and hospitalizations hit new highs in the week of November 9 and continue to increase; however, improvements in therapeutics have contributed to declines in the case fatality rate.⁹ The recent news that the Pfizer-BioNTech vaccine candidate, BNT162b2, could be 90% effective was an exciting development,¹⁰ especially since 50 million doses could be available for distribution this year.¹¹ The vaccine news comes as a relief to not just higher risk Americans and weary

Pfizer's November 9 vaccine candidate announcement ignited a powerful rotation out of large cap growth stocks and into smaller cap stocks.

healthcare workers, but also to the less heroic, but no less weary, value investors. Pfizer's November 9 announcement ignited a powerful rotation out of large cap growth stocks and into smaller cap stocks and into traditional value sectors, including energy and financials.

One-Day Performance Spread (11/9/2020)

Sector/ Factor	Index	Spread, %
Energy vs Tech	S&P 500 Energy vs S&P 500 Info. Tech.	14.9
Large Cap Growth vs Small Cap Value	Russell 1000 Growth vs Russell 2000 Value	8.7
Momentum vs Value	MSCI USA Momentum vs MSCI USA Value	6.9
Large Cap Growth vs. Large Cap Value	Russell 1000 Growth vs Russell 1000 Value	6.0
Growth vs Value	MSCI USA Growth vs MSCI USA Value	5.6
Equal Weight vs Market Cap Weight	S&P 500 Equal Weight vs S&P 500	3.0
Best vs Worst	S&P REIT Hotel/Resort/Leisure vs Silver	30.4

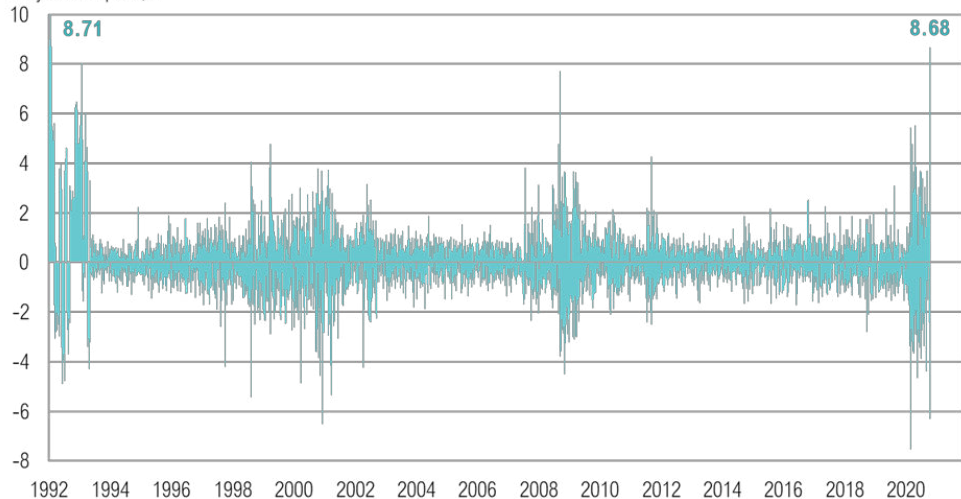
Source: Bloomberg

On November 9, the Russell 2000 Value Index outperformed the Russell 1000 Growth Index by 8.7%, the largest single day relative gain since 1992. It remains to be seen if this brief-but-spectacular reversal is the start of a larger trend.

Large Cap Growth vs. Small Cap Value

Russell 2000 Value Index - Russell 1000 Growth Index, 2/1/1992 - 11/9/2020

Daily Return Spread, %



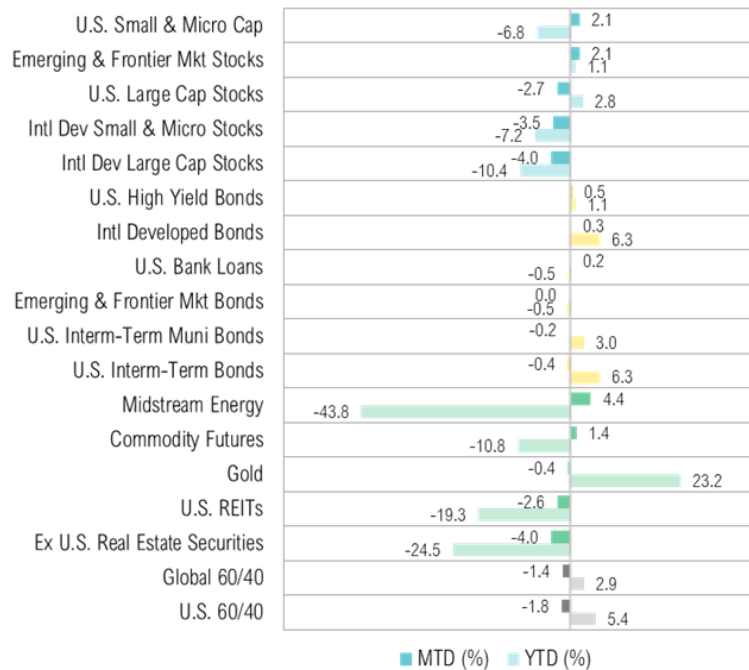
Source: Bloomberg

Since election day, U.S. stocks have rallied, turning the S&P 500's 2.8% year-to-date gain through October into an 11.6% gain by November 9.

Markets

After some early selling on election day, U.S. stocks started rallying and have barely looked back since. The S&P 500's 2.8% year-to-date gain through the end of October turned into an 11.6% gain by November 9. Riskier parts of the credit markets have also participated in the rally, while investment-grade bonds declined modestly in October (and in early November) as the yield on the 10-year Treasury Note has continued to drift higher from its low of 0.68% on October 1 to 0.96%, as of November 9. (Bond prices move inversely to yields.)

October 2020 Key Market Total Returns



Source: Bloomberg

Looking Forward

While policy in Washington remains unpredictable, supportive monetary policy provides at least one reason for investors to be optimistic.

It is not possible to predict exactly where all the “chess pieces” will land in Washington nor how those pieces will shape policy in the coming years, but there are reasons to be optimistic. Even without clarity on the exact path of fiscal policy, monetary policy remains extraordinarily supportive of markets. On November 5, the Federal Open Market Committee (FOMC) noted in its press release that it will continue its quantitative easing program at a pace at least equal to the current \$120 billion per month. Chairman Powell said the FOMC could do more if needed.¹⁵ The notion that taxes will not need to be raised to fund another round of stimulus could help clear at least one major obstacle in the way of Congress getting something done should more stimulus be needed. On the virus front, the estimated 90% efficacy of the Pfizer-BioNTech vaccine could place it among one of the most effective of all the major vaccines (versus between 40% to 60% effectiveness for the seasonal influenza vaccine).¹² That said, there are valid concerns around production and distribution given the unusually low temperatures required to store the vaccine.¹³

Performance Disclosures

All market pricing and performance data from Bloomberg, unless otherwise cited. Asset class and sector performance are gross of fees unless otherwise indicated.

Citations

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DEFINITIONS

Asset class performance was measured using the following benchmarks: U.S. Large Cap Stocks: S&P 500 TR Index; U.S. Small & Micro Cap: Russell 2000 TR Index; Intl Dev Large Cap Stocks: MSCI EAFE GR Index; Emerging & Frontier Market Stocks: MSCI Emerging Markets GR Index; U.S. Intermediate-Term Muni Bonds: Bloomberg Barclays 1-10 (1-12 Yr) Muni Bond TR Index; U.S. Intermediate-Term Bonds: Bloomberg Barclays U.S. Aggregate Bond TR Index; U.S. High Yield Bonds: Bloomberg Barclays U.S. Corporate High Yield TR Index; U.S. Bank Loans: S&P/LSTA U.S. Leveraged Loan Index; Intl Developed Bonds: Bloomberg Barclays Global Aggregate ex-U.S. Index; Emerging & Frontier Market Bonds: JPMorgan EMBI Global Diversified TR Index; U.S. REITs: MSCI U.S. REIT GR Index, Ex U.S. Real Estate Securities: S&P Global Ex-U.S. Property TR Index; Commodity Futures: Bloomberg Commodity TR Index; Midstream Energy: Alerian MLP TR Index; Gold: LBMA Gold Price, U.S. 60/40: 60% S&P 500 TR Index; 40% Bloomberg Barclays U.S. Aggregate Bond TR Index; Global 60/40: 60% MSCI ACWI GR Index; 40% Bloomberg Barclays Global Aggregate Bond TR Index.

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