

October 26th, 2020

US elections 2020

For exactly 175 years, Americans have been called to the polls to elect their president "the Tuesday next after the first Monday in the month of November" as established in the constitution. This month was chosen because it did not interfere with spring plantings, summer work, or fall harvests, but it also did not hinder transport with the onset of winter. A Tuesday was chosen so that voters could go to church on Sunday, travel to the polling station on Monday and vote on Tuesday, just in time to set up the Wednesday market. A perfect system for an agrarian society. Much has happened since then, but 175 years later, "the Tuesday next after the first Monday in the month of November," Donald Trump, current US President and Republican candidate, will face Joe Biden, former Senator and Democratic candidate.

The impatience that prevails today's society pushes the media to proclaim a winner that very night in the wee hours of the morning. But the reality is that the counting system is still archaic, and it is not until after a month that governors of each state send the official results to the National Archives. Taking into account that due to the pandemic, voting by mail has skyrocketed - it is estimated that 27% of the voters in 2016 have already voted - even more pertinent is to remember that it is more of an *election month* and not an *election night*. This year there is a high probability that we will find ourselves with an inconclusive scenario the night of the elections and that a similar situation to the 2000 elections will be repeated. George W. Bush won the American elections against Al Gore by a very tight result in Florida of 537 votes, that is, 0.009% of votes.

But the situation today has nothing to do with that of 20 years ago. Despite the fact that Jeb Bush, George W. Bush's brother, was the current governor of Florida at the time, there was no disturbance or social unrest and Americans waited patiently for official results while the ballots were recounted. This year we find ourselves with an extremely polarized population and with a candidate willing to not comply with results if he believes that the elections have not been fair.

What could possibly go wrong?

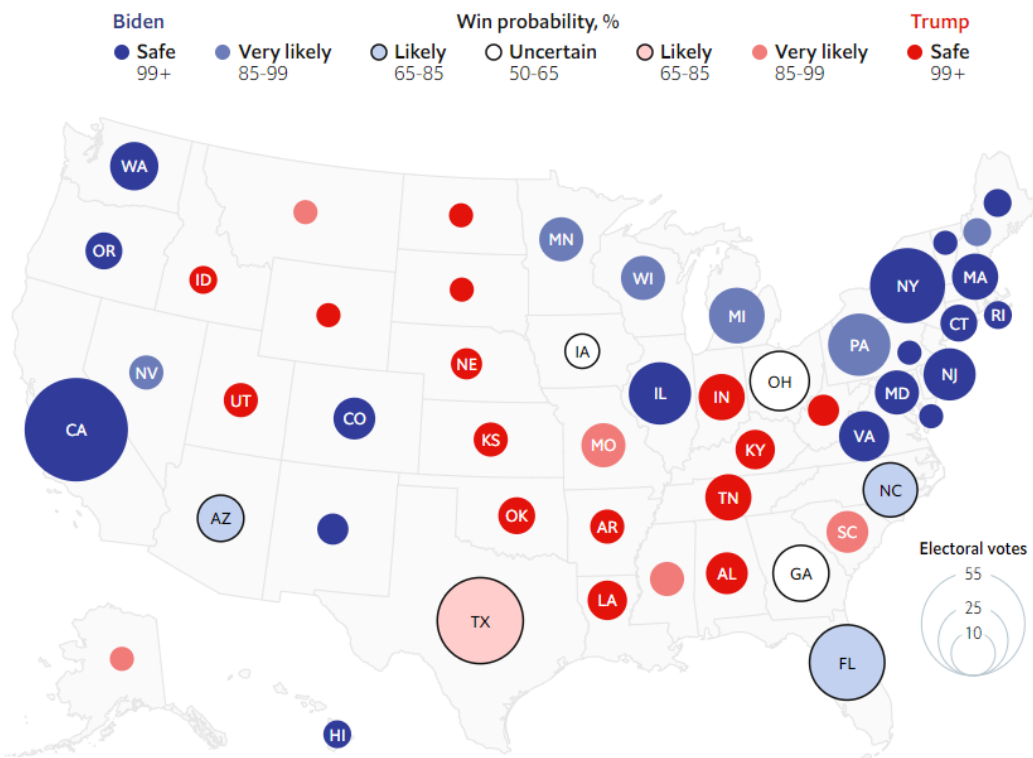
The main story currently dominating the financial market is "The Blue Wave Plus Vaccine." With Joe Biden well ahead in all polls and Democrats very well positioned to regain the US upper house, the Democrats would come to control the executive and legislative branches without much impediment. That would allow Biden's economic and social agenda to unfold and we could, for example, see a strong push in energy transition and public spending. In parallel, several vaccines against Covid-19 are in their final testing phase and could begin to be distributed in the coming months. The confidence that the vaccine would generate in the economic reactivation, added to the great fiscal stimulus that Democrats are promising, is the perfect cocktail to support the bullish thesis. But along the way many things could go wrong; these are the steps that must be completed to achieve "The Blue Wave Plus Vaccine":

1. Joe Biden needs to win enough Electoral Colleges to win the US elections neatly on the same night of the elections

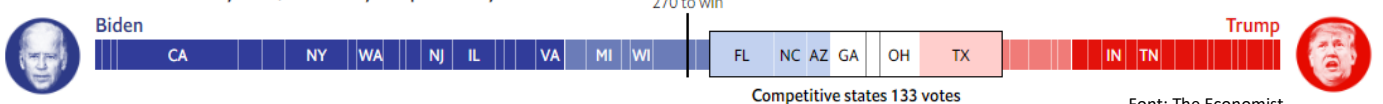
According to pollsters and surveys this is the most likely scenario. Most claim to have corrected mistakes that failed to foresee Trump's historic victory in 2016. On the same election night, they claimed that Hilary Clinton had a 90% chance of winning against Donald Trump. Voting by mail is overwhelmingly Democratic, so there is the possibility of a seemingly good outcome for President Trump on Election Night, followed by a progressive blue trickle that subsequently tips the balance towards Biden.

Each state has its own laws, but the key is in Florida, which allows mail ballots to be counted as they arrive. This will allow to have a result in this state early at night. If Biden seizes Florida, it is virtually impossible for Donald Trump to hold the presidency. If the victory is clear, no matter how much Trump tries to question the result, the market will react by giving Biden the victory immediately.

If instead Trump takes over Florida, his probability of victory heavily increases and in the event of a global victory for Biden through other smaller states in a very tight way, it could lead to Trump trying to contest the election. This is precisely the scenario that terrifies the market. With the new composition of the Supreme Court, where the president has just nominated a new conservative judge, the Court will most likely give Trump the benefit of the doubt. It could take months to clarify the outcome and there would be a high risk of social unrest. It is true that the market navigated the protests by George Floyd at the beginning of the year with certain disinterest, but a social revolt in full contested elections could take unexpected dimensions.



Electoral votes by state, ordered by win probability

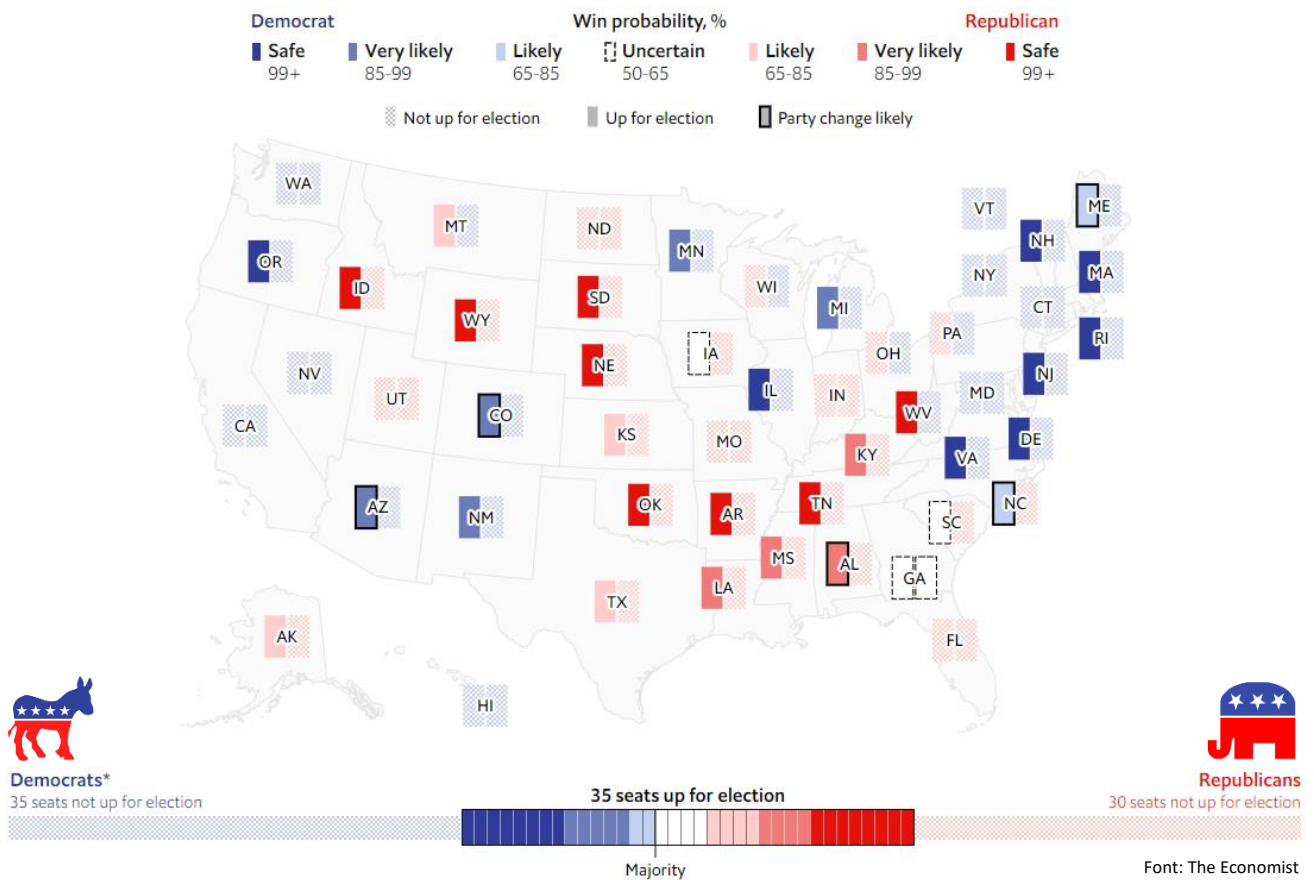


Font: The Economist

2. Democrats need to retake the Senate

Despite being the favorites, this task is more complicated than winning the presidency. The upper house of the United States Congress is made up of two senators from each state regardless of its population. With 50 states in the Union, there are currently 100 senators of which 47 are Democrats. In the event of a tie, the tie-breaking vote is held by the President of the Senate, who, as the constitution establishes, is the Vice President of the United States. The mandates are for six years and three groups are formed, a third of the senators are put to vote every two years, which means on November 3rd, only a third of senators will dispute their seats.

Currently at 47, Democrats only need to get to 50 in the event of a Biden victory - which would award the runoff vote to vice presidential candidate Kamala Harris. It all indicates that they will lose the Alabama seat in favor of Republicans and that they will be able to snatch seats in Colorado, Arizona and North Carolina. Only one would be missing. The most likely candidates are Maine (78% probability), or Iowa (60%). Should the Republicans retain control of the Senate, the experience of the past few weeks will set the tone for the next two years. Republicans will likely revert to their principles of a hawkish approach to public spending and make life miserable for Biden and Democrats by blocking their legislative agenda.



3. A vaccine must be approved, distributed, and the population must agree to be vaccinated

Here we find contradictory versions. Politicians keep repeating that the vaccine is practically ready for distribution and that citizens will be able to start getting vaccinated in weeks, while scientists keep asking for caution and patience. Vaccines typically take four to five years to develop, and the relapses and side effects of some volunteers recently remind us why. On the other hand, the initial shortage will generate moral dilemmas between countries and within them about who should be vaccinated first. The final unknown will be the predisposition of citizens to be vaccinated. Recent polls show that at least 36% of Americans probably will not want to take it. What's prudent is to assume that the vaccine will not arrive in time for this second wave and that this is going to be a complicated winter with partial lockdowns.

If the Democrats' Blue Wave does indeed arrive - controlling the presidency, the House of Representatives and the Senate - while weeks later a vaccine is finally approved generating great confidence in the majority of the population, we could certainly find ourselves before a strong bull market. We believe that cyclical sectors will perform better than technological ones, that the US interest rate will rise, and the dollar will weaken. A strong economic recovery combined with strong stimulus expected from Democrats and an expansionary monetary policy could lay all the bases for the return of inflation to Western countries after 30 years.

On the contrary, and given the uncertainty that all previous points will materialize, it is possible to find a bump in the road. As the expression goes, if the United States sneezes, the whole world gets a cold. It is in the interest of every investor to adopt scenario analysis and not bet everything on a "New Deal", but instead to limit risk and dent part of potential profits in exchange for protection. The next two weeks will mark the future of the world for the next few years.

Appendix: Hanway Capital Fund historical returns:

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2019	-	-	-	-	-	-	-	-	-	-	-0.4%	1.2%	0.8%
2020	-2.9%	-3.0%	18.3%	4.6%	-0.4%	3.2%	-2.3%	0.5%	-2.7%				14.5%

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