All the Ways Wall Street's Telling Clients to Trade the Election

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Every four years, Wall Street pundits butt heads on how to trade the biggest political risk on the planet.

This time around, there's more consensus than usual over the likely winner -- Joe Biden. After that, there's plenty of disagreement on strategies to wager on an election that's been flashing warnings of chaos ahead in volatility markets.

After fretting over a President Biden raising taxes and tightening regulations, some stock pundits are now cheering the stimulus and political certainty his administration could usher in.

Foreign-exchange strategists are similarly divided on whether a second term for Donald Trump or a new Biden-led White House would boost the dollar.

All told, market prognosticators are notoriously bad at this stuff. Yet even as the pandemic dominates market moves, the sell-side is full of conviction on how the November vote will spur regime shifts in cross-asset trading.

Here's how strategists are embarking on the high-wire act of predicting the post-election aftermath.

Biden Will Sink Stocks. No, He'll Lift Them.

Barclays Plc and Saxo Bank say a Democratic win could be bad for stocks because of higher taxes. The former estimates Biden's proposed tax hike amounts to rolling back half of Trump's 2017 cuts and would shave 5% off equities. JPMorgan Chase & Co. and Evercore ISI meanwhile reckon a stimulus-friendly "blue wave" might lead to a risk-on rotation across sectors.

Goldman Sachs Group Inc., for its part, offers two separate forecasts depending on whether the market focuses on economic optimism or taxes. In one scenario, the market homes in on faster growth from more fiscal spending, lifting the S&P 500 roughly 4% to 3,633. In the other scenario, investors fretting over higher taxes drag down the benchmark.

Political Trading
Goldman forecasts market reactions to electoral results

	Friday close	Biden win with stimulus focus	Biden win with tax focus	Trump win	Contested election
S&P 500	3.48K	3633 (4.5%)	3340 (-3.9%)	3559 (2.4%)	3122 (-10%)
Euro Stoxx 50	3.27K	3503 (7%)	3196 (-2.4%)	3271 (-0.1%)	3068 (-6.3%)
MSCI EM	1.12K	1189 (5.9%)	1092 (-2.8%)	1090 (-2.9%)	N/A
EUR/USD	1.18	1.21 (2.5%)	1.2 (1.7%)	1.18	1.17 (-0.8%)
10-year Treasury yields	0.77	1.02 (25bps)	0.76 (-1bps)	0.76 (-1bps)	0.68 (-9bps)
5-year breakeven rates	1.57	1.73 (16bps)	1.52 (-5bps)	1.64 (7bps)	N/A
USD high-yield spreads	492.00	452 (-40bps)	533 (41bps)	488 (-4bps)	N/A

Source: Goldman Sachs; Bloomberg data for Friday close
Numbers in parentheses show changes compared to last Friday's close as calculated by Bloomberg News.

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The buy-side is similarly divided.

The S&P 500 has gained around 4% this month despite uncertainty over the next stimulus package. To Brian O’Reilly, that’s a sign more fiscal support is probably priced in, but Biden’s tax policies aren’t.

“Markets are expecting a pretty strong V-shaped rebound in earnings next year but obviously, taxes could be one thing that could derail that,” said the head of market strategy at Mediolanum Asset Management. “A Biden victory would be initially viewed as risk-off.”

Yet in the estimation of Brian Jacobsen, a strategist at Wells Fargo Asset Management, the former vice president is still likely to prioritize stimulus before any tax increases, so his victory would still prove positive for the equity market.

Policy Implications

Saxo Bank lays out the election's equity winners and losers

	Winners	Losers
Biden	Green energy, infrastructure, marijuana stocks	Technology, financials
Trump	Oil and gas, small caps, infrastructure	Chinese tech, health care

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Policy Implications

While predicting how the broader index will react is hard, analysts are more united on how the election will sway sectors. The Biden baskets compiled by Goldman and a partnership between Nomura Holdings Inc. and Wolfe Research, for instance, move roughly in the same direction. Both have rallied along with the Democrat's chances.

The consensus is that his policies would boost renewable energy, infrastructure and the health-care companies benefiting from Obamacare. Conversely, he is seen as negative for oil and gas, banks, for-profit education and technology.

Whether markets have essentially priced in a Democratic presidential win is another question. The Invesco Solar ETF, which buys shares expected to gain from policy support for green energy, has already climbed 17% since the last presidential debate.

Another Dollar Bull Run For Trump?

When Trump was elected in 2016, the Bloomberg Dollar Spot Index surged 5% in two months.

Four years on, many analysts are expecting history to repeat itself, but have different rationales. UBS Wealth Management says a "red wave" could boost the greenback because of faster economic growth. Barclays says that will be due to haven demand from policy uncertainty.

Goldman projects that a Biden victory would weaken the dollar to 1.20-1.21 versus the euro whereas Trump would keep it at 1.18, roughly similar to the level now.

Not everyone agrees. At Wells Fargo, Jacobsen says the firm's analysis found that higher Biden odds are actually associated with a stronger dollar, probably because of a larger spending package.

Still, exchange rates move for all sorts of macro reasons, including the U.S. yield gap with the rest of the developed world, which has been narrowing lately.

"You read all kinds of predictions being made, but what is clearly the most important driver of exchange rates is real interest rate differentials," said Dirk Thiels, head of investment management at KBC Asset Management.

Global Shockwaves

U.S. policies will naturally spur profound consequences for the rest of the world.

Barclays's dollar-neutral Biden basket bets on exchange rates linked to China and Europe and against the Russian ruble, Turkish lira, Canadian dollar and Mexican peso. That's based on a mix of correlations and predictions around greater trade certainty and stronger political sanctions against countries like Russia. So far, the basket appears to be tracking the Democrat's chances.

Whoever It Is, Reflation All the Way

Here's another popular take: A landslide Democratic victory would usher in a massive stimulus package that will raise market-derived inflation expectations and steepen the yield curve.

Goldman predicts reflation under a Biden presidency would bring forward the next U.S. rate hike to 2023, instead of 2025 otherwise, and boost 10-year Treasury yields by 30 to 40 basis points in the month following the election.

The Treasury yield curve has been steepening

Still, whoever wins, the U.S. is expected to loosen the fiscal taps to revive an economy battered by Covid-19. That’s why Alasdair McKinnon, lead manager of the Scottish Investment Trust, has made gold miners his biggest wager.

“At the very highest level they’re very similar: they both believe in increased spending and they both believe in the status quo,” he said from Edinburgh. “In that regard, they are both committed to a highly inflationary road map.”

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