Markets Update: Election Outlook

JAKE SIEWERT: Welcome to our Exchanges at Goldman Sachs markets update for Thursday October 22nd. Each week we check in with a leader across the firm to get a quick take on what they're watching in markets. I'm Jake Siewert, Global Head of Corporate Communications here at the firm. And joining us today we have Alec Phillips who's our chief US political economists out of Goldman Sachs Research. Alec, welcome back to the program.

ALEC PHILLIPS: Thanks a lot.

JAKE SIEWERT: So, we're within two weeks of election day, Alec, and there's obviously a lot going on on the campaign trail. What can we learn from the markets about what investors are expecting to happen on November 3rd?

ALEC PHILLIPS: So, I think we've seen a couple of things. One is if you look at some of the baskets on the equity side that we have that reflect kind of different themes, so as an example one would be stocks that benefited from tax reform in 2017 versus those that, you know, maybe benefited less, they do seem to be reflecting an expectation of a change in tax policy. And so, that presumably implies that they are also expecting a change in control.

Now what seems to be the case is they're not expecting the full change in tax policy. So, that either reflects an expectation that, you know, there is still some uncertainty around the election, or it reflects the idea that, well maybe a Democratic sweep is the more likely outcome. But that things won't change as much as what former Vice President Biden has laid out in his campaign plans.

I was going to say, you can see that concerns around a hung-up election results have also subsided some. So, we used to see that there was a pretty noticeable kink in the curve. So, essentially a lot of implied volatility right after election day. But that it sort of spread out over a couple weeks past election. It's now looking a little bit more concentrated pretty close to the election, which I would say probably reflects the idea that Biden has a bigger lead, and therefore maybe a higher probability that you have a clean election result on election night and it's not, you know, a really close result. And maybe also just a little bit better understanding of how the mechanics work behind all of this.

JAKE SIEWERT: So for investors what's the biggest variable that they're still focus on? What's up in the air that investors would like certainty around?

ALEC PHILLIPS: Well, I mean, I think probably the most important thing from the sort of policy or political world is really just fiscal stimulus still. For two reasons. One, obviously, it matters a lot to the economy in the near term what happens. But also, you know, there has been a clear focus on the idea that a Democratic sweep this year would be maybe different for stocks than it would be normally. Normally we hear about, well, taxes might rise. Regulatory risks might increase for certain sectors. Et cetera, et cetera. Now, you know, there is still discussion of all of that. But there's also discussion of a much larger fiscal stimulus expectation under a democratic sweep than you would get under, say, like a status quo outcome.

And so, that's very noticeable in client conversations where two months ago it was the number one question was, "Well, how much do you think the corporate tax rate will increase?" And now the number one question is, "How much fiscal stimulus do you get under a Democratic sweep versus other election scenarios?"

JAKE SIEWERT: So Alec, you spent some time in the US Senate. And investors are very focused on the Senate there. There's a range of possible outcomes, not a huge range, but a range of possible outcomes today that are plausible. How do you think about what the Senate might look like after the election and what that means for policy?

ALEC PHILLIPS: So, I think there are sort of two main questions there. One is who is the incremental vote or the marginal vote on the big bills that they're moving through, whether it's stimulus or whether it's a tax and healthcare bill or something later in the year? And that, you know, the margin makes a big difference for that. Because if it's 50/50, it's going to be essentially the most centrist Democrat. A lot of people might point to, for instance, Senator Joe Manchin from West Virginia. There are a few others that if just look at sort of vote rankings and things like that would pop up. On the other hand, if you get to, like, 52 or 53, then the position that that person holds might change. And so, just as one example of this, if we look at fiscal stimulus which is the big thing that people are focused on first up next year in the scenario of a Democratic sweep, Manchin has already said he doesn't want to vote for something over 3 trillion. But nobody else has really put a price tag. Now, 3 trillion is probably well within the range of expectations anyway, but nevertheless it tells you that there might be a little bit of a limiting factor there.

If you get to 52 or 53, then you're not going to necessarily have as much of a limit there. And you also then, on the other side, probably have, you know, maybe a little bit more appetite for a corporate tax increase or other things like that.

The other thing though that's unique about this election, at least that I can remember, is this question of getting rid of the filibuster. And so, you know, that's the other big thing that people are starting to focus on. If we get a 50/50 result, I think most people would say we're unlikely to see the filibuster end, certainly not right away anyway. And that's largely because a few senators have said that they don't want to do it on the Democratic side.

If we get to, you know, 53 or 54, which is probably the outside range of possibilities, then in that scenario, you know, it becomes probably at least certainly very possible that they get rid of the filibuster. And what that does is it opens up a whole new set of issues that investors will have to think about because instead of just thinking about fiscal policy, which typically can pass with 51 votes in the Senate, they'll also have to start thinking about all of the different regulatory issues.

And so, my guess is from like an equity market perspective, it could turn out to be sort of too much of a good thing where I think the equity market is after fiscal stimulus. They're not necessarily after an additional sort of set of regulatory uncertainties that would come with 53 or 54 votes in the Senate.

So, you know, right now if you look at prediction markets, the most likely scenario implied in those markets is 51. And that seems like my guess is sort of the golden outcome from an equity market perspective, or for that matter, a financial market perspective more generally.

JAKE SIEWERT: So, anyone who was around for the last election knows that no one knows anything. And you know, most of the political prognosticators got it wrong, not all of them. But what's similar to the 2016 election? And what looks different from a markets' perspective?

ALEC PHILLIPS: Well, I mean I'll say one similarity, and this not necessarily the market, but I mean the polling right now is eerily similar to what it was in 2016. So, if you look at Wisconsin, this day in 2016, Clinton had a seven-point lead. Pennsylvania this day in 2016, six-point lead. Florida, four-point lead. Those are basically the same margins that we have today in those same states. So, you know, clearly there is some similarity there.

I mean, I think what's different this time is that there is probably more of a focus on the policy consequences, on the specific policy consequences coming out of the election whereas in 2016 what we had was a market that seemed to trade up, equities seemed to trade up when Clinton looks more likely to win. And traded down when Trump looked more likely to win. And this is one of these things where you can actually show this, you know, quantitatively looking at prediction markets versus the S & P or whatever. And then on election night it totally went the other way.

So, I think one of the things that people are trying to figure out now is are we sort of looking at the same thing again, where right now it looks like the market is trading more positively when it thinks we're going to get more stimulus, and that seems to be equated with, you know, a Democratic sweep. But could it turn out that, you know, like in 2016, once the election happens things go the other way because maybe the stimulus is, like, already baked in and people focus more on some of the other factors? So, in some ways it's similar. But I think, you know, to me, the difference is that ultimately what the market is probably going to focus on is the actual tangible policies. And at least right now the one that seems to be most obvious is this question of fiscal stimulus. So I think that probably still dominates the other factors.

JAKE SIEWERT: So, what are you personally watching most closely between now and November 3rd?

ALEC PHILLIPS: So, I think probably the most important thing from here is just going to be what we see in terms of the early vote. It was notoriously misleading in 2016. You know? I think a lot of people were looking at the early vote in Florida thinking that was pointing to, you know, strong Democratic performance, which turned out not to be the case. I think this year what we're seeing right now is, again, like you know, Democrats seem to be doing pretty well down there in terms of raw numbers. But the difference is that the polls are suggesting that they should be doing even better because so many of them, just in responding to polls, are saying that they're going to vote by mail. And yet you're not quite seeing that in the numbers.

So I think that from here, unless we get some kind of big surprise out of the blue, I think it's going to just be about early voting and how that shapes expectations going into election day.

JAKE SIEWERT: Well, Alec, thanks for joining us. We'll have you back after the election to talk about what's next. But appreciate you taking the time today.

ALEC PHILLIPS: Sounds good, thanks.

JAKE SIEWERT: That's all for this week's markets update on Exchanges at Goldman Sachs. And in case you missed it, check out our other episode this week with Jason Granet on the LIBOR transition and the impact it's having both on Wall Street and Main Street. Thanks for listening and hope everyone has a great weekend.

This podcast was recorded on Wednesday October 21st in the year 2020. Thanks for listening.