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Markets Update: Investors Anticipate Next Week's U.S. Election

JAKE SIEWERT: Welcome to our Exchanges at Goldman Sachs markets update for Friday October 30th. 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 my guest today is Amelia Garnett, back with us from our Cross Asset Sales Desk in the Global Markets Division.

Amelia, welcome back.

AMELIA GARNETT: Thanks so much for having me after such a critical week.

JAKE SIEWERT: You've left Maine. Back in New York City. We're taping this Thursday afternoon. A lot could happen between now and the morning. But we're only five days from the US election. Arguably, one of the more important macro events of the past four years. What are your clients thinking about as we sit here right before the election?

AMELIA GARNETT: Sure. So, I think that right now it all comes down to two things. The first is the election which will dictate policy, and most importantly, fiscal policy in the short term. And two, the vaccine, which will dictate the future path of COVID. So, just on the election, I'd say that consensus expectations are that we see the Democrats take the presidency, the House and the Senate. Though, there's definitely uncertainty around a couple of things. First, polling error. People have pretty raw memories of 2016, and particularly in the more contentious states like Florida, Pennsylvania, Arizona, and Wisconsin, investors are certainly cautious about how accurate the polling is.

I'd say the second part of uncertainty is around the ultimate composition of the Senate. For example, if the Democrats take 51 seats, they'd be able to get their fiscal policy through. But if they get 53 or 54 seats, that could definitely enable them to eliminate the filibuster and address other policy issues like tax and the judicial nominees. I personally cover a mix of equity, credit, and macro-oriented hedge funds. And I'd say that the consensus amongst my clients are that we see a blue wave, but not necessarily enough of a Democratic Senate majority to really have that more negative market outcome like tax change

and immediate policy concern.

I'd also add that client views have shifted pretty dramatically around what the blue sweep represents. Because I think, in [UNINTEL] where we've discussed this before, you know, clients certainly were more bearish about the implications for tax policy. And now I think that there's a recognition that a unified Democratic government offers our best chance of a large fiscal package. And so, it's really about the relative sequencing of fiscal versus tax that will matter for markets. And we reckon that the fiscal will come prior to the tax.

JAKE SIEWERT: So, you started mentioning the vaccine but then went right into the election. Investors were super optimistic about the prospects for a vaccine reasonably shortly. How are they feeling now?

AMELIA GARNETT: Yeah, so look, the last week has been troubling because we've seen these rising case counts across Europe and the US. And stricter lockdowns in Europe. So, clients are very focused on the upcoming vaccine approvals because they hopefully see that once that arrives, that will mark the start of a return to normal.

In terms of timeline, clients are looking for Pfizer, Moderna, and possibly Oxford and AstraZeneca to provide data from their phase III trials in November. And that could result in a request to the FDA approval in December. And though, there are certainly risks to that timeline pushing into next year.

And then the expectation from there would be that we get broad circulation of a vaccine probably by the first quarter of next year in the US, maybe March. And more like the summer in Europe.

JAKE SIEWERT: So, given the uncertainty around vaccines and the election, how are your clients positioned right now?

AMELIA GARNETT: Sure. Well, I'd say most are pretty bullish if we do get this combination of a vaccine and we get the blue sweep. That's a pretty powerful cocktail for the economy and cyclical assets more broadly. So, just making a couple of observations across different asset classes, in equities clients are unquestionably long and they have a regional bias towards the US. Though I would say that there's an open mindedness to consider length in emerging market equities as well because they are undervalued at these levels. They benefit from global growth. And they could also benefit from a lower dollar.

In currencies, clients are increasingly supportive of the lower dollar view. And that's something that you and I have discussed on prior episodes as well. And I think back in June when we talked about it, the view was that you go long the euro and short the dollar. And that trade actually paid out very well through the summer. But now with rising COVID cases and lockdowns across Europe, investors are thinking about where else they can go long. And the Chinese yuan actually stands out as one of those pairs. Performance in the Chinese yuan has been very strong in recent months. And I think that's for several reasons. The first is that China's economy is undeniably outperforming the rest of the world right now. It also offers a high carry. And there's also potential for Biden to adopt a different style of engagement of with China than Trump necessarily has.

I'd say on the commodity side of things, clients are bullish on a six month to one-year timeframe. They think that oil should benefit from rising activity in travel. Base metals like copper should do well as industrial activity picks up. And then the likes of gold and silver should do well in a higher inflationary environment, and particularly silver actually, which is a higher beta [PH] play on gold, but could also benefit from Biden's [UNINTEL] plans.

And then I'd say just finally on the rate side, the market is currently pricing the Fed to hike rates for the first time in the middle of 2024, which feels a long, long time away. But if we do get this combination of vaccine and blue sweep, there is certainly potential that the market brings that first hike forward into something like 2023. So, we've seen clients position for higher front-end deals. And then further out the rate curve, the expectation is that the market should reprice longer-term inflation and growth expectations, which should lead to a steep yield curve. So, people are also positioning for higher yields in the kind of 30-year point of the curve.

JAKE SIEWERT: How about risks? What are the biggest risks in the market? And how could markets react?

AMELIA GARNETT: Yeah. So, I think in the very short term there is a risk of a contested election, which would lead to a period of uncertainty for financial markets and potentially some indigestion. I also think there is a risk that in the blue wave scenario the market doesn't necessarily buy the fiscal story up front and instead focuses on taxes and trade, which could lead

to lower equity markets. But beyond the election, I really do think that the biggest risk out there is that of COVID. You know? We've got major geographies in the northern hemisphere heading into winter. And as we've seen this week and as I already mentioned, the markets just don't take that well. It's been a tough week in markets with equities pricing lower, emerging market assets pricing lower, and the dollar strengthening. So, anything that will extend the timeline for COVID to be around presents more of a systemic and long-lasting risk for health, and also the economy.

JAKE SIEWERT: So, four years ago election night and the following day were pretty wild in markets, in the options markets, particularly futures markets. What do you think we can expect in terms of timings on election night? What specifically will you be watching for?

AMELIA GARNETT: Yeah, it's a great question around logistics. So, for the presidency there are three states that we're going to be watching closely. So, that's Florida, North Carolina, and Ohio. And each of them we're focused on, because, A, their polls are released between 7 and 8pm New York, which is early in the grand scheme of things. But also, they have the ability to count votes early. And so, we would actually expect to see a large share of the votes being released within, possibly, an hour of the polls closing. So that's certainly informative.

I'd also say that FiveThirtyEight, so Nate Silver's model, has said that the conditional probability of Biden winning the election, if he wins either of those three states, is around 99 percent. So, clearly, they matter.

I would also note, though, that Trump is currently polling ahead in Ohio. But it does have a high correlation to other Midwestern and rural voting areas. So, that will be informative for us on the night.

As for the Senate, you know, it could take longer. And it's certainly possible that we don't know the ultimate balance until January given the likelihood of a Georgia runoff election on January the 5th.

JAKE SIEWERT: Well, I for one, am hoping for an early evening. I confess four years ago, and I've worked on a lot of presidential campaigns, I was in bed by 11. Sort of saw that one being over early. What does the election look like on the

trading floor in the time of COVID, or before that too?

AMELIA GARNETT: Yeah, so it's funny, I was talking to a colleague this morning about this. And we were saying this is like our Super Bowl moment. But I guess the right analogy would be the Olympics given it's every four years. But you know, we really have practically spent four years preparing for this moment. And I'm delighted to say that we will be staffed on the trading floor in a safe and socially distanced manner. Currently markets and futures markets will be open and tradable all night long as the results get released. And you know, we'll have staffing all around the globe for, frankly, as long as the uncertainty remains. So, I think we're all very excited and ready for it to be on our doorstep.

JAKE SIEWERT: All right. Well, we'll send you some pizza. Thanks for joining us Amelia. Nice to see you.

AMELIA GARNETT: Thanks so much for having me.

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 Kim Posnett and two entrepreneurs from our Builders and Innovators Summit. They talked about how founders are staying resilient through an unexpected year.

Thanks for listening and we hope everyone has a great weekend. And please remember to vote. This podcast was recorded on Thursday, October 29th in the year 2020.

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