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Blue or red

The US presidential election is just two weeks away and its result can have major consequences globally. As the biggest economy and stock market in the world, the US provides direction to the global economy and financial markets. In urging his fellow Americans to vote, ex-President Barack Obama said it best: "Our elections matter to everyone; we set a tone."

Blue wave in 2020?

A Democratic sweep in the upcoming US election has become more likely with former US Vice President Joe Biden currently enjoying a comfortable lead in most polls. Still, the outcome is far from certain. As we have seen in the 2016 presidential race between Trump and Hillary Clinton, a number of battleground states can swing the outcome of the electoral college vote.

The Democrats control the House and are vying for Senate leadership. A blue wave would unite the US government under one party, remove bottle-necks to policy-making, and make it easier for the administration to execute its agenda. Markets were initially worried about a Democratic sweep as this would mean more taxes and more regulations. There were fears that a blue wave may open the door for socialist programs offered by radical lawmakers. However, investors have recently warmed up to a possible blue wave as the Democrats propose a massive stimulus that would jumpstart the recovery.

It is also possible for Biden to win as president, the Democrats to keep control of the House, and the Republicans to retain the Senate majority. A Biden presidency with a split Congress is viewed positively by the financial markets.

A red comeback

Although Trump is currently behind in pre-election polls, history shows that he is capable of delivering last-minute surprises. A Trump reelection and the return of a Republican-controlled Senate would maintain the status quo and keep the tax cuts that went into effect in 2018. Trump considers the stock market as his main barometer for success. Thus, we expect him to continue implementing lower taxes, less regulations, and US-centric policies if he gets re-elected.

Contested election brings greatest risk

Among the possible outcomes, a contested election brings the greatest risk to investors. Trump has previously refused to commit to a peaceful transfer of power in case Biden wins. Trump has also thrown shade at mail-in voting, claiming that it can be a source of fraud. Mail-in voting has surged as a result of the pandemic; this can delay election results and fuel Trump's accusations of cheating. A political crisis arising from a contested election and a hung government can give rise to more uncertainty and cause additional volatility in the stock market.

Biden stimulus to offset tax hikes

The Democrats propose a $2.2t stimulus package to perk up the US economy. This will deliver another round of stimulus checks to qualified Americans. It will also provide enhanced unemployment benefits, housing assistance, and worker protection. Crippled by the pandemic, the American economy fell 31% in 2Q20. It would thus benefit from a massive government stimulus program that can induce growth.

Proposed stimulus sparks hope for recovery

Hopes for a stimulus-driven recovery, unprecedented monetary easing by the Fed, and the strong performance of mega-tech stocks have kept US indices near their all-time highs despite weak economic conditions brought about by the pandemic. The market's initial fear of higher taxes was offset by anticipation for government stimulus and infrastructure spending that would re-ignite industrial activity. Sectors that are poised to benefit are cyclicals such as industrials, construction, metals, renewable energy, and consumer discretionary. Last week, Goldman's Chief Global Equity Strategist Peter Oppenheimer called for a shift from defensives to cyclicals which should outperform with stronger economic growth, rising inflation expectations, and higher bond yields.

Blue wave may ease US-China tensions

Aside from the proposed stimulus by the Democrats, a blue wave in the US election may ease trade tensions with China. The trade war versus China is a primary strategy of Trump and has been a constant theme throughout his term. However, tariffs implemented by the US and China on each other had a negative impact on trade and their respective economies. If the Democrats regain control of the US government, relations with China may improve and this can unlock pent-up trade between the two biggest economies in the world.

Resurgence of US economy to benefit Philippines

The race between the blue Democrats and red Republicans not only impacts the US but also the direction of the global economy and stock market. A blue wave would mean the swift implementation of the government stimulus and a de-escalation of trade tensions with China. Meanwhile, a Trump victory and a return of a Republican Senate would keep the status quo which supports a strong US stock market. However, a contested election would usher uncertainty and may cause global markets to drop.

China is touted as the direct beneficiary of a potential blue wave. Other Asian countries including the Philippines are likewise poised to benefit from a resurgence in industrial activity that may result from the US government's stimulus program. A stimulus-driven recovery of the American economy may spur risk appetite and result in a rotation from defensives to cyclical stocks in the US. Barring any negative shock, this may be followed by a global rotation from outperformers to laggard countries such as the Philippines. The US election thus bears watching because of the far-reaching implications that it will have on the course of the global economy and international equity markets.