

BY THE NUMBERS

187

Number of electoral votes up for grabs in states defined by Real Clear Politics as “swing states”

76.7 MILLION

Number of mail-in ballots sent to voters around the country

13

Number of states that cannot begin counting mail-in ballots until after polls close on Election Day

3

Net number of Senate seats that Democrats need to win to gain control of the chamber

7

Number of Senate races rated as “toss ups” by Real Clear Politics

SOURCES:

1. Real Clear Politics, 2020 Electoral College Map
2. The New York Times, Tracking Absentee Votes in the 2020 Election
3. The Wall Street Journal, Declaring 2020's Winner Could Well Hinge on How Quickly States Count Mail Ballots
4. Real Clear Politics, Battle for the Senate 2020
5. Ibid

AS AN EXTRAORDINARY CAMPAIGN REACHES ITS CLIMAX, AFTER THE SOUND AND FURY HAVE FADED, WHAT COMES NEXT FOR MARKETS?

BY JOHN VELIS

With just a handful of days remaining until the US Presidential election, the risks are rising. What was already building in portent and consequence has taken yet another unexpectedly dramatic turn with the President's coronavirus infection.

The result of the race had appeared to be foreordained in the polls after the conclusion of the first debate, with a Biden victory anticipated, but the true extent of the President's medical condition presents a major wild card that complicates placing odds on the final outcome.

In light of the President's COVID-19 diagnosis, in this piece we first examine what would happen if either candidate could not continue at the top of the ticket. We then look at three possible electoral scenarios and their policy implications: a Biden victory along with the Democrats taking control of the Senate; a Trump victory with a divided Congress; and finally, a disputed and/or

delayed election result that could leave the US political landscape in limbo for weeks or even months.

COVID UPENDS RACE

What was already shaping up to be a closely contested presidential election has been upended by President Trump's COVID-19 diagnosis. Although the President is no longer in the hospital, and his condition has ostensibly improved, his age and other health factors make it difficult to definitively state that he is entirely out of the woods.

This uncertainty has been compounded by the cancellation of the second presidential debate that had been scheduled for October 15. After the Commission on Presidential Debates announced that the event would take place virtually following the President's recent infection, the Trump campaign refused to participate, stating there was "no medical reason" to cancel the in-person format and that "the President will be healthy and ready to debate."

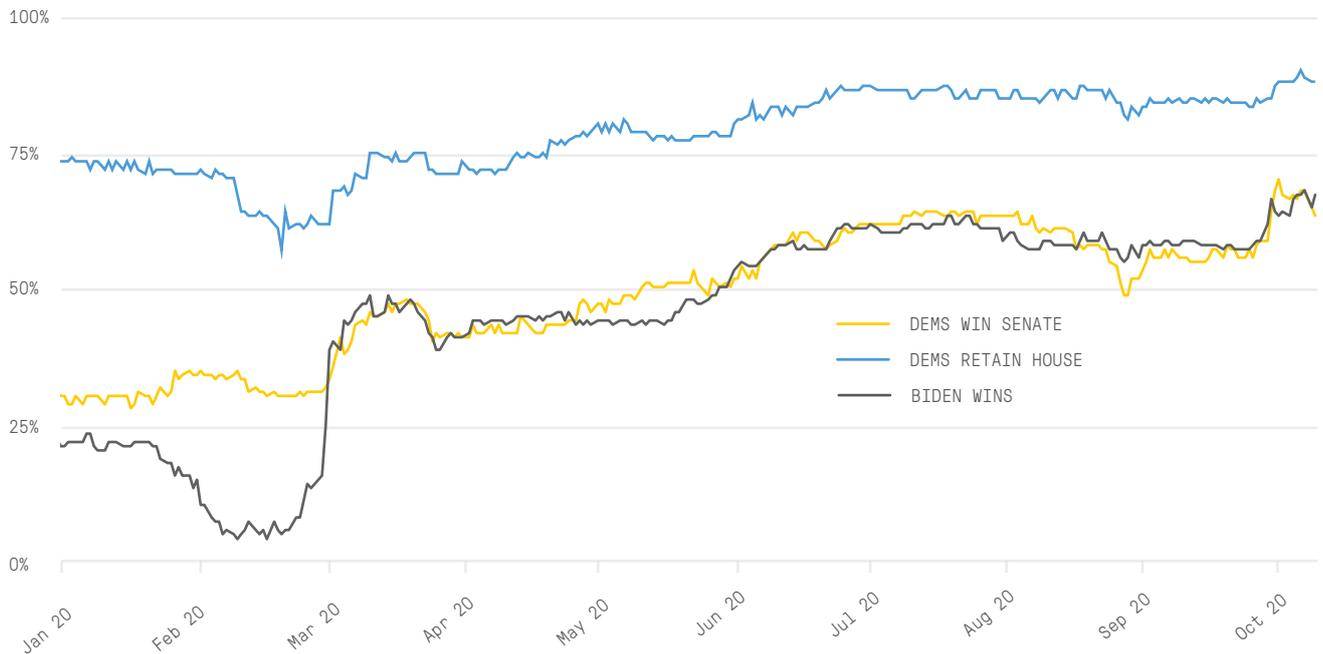
Despite the President's insistence that he will still debate Vice President Biden on October 22, it is an open question whether additional debates will help or harm the President's standing, especially considering his first debate performance was almost universally poorly received. Indeed, recent polling post-debate has moved the race further in Biden's direction.

What would happen if a candidate were unable to remain on the ticket due to poor health? Although this has never occurred, both parties have provisions in their nominating procedures for this eventuality. Each party's national committee would hold a re-nomination process at the committee level and approve a new candidate to put on the ticket. We assume that it is a reasonable expectation that both of the Vice Presidential nominees would receive the nomination.

Then there is the matter of the ballots. Over 76 million ballots with Trump and Biden's names on them have been sent to voters, out of a total electorate

ELECTION BETTING ODDS

The odds of a Biden victory and gains for congressional Democrats have improved through 2020



SOURCE: PREDICTIT, BLOOMBERG; DATA THROUGH OCTOBER 12, 2020

FIGURE 1

of up to 207 million registered voters. If a candidate were to be replaced before the November 3 election, there would not be sufficient time to reprint and redistribute mail-in ballots – or even print new on-site ballots. Furthermore, many early votes have already been cast.

This is where the power of individual states to choose presidential electors comes in. The vast majority of states award all their electors by popular vote; in some – but not all – states, the electors are legally bound to vote for the named candidate. Nevertheless, we think it is likely electors would, when gathered on December 14, vote for the candidate at the top of the ticket at the time of the November 3 election.

The bottom line is that although it has never happened before, there are party procedures to replace a

candidate, even at a very late date before the election, although the practicalities make it tricky.

The chances of postponing the election are remote. Federal law mandates the date of the election, and it would take an act of Congress to change it – something highly unlikely given that control of the two chambers of Congress are held by opposing parties. The Constitution declares that a presidential term expires at noon ET on January 20. If no new President and Vice President has been declared, the Speaker of the House will become president at that time.

POLLS SUGGEST BIDEN VICTORY

At the time of publication, the polls strongly suggest that the election is Joe Biden's to lose. The most recent averages by several respected poll

aggregators show him ahead in the national popular vote by 7-8%. What's more, Biden's average polling support, according to these aggregators, is near or just above 50%, while President Trump is in the low 40s.

When one candidate is polling above 50%, it is generally considered a much stronger indicator, as it would require the candidate trailing in the polls to not just convert undecided voters but also convert previously committed voters to his or her side. Betting odds also have the election strongly in Biden's favor. See Figure 1 for the current state of the polls.

Winning the national popular vote would not necessarily result in a Biden victory, as Hillary Clinton proved in 2016, when she garnered 48% of the popular vote to Donald Trump's 46% – a margin of nearly three million votes – but still lost in the Electoral College,

A handful of battleground states will determine how the election is decided

the mechanism by which the President is actually elected. This means 50 separate elections in each of the states will effectively decide who wins the White House.

When we look at these state-wide polls, the race appears much tighter, and a handful of states are closely contested. These will ultimately be the battlegrounds where the election is decided. This list includes Pennsylvania, Michigan, and Wisconsin, reliably Democratic states that Trump unexpectedly won in 2016 by narrow margins.

Other, “purple” states are up for grabs. As Figure 2 shows, the states rated by Real Clear Politics as “toss up” or “leaning Biden” (meaning still in play) make up a sizeable chunk of the 270 electoral votes needed to win. With such a large number of battleground states there are still multiple paths to victory for both candidates.

The betting markets currently have Biden in the lead as well. Just after the

first debate on September 29, Real Clear Politics – an influential aggregator – showed Biden’s odds of winning at 60%. We have been burned by polls in the past, of course, and by all measures, Hillary Clinton was also the favorite to win on the eve of the 2016 election. CNBC reported on November 1 of that year that betting markets had her odds of winning at between 71% and 81%.

SCENARIOS AND IMPLICATIONS

Democratic Sweep

Control of the Senate is also up for grabs. The Democrats are competitive in a number of races where they could flip a seat from red to blue and gain a majority in the upper chamber (See Figure 3).

We judge it most probable that the party that wins the White House would also win the Senate. With the House of Representatives likely to remain Democratic, there is a real chance of a Biden presidency with the Democrats in control of both houses of Congress.

This would have significant policy implications.

Tax and Stimulus

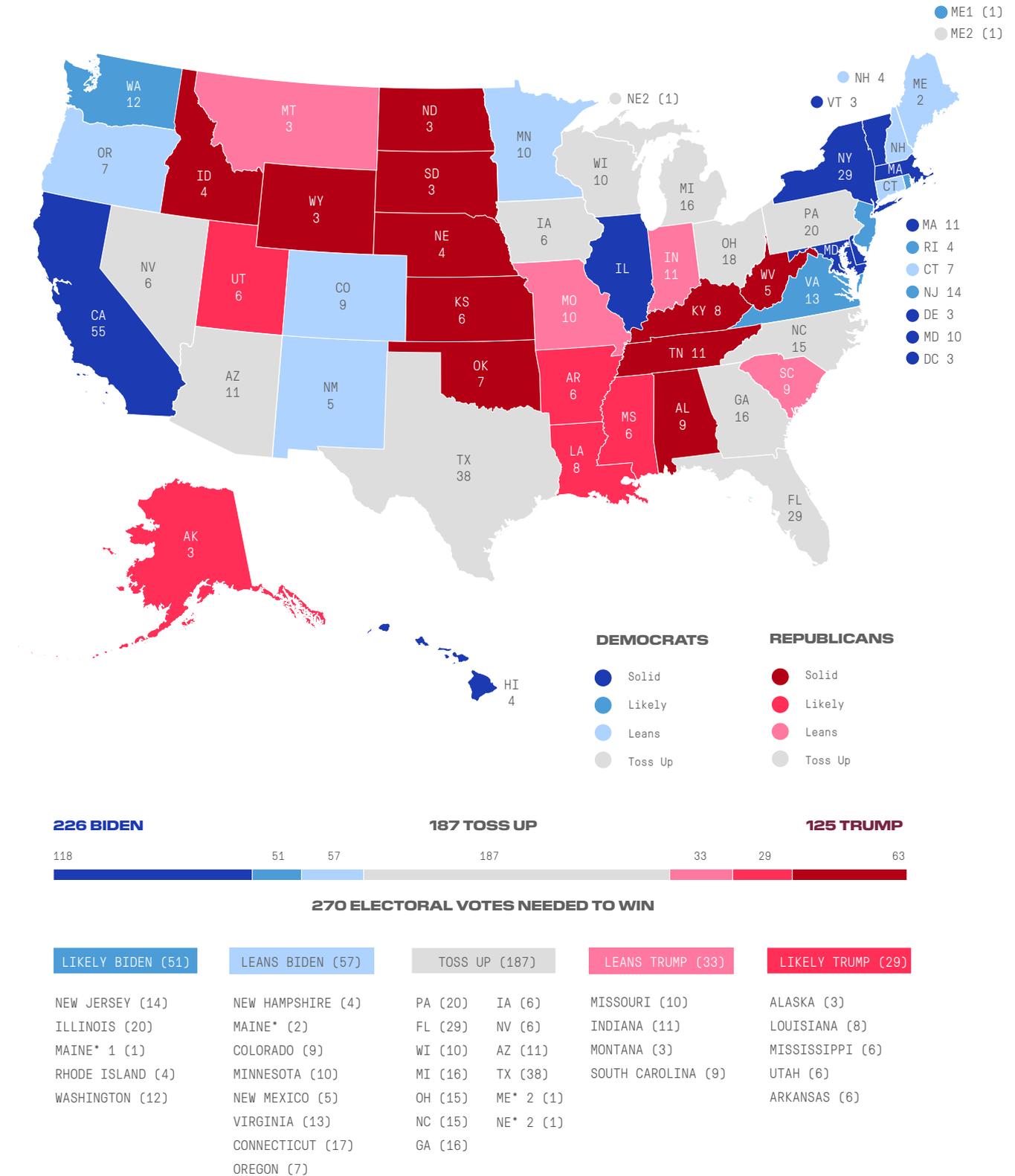
A Biden administration with a friendly Congress would probably move quickly to enact a large fiscal package touching COVID-19-related relief, infrastructure and green projects. Taxes would likely rise on corporations and high earners. Health care, climate policy and international economic relations would see major attempts at reform.

With both houses of Congress on board, we would expect the first order of business to be a coronavirus package similar to the \$3 trillion Heroes Act passed by the Democratic House of Representatives in May of this year, but which had no legitimate chance of passage in the current Congress.

Even though we expect the US economy to remain weak into 2021 when a potential Biden administration would take office, Biden might seek to enact tax reform with haste, including a repeal of the Trump tax cuts on both corporations and individuals.

BIDEN'S TO LOSE: 2020 ELECTORAL COLLEGE MAP

Current polling gives Biden 226 Electoral College votes to Trump's 125, with 187 votes in play



*Maine and Nebraska do not award their electoral votes on a "winner takes all" basis. Consequently, while some electoral votes in these states are solid or lean in favor of a candidate, one vote from each state currently sits in the toss up column.

FIGURE 2

SOURCE: REAL CLEAR POLITICS

A Biden victory and a net pickup of 3 seats in the Senate would hand the Democrats control of the executive and legislative branches

Signum Global Advisors, a policy and strategy consultant, estimates that along with raising the basic corporate tax rate from 21% to 28% and other measures, the overall impact of Biden tax reforms could account for as much as 10%-12% of corporate earnings per share (EPS) on average for the next few years.

Currently, consensus earnings expectations for 2021 are \$168 per share (Bloomberg estimates), implying an EPS growth rate of about 25% between 2020 and 2021. Applying a Biden tax estimate to corporate earnings implies a substantially lower EPS growth rate of just 10.5%.

The tax plan would raise taxes on corporations and individuals by over \$3 trillion in the next decade. That said, a Biden administration would potentially pump hundreds of billions of dollars of infrastructure spending into the economy, much of it aimed at “buy American” and green projects ranging from broadband to climate-friendly programs. Expect a gradual re-empowerment of unions associated with big-ticket projects.

Health Care

Health care policy is harder to forecast at the moment, given that the fate of Obamacare hangs in the balance via a Supreme Court challenge that will be taken up in mid-November. If the Affordable Care Act is rendered unconstitutional and therefore winds up eliminated, the response will be to replace it with a Biden version in short order.

We cannot define the contours at the moment given the unknown outcome in the Supreme Court. We do know that one feature of the Biden health care program would be to create a government-run Medicare-like public option to compete with private insurance plans, and that low-income Americans prohibited from accessing Medicaid due to state restrictions would be eligible for premium-free access to that public option.

Fiscal Policy and Trade

Federal Reserve Chairman Jay Powell's term ends in 2022, and Biden has not indicated if he would reappoint him. While Powell's appointment as a Fed Governor expires in 2028, it is not

unreasonable to think that he would resign from the Board if not reappointed as Chair.

At the moment there are also two vacancies on the Board of Governors, and the nominees have been languishing in the US Senate. The term of current Vice Chair Richard Clarida expires in 2022.

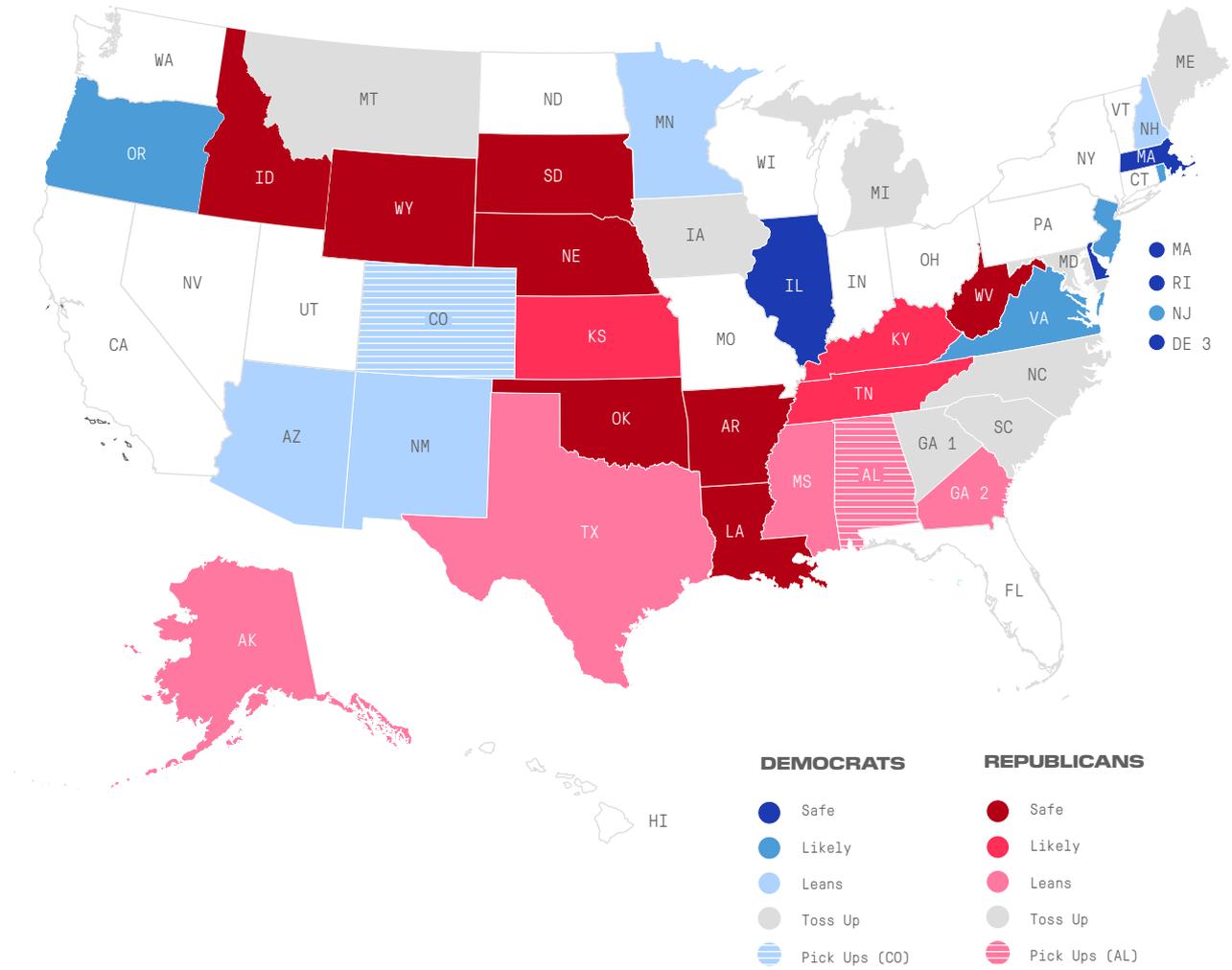
Furthermore, a President Biden might very well nominate current Governor Lael Brainard to be Secretary of the Treasury, meaning within the first two years of a Biden administration, there could be as many as five seats on the seven-member Board to be filled, including a Chair and two Vice Chairs, potentially reshaping the Fed for a generation.

With respect to international economic relations, there should be some climb-down in the current rhetoric and approach to trade policy, but Biden would likely not be an ardent free trader – especially with respect to China.

Tariffs would probably come down, particularly as a means to obtain relief for those industries that have been

ON A KNIFE EDGE: 2020 US SENATE ELECTION MAP

Dems on 47 seats, Reps on 46, with 7 seats in play, 6 of which are held by the GOP



47 DEMOCRATS

7 TOSS UP

46 REPUBLICANS

40 SAFE OR NOT UP

2 5 7 4 4

38 SAFE OR NOT UP



51 SEATS NEEDED FOR MAJORITY

LIKELY DEM	LEANS DEM	TOSS UP	LEANS GOP	LIKELY GOP
NJ: BOOKER (D)	AZ: MCSALLY (R)	GA1: PERDUE (R)	AK: SULLIVAN (R)	AL: JONES (D)
VA: WARNER (D)	CO: GARDNER (R)	IA: ERNST (R)	GA2: LOEFFLER (R)	KS: OPEN (R)
	MN: SMITH (D)	ME: COLLINS (R)	MS: HYDE-SMITH (R)	KY: MCCONNELL (R)
	NH: SHAHEEN (D)	MI: PETERS (D)	TX: CORNYN (R)	TN: OPEN (R)
	NM: OPEN (D)	MT: DAINES (R)		
		NC: TILLIS (R)		
		SC: GRAHAM (R)		

* Senators Angus King (I-ME) and Bernie Sanders (I-VT) currently caucus with the Democrats. Current Senate: 47 Democrats, 53 Republicans

SOURCE: REAL CLEAR POLITICS

FIGURE 3

If he wins, Biden could find himself with five Federal Reserve Board vacancies to fill in his first term

retaliated against by China, but the US will probably vigorously confront trading partners on intellectual property, strategic technologies, and market access.

Biden's pro-American economic message will likely extend to the World Trade Organization (WTO). A Biden presidency would be unlikely to rein-vigorate the WTO. The Obama administration actually started down the path of marginalizing the WTO (a process greatly exacerbated by President Trump) by withholding appointments to its appellate body. On the other hand, Biden has talked about a "Summit for Democracy," and pushed for more multilateral cooperation on a host of global issues, including rejoining the Paris climate accord. Attitudes toward the EU will certainly soften, even though we still expect Biden to jealously guard US commercial interests.

Trump Win, Divided Congress

In the event of President Trump's reelection, it is also likely the Republicans would retain the Senate, although they would still likely face a Democratic House, making meaningful

legislation difficult to pass. If the current antagonistic political climate endures into a second Trump administration, it is unlikely much would be accomplished legislatively.

We would expect that the President would continue with his rollback of those regulations within his authority to repeal. Almost undoubtedly, with congressional cooperation elusive, President Trump would attempt to get as much as possible accomplished via executive order, although the scope of what can be enacted via this method is limited.

There is a potential flashpoint coming in the summer of 2021, when the federal debt ceiling becomes a looming issue, as it has many times in the past. The debt ceiling puts a statutory limit on how much debt the US Treasury can issue and must be raised periodically to allow the government to raise finances.

In the past, raising the debt ceiling has proved to be contentious; memorably, in 2011 the US came very close to not raising the ceiling and defaulting on a portion of its public debt. In August 2019, Congress and the President

agreed to suspend the debt ceiling for two years, but only after intense negotiations that saw House Democrats successfully demand additional spending for domestic priorities in return for a debt limit increase.

The debt limit will have to be addressed in the summer of 2021 and it is likely that a Democratic-controlled House of Representatives would again seek to extract concessions on spending in return for a debt limit increase.

Delayed or Disputed Election

There is a nontrivial chance that we encounter a third scenario: the dispiriting prospect of a delayed result or disputed election cannot be dismissed. An indeterminate outcome, which might not be resolved until the end of the year, could come about in one of several ways.

Mail-in balloting has been on the rise in the US over recent election cycles. By 2016, over 23% of ballots cast were by mail – either traditional absentee balloting or other forms of vote-by-mail. That year, only 60% of all votes were cast in-person on Election Day (while 18% were cast in early voting).

A dispiriting scenario of a disputed or delayed election result cannot be excluded

A number of states have offered voting-by-mail historically and five rely exclusively on the practice. Another 29 states, including important swing states, offer no-excuses mail-in balloting in 2020, and some send all their citizens mail-in ballots without needing a request.

The presence of COVID-19 has exacerbated this trend, and over 76 million mail-in ballots this year have been requested or sent out. This would represent a staggering 55% of the electorate in 2020 (if we assume 2016-level turnout of 137.5 million).

The issue is that not all states can even begin counting their postal ballots until Election Day. This includes key swing states Michigan, Pennsylvania and Wisconsin, all of which are considered crucial for either candidate's hopes. Other states may not start counting their mail-in ballots until after the polls have closed on the evening of the election. Of these states the most notable is Ohio, which has voted for the winning candidate in every election since 1964.

It could be days or even weeks after November 3 before we know which

candidate has won the required 270 electoral votes. The President has made his opposition to the large number of mail-in ballots very clear and has questioned the integrity of an election with so many mail-in ballots.

It is not difficult to imagine a scenario where the results are not known soon after the in-person polls close and the President challenges the counting of mail-in ballots or otherwise refuses to accept the results.

This nightmare scenario – in addition to the implication of President Trump's COVID-19 diagnosis – is not out of question, and poses significant risks to the political landscape.

There is some cause for optimism, however. Given the current polls, there is a likelihood that enough key states representing sufficient electoral votes will be able to declare a winner on or soon after November 3, or even that the election outcome can be declared without a delay in tabulating the mail-in ballots in those states we have mentioned.

Nevertheless, the mail-in ballot issue, and the President's opposition to them, represents a significant risk and could

mean an unresolved, litigated vote well past Election Day.

By law, electors must meet this year on December 14 to choose the next president. All results and disputes have to be resolved by that date.

If there is no President-elect by noon on January 20, the law declares that the Speaker of the House of Representatives, Nancy Pelosi, would be sworn in as President for a four-year term. Importantly, given her age, she would also choose a vice president subject to ratification of the Congress.

This scenario is very unlikely, but there may be quite a few twists and turns before we know the identity of the next president. ●

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Questions or Comments?

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