Fixed Income
Politics is the Art of the Possible

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As the dust settles on the US election, investment opportunities arise.

As the dust finally settles on what was a much closer election than many people had expected, investors are now deciphering what a Biden administration means for the economy, international relations and implications for financial markets.

Don't believe the Polls

There was plenty of exuberance in the US treasury market leading up to the election date, as bond investors began pricing in what they saw as a likely "Blue Wave,' where the Democratic Party would win control of the presidency and the Senate while maintaining a majority in the House of Representatives. A stimulus packages of between $2-3trn was being discussed and discounted, pushing yields higher and curves steeper. However, the opinion polls were not to be believed. Although not completely decided (with two Senate seat runoffs in Georgia in January), the likely election outcome points to a split Congress with Republican control of the Senate and Democrat control of House of Representatives. Stimulus and economic growth forecasts are being reigned in dramatically and treasury prices have readjusted higher.

Politics is the Art of the Possible

Prior to the election, a split government and likely gridlock was seen as the worst possible outcome for markets. GOP (Grand Old Party - a nickname for the Republican Party) senators are expected to abandon the Budget-busting of the past four years and rediscover the tea-party fiscal hawkishness. It is often said, "the GOP only worries about deficits when there is a Democrat in the White House."

Bank economists have scaled back estimates of support and are now forecasting a much smaller fiscal package, perhaps more in-line with Mitch McConnell's suggestions of $0.5-1trn and likely to come after President-elect Biden is sworn on January 20. In addition, fiscal stimulus is likely to be 'reactive', sized according to economic prospects rather than a large pre-emptive boost ahead of the coronavirus vaccine rollout. Gone is the expectation for a multi-trillion large-scale infrastructure spend later on in a Biden presidency as the newly elected President is expected to appoint a more centrist cabinet as he will need to reach across the aisle to gain bi-partisan approval to pass more limited legislation.

As a result, unlike the 2016 Trump election, this election result alone is unlikely to provide a new catalyst for domestic investment opportunities. For US treasury price direction, we are left weighing up the economic damage done by Covid-19 against the relief vaccines will hopefully bring later in 2021. As we believe the Fed will not want to disturb the recovery, any tightening will only happen once the economy has been running hot for some years. As a result, we believe the yields curve will steepen throughout 2021.

Fed Remain in the Game

Federal Reserve Chair Powell has been calling for continued aggressive fiscal stimulus, hence any disappointment on the spending front is likely to be met with increased monetary accommodation, primarily in the form of increased treasury purchases. Four years is a long time to make predictions, but we would not be surprised if the FOMC (Federal Open Market Committee) does not raise Fed Funds for the whole duration of the Biden administration.

From MAGA to MALWA

Although President Biden may find his domestic agenda frustrated by fiscal hawks, internationally he may find himself less constrained, providing investment opportunities abroad.

The implications of a Biden win on Emerging Markets will mainly be driven by the perceived reorientation of the US from MAGA (Make America Great Again) to what we are calling MALWA (Make America Lead the World Again). This will mean a shift to a more multilateralism model (similar to Obama's time in office) and is broadly speaking positive to Emerging Markets who should benefit from a more consensus led global world view. The implications will be felt in the following key areas:

- Multilateralism in trade
- Multilateralism in international diplomacy
- Democracy and populism

However there are few clear winners or losers, as when one looks beneath the surface the issues are generally finely balanced.

Trump's pull-back from a multilateralist world view into an 'America First' strategy which prompted the so-called "China Trade Wars" probably had the biggest impact on markets during the Trump era. The sharp contraction in global trade was felt particularly keenly by Emerging Market economies but another key element was the nature of President Trump's style, for example the much anticipated but wholly unpredictable early morning tweets. Clearly with Biden at the helm we expect market volatility to reduce which, all things being equal, is positive for market sentiment. However despite the global upheaval, from the US perspective the policy could be viewed as a partial success. For example the US trade balance has improved significantly and standing up to China plays well with the US electorate. Therefore we expect Biden to have a more sympathetic view but continue the push against China albeit through multilateral channels such as WTO (World Trade Organization) and building a more global consensus.

However, the Covid pandemic has also accelerated the move to bring supply chains back home, and therefore away, from Emerging Markets. As such, although it is unlikely we are returning to the free-wheeling supply-chain intensive world trading system, there will be an improvement in sentiment. We will also see a re-engagement with international organisations such as the WHO (World Health Organisation), which though not directly relevant, also means less risk with important international organisation such as the IMF (International Monetary Fund) and the World Bank. Overall we believe the net effect of these factors will be a positive for Emerging Markets.

Building new bridges

In terms of international diplomacy, Trump's time in office has been characterised by "Strong Man Diplomacy" where he talked up his ability to form relationships with political leaders with controversial political reputations such as Putin, Erdogan, Bolsanaro, Muhammed bin Salman and of course Kim Jong-un. For example the assassination of Kashogji (a Washington Post journalist) in the Saudi embassy in Istanbul would more than likely elicited a much stronger response from Biden and therefore these types of leader must be considering how much leeway they now have. One of the main flashpoints on the international agenda is the Joint Comprehensive Plan of Action (JCPOA), more commonly known as the Iran Nuclear Deal. This was signed by Obama in 2015 but effectively withdrawn from by Trump in 2017. Iran is not an investable Emerging Market but touches on several more relevant issues. Trump's shift away from Iran has also meant a shift towards countries such as Saudi Arabia and Muhammed Bin Salman and these power shifts are critical for the Middle East outlook. Therefore countries such as Oman and Qatar, who have been seen as neutral or more in the Iran camp, may benefit from a more balanced approach. It may even be beneficial to the political process in Lebanon where the Iran backed Hezbollah political factions may respond in kind to a less hard-line approach from the US.

We never thought we would see Israeli planes flying to the United Arab Emirates over Saudi Arabia in the last 4 years, therefore Trump's policies have achieved something that many other Presidents have patently failed to do, namely improve Israeli relations with key Arab states. Nonetheless the re-inclusion of Iran into the global mainstream also has implications for the price of oil. Oil supply/demand is finely balanced and although a global economy more attuned with trade is beneficial for oil demand, Iranian oil supply, of up to an additional 2million barrels per day, is potentially significant and may impact those countries with high oil sensitivity such as Ecuador and Angola.

Possible winners and losers

Biden has also stated his intention to host a Summit for Democracy in his first year in office, which is a veiled response to rise in populism as personified by Trump. We do believe that this new focus will lead to specific countries feeling the benefits and downsides of this new policy shift. For example Venezuela may be the beneficiary as although there has been bipartisan support for the restoration of democracy, Biden's focus on negotiations rather than sanctions may be a better path to breaking the impasse. On the other hand, Turkey is potentially one of the clear losers as Trumps almost fraternal relationship with Erdogan is unlikely to be reciprocated by Biden. In fact Biden has been increasingly vocal on a diverse range of issues including Turkey's aggressive stance in Syria and Libya, the Russian S-400 missile system, and jailed US Embassy personnel, escalating disputes with Greece over energy exploration in the Eastern Mediterranean and increasing tensions and calls from European countries for sanctions. The list is long and relatively serious but the flip-side is that Turkey's shift towards Russia is a major concern given Turkey's extensive and historic security ties with NATO and therefore it is probably in Erdogan's and Biden's interest to reset the relationship and try to find a better one.

Into the election there was a risk that a deadlocked election would result in a disputed election that may involve the Supreme Court and we took a cautious approach even with polling putting Biden ahead. Now that Biden seems to be a clear winner we are factoring in the overall positive story for Emerging Markets versus market valuations that have tightened significantly since the start of the pandemic. Having said that, we are also focussed on the opportunity to use our bottom up analysis to identify the idiosyncratic winners and losers in Emerging Markets.

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