FLASH

US ELECTIONS: MANAGING SHORT-TERM VOLATILITY

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This was an unthinkable scenario for many, yet here we are: while the result of the election remains far from certain, the initial results credit Donald Trump with a lead in several key states, providing a margin for the incumbent president to claim victory.

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As widely discussed before the election, the mail-in votes yet to be counted may eventually flip the lead to give Joe Biden the presidency. But of course we can expect Mr Trump to challenge those postal votes at a state and even federal level through the Supreme Court. This could prove pivotal since Mr Trump has appointed three of the nine justices over the course of his 4-year term.

The US is now entering a period of political uncertainty, and possibly social instability that could last weeks or longer.

States now have until 8 December to fix any controversies over registered voters or the validity of mailed-in ballots, and the Electoral College then has to ratify its allocation of seats to each party on 14 December, handing the presidency to Mr Trump or Mr Biden. This majority should then, ordinarily, be rubber-stamped by Congress at its first session on 6 January, ahead of the inauguration on 20 January.
The period of uncertainty ahead of us has the potential to unsettle financial markets, especially just as the Covid pandemic is again forcing many countries to resume social distancing and disrupt economies.

If Mr Trump were eventually confirmed for another four-year term and re-elected with a split Congress, we may see equity markets resume their positive trend, but we think this is unlikely as long as uncertainties and the possibility of social unrest remains. Since we have already reduced our market exposure in client portfolios over the past two months, we are not in a rush to cut exposure further.

Although the USD could strengthen during the period of political uncertainty, we expect to see range-bound long-term dollar interest rates as the structural trends of slow growth and inflation remain in place, along with very accommodative monetary policy from the Federal Reserve. We have a number of positions in place to contain the impact of any significant short-term equity market volatility, as well as defensive assets such as high quality bonds and gold, all of which should play a defensive role. Such volatility will also provide opportunities to add exposure as this low interest rate environment is here to stay and will ultimately supporting yielding assets.

POSITIONING PORTFOLIOS - AN OVERVIEW OF KEY ASSET CLASSES

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ELECTION OUTCOME	BIDEN PRESIDENT & DEMOCRATIC SWEEP	BIDEN PRESIDENT & SPLIT CONGRESS	TRUMP PRESIDENT & SPLIT CONGRESS
PORTFOLIO ASSET ALLOCATION	Underweight equity allocation, especially US exposure Lower duration Favor US Inflation-Linked bonds and EUR credit Weaker USD	Overweight equity allocation, supported by low rate environment Neutral duration Positive for IG credit excluding Energy sector Neutral USD	Overweight equity allocation, supported by low rate environment Neutral duration Positive for USD credit (IG & HY) Neutral USD
EQUITIES	**FAVOR:** Asia markets (easing in global trade tensions) Infrastructure (Dem. program) Renewable energy (Dem. program) **AVOID:** Conventional energy (Dem. program) Big Pharma (regulation in drug prices) Financials (regulation)	**FAVOR:** Asia markets (easing in global trade tensions) Infrastructure (Dem. program) Renewable energy (Dem. program) Big Tech (no change in current favorable environement) **AVOID:** Big Pharma (regulation in drug prices)	**FAVOR:** US equities vs RoW markets Infrastructure (Rep. Program) Big Tech (no change in current favorable environement) **AVOID:** European exporters (trade tensions & tariffs)
RATES	Higher USD long term rates Yield curve bear steepening on prospect of significant increase in public deficits and higher inflation Favor Inflation-linked over nominal bonds as fiscal policy drive inflation expectations higher	Range-bound USD long term rates and yield curve slope given combination of accommodative monetary policy and structural lower growth and inflation Favor nominal bonds over inflation-linked as inflation expectations set to remain low	Range-bound USD long term rates and yield curve slope given combination of accommodative monetary policy and structural lower growth and inflation Favor nominal bonds over inflation-linked as inflation expectations set to remain low
CREDIT	Favor EUR credit over USD credit given less business-friendly environment (especially conventional Energy sector)	Positive for USD credit (excluding conventional Energy sector) given low-rate environment	Positive for USD credit given low-rate environment
FX	Weaker USD on combination of low real USD rates and rising "twin deficits" (public and external balance)	Neutral USD due to stable real rate differentials and public deficit trends vs other main currencies	Neutral USD due to stable real rate differentials and public deficit trends vs other main currencies
COMMODITIES	Higher Gold prices on rising inflation expectations and depressed real rates Lower oil prices on higher supply from easing in geopolitical tensions	Range-bound Gold prices as real rates still depressed but inflation expectations remain low Stable-to-higher oil prices supported by geopolitical tensions and global supply constraints	Range-bound Gold prices as real rates still depressed but inflation expectations remain low Stable-to-higher oil prices supported by geopolitical tensions and global supply constraints

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