Flossbach von Storch

NEWS

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CAPITAL MARKETS

Political events influence stock markets

The US election is imminent. There is speculation worldwide as to how its outcome could affect the international capital markets. In other words, who would be the best president for Wall Street and the rest of the international stock markets? But is this relevant from the perspective of a long-term investor?

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BY PHILIPP VORNDRAN AND THOMAS LEHR

Not a day has gone by in recent weeks when we have not been asked to assess the duel between Donald Trump and Joe Biden. It is precisely because the outcome could, and probably will, massively influence the markets in the coming months.

Our response to this has always been a sober one, even though it is of course very exciting, even imperative, to think about political matters particularly regarding the US presidential election. From our point of view, the outcome is irrelevant, at least from the perspective of a long-term investor with the explicit exception of traders.

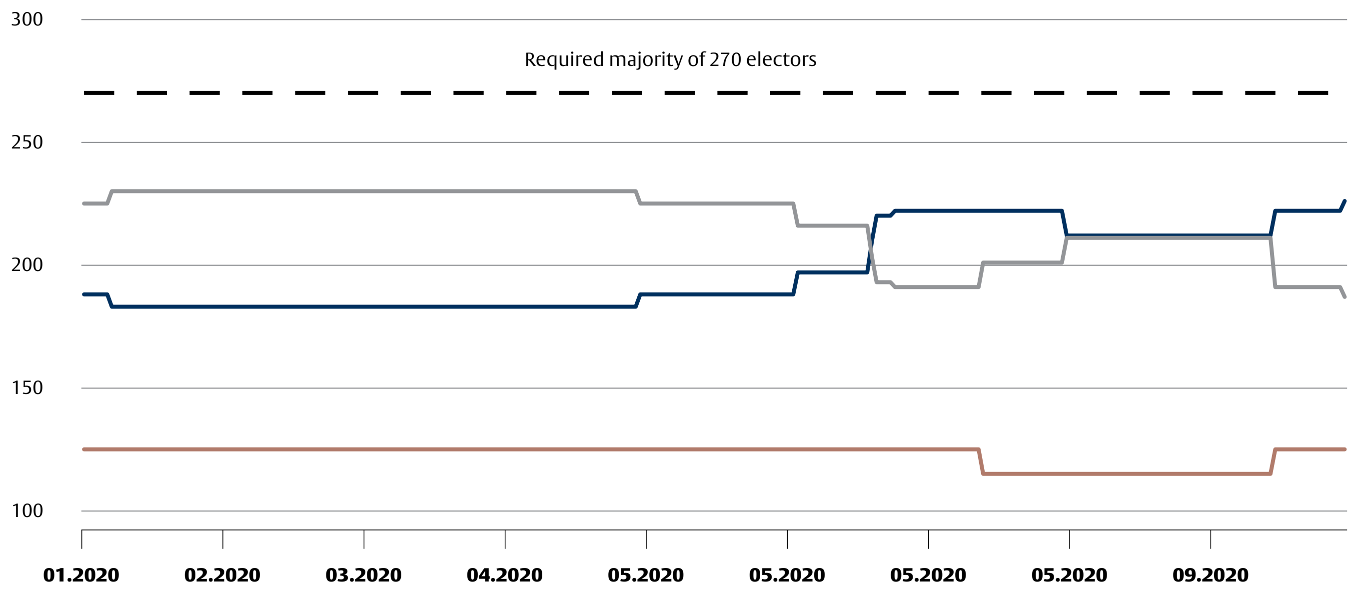
This is because neither Trump nor Biden will (be able to) change anything with the major market drivers. They will not influence central bank policy, which will remain expansive for a long time and possibly permanently (due to high levels of indebtedness). Nor will fiscal stimuli disappear given the impact of the Coronavirus on the US economy. Ultimately, the conflict with China will probably continue with undiminished severity, no matter who sits in the White House in the future. Joe Biden may strike a less aggressive tone, tweet much less, but he will not deviate from the "America First" doctrine, which would be called a different name under him. As a result, the US election is not high on our investment strategy agenda.

Nevertheless, we of course followed the TV debate closely, although the level – one might hardly call it that – was almost unbearable and, as far as upcoming debates are concerned, will probably be hard to beat.

The mood is too hypothetical for investors

We know only too well from past experience that all the polls in which Biden is currently leading are worthless if the electorate in the relevant states ends up voting for Trump (see Figure 1). However, it seems questionable whether they will do so in November, at least that is the impression of US election campaign analysts, which is in line with our assessment. It seems that Trump will

Figure 1 **A sure thing?** – Poll results before the US presidential election on 3 November 2020



Source: https://www.realclearpolitics.com/, Flossbach von Storch, Data as at: 30 September 2020

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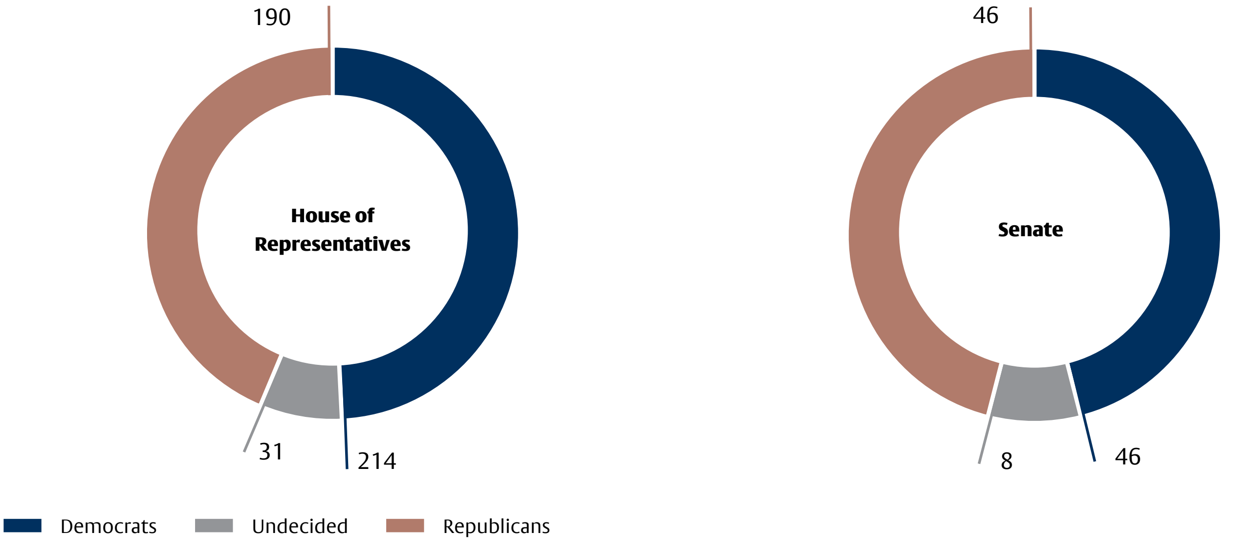
probably have a hard time getting re-elected, but ultimately this does not necessarily mean too much, as things could turn out quite differently in the end.

However, if we consider the above assessment, the next question to follow would be: what would happen if Biden were to reverse the corporate tax reform? Would it place a major brake on the markets? Not necessarily. Firstly, it is not certain that he would completely reverse it, nor is it certain what the necessary majority in Congress would be if he were elected (see Figure 2). And if it were reversed, to whatever extent, it would not be an issue until 2022 at the earliest. So, there are a great number of hypothetical situations – perhaps too many – from an investor's perspective.

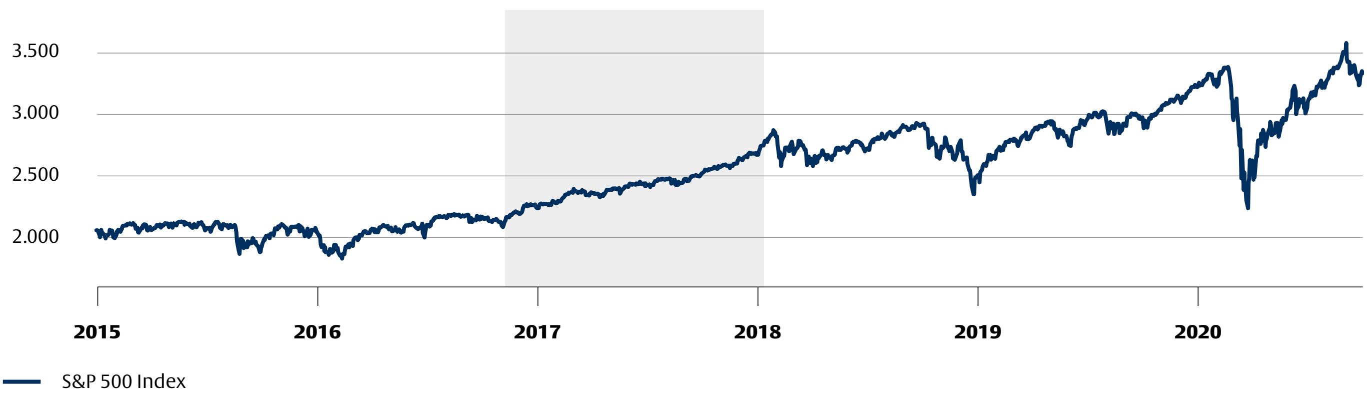
In addition, there is one thing we must not ignore in this discussion: the Democrats' election campaign also talks about fiscal stimuli; about USD seven trillion declared for minimum wages, infrastructure projects and the health-care system. So, even if a possible Biden government were to "put the brakes" on business, the US economy as a whole would still be receiving dollars.

Figure 2 **Finding a majority will be difficult** – Poll results before the congress elections on 3 November 2020



Source: https://www.realclearpolitics.com/, Flossbach von Storch, Data as at: 30 September 2020

Figure 3 **A rally, not a crash!** – Performance of the S&P 500 Index after the 2016 presidential election



Source: Refinitiv, Flossbach von Storch, Data as at: 30 September 2020
Past performance is not a reliable indicator of future performance.

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The bottom line is that if a redistribution occurred, it should not cause permanent damage to quality US companies.

Either way, we as long-term investors should move away from trying to accurately anticipate the possible effects of the outcome of the election. When Trump won the election four years ago, almost all market observers assumed that great adversity was imminent and that panic would possibly break out in the markets. None of this happened. On the contrary, the US stock markets began to rise sharply (see Figure 3). During the first 15 months of Trump's term, the S&P 500 gained practically without any setbacks. Historically, volatility has never before been as low as during that period. In other words, the exact opposite of the expected chaos happened (see Figure 4).

Can it be concluded then that political events have little effect on the stock markets? Yes and no. As with almost all stock-market sayings and proverbs, there is some truth to it, but nothing more. Especially since a US election is never exclusively political, but often has tangible economic effects. Whether these are relevant in the long run remains to be seen.

Turkey as a cautionary reminder

Turkey is another political-economic example. An economically fragile economy, whose population is suffering and will continue to suffer from the massive rise in inflation, leading to an increasing loss of confidence by Turks in their currency, the lira, as can be seen among other things by the loss of purchasing power against the US dollar, the euro and gold (see Figure 5).

Although it is possible that subsequent developments in Turkey will only have an impact at a regional level and on some European banks granting credit, their example also allows some conclusions to be drawn for investors in Central Europe. There is no need to worry that inflation rates in the eurozone will reach

Figure 4 **Calm as never before** – US stock-market volatility after the 2016 presidential election

* Chicago Board Options Exchange
Source: Refinitiv, Flossbach von Storch, Data as at: 30 September 2020
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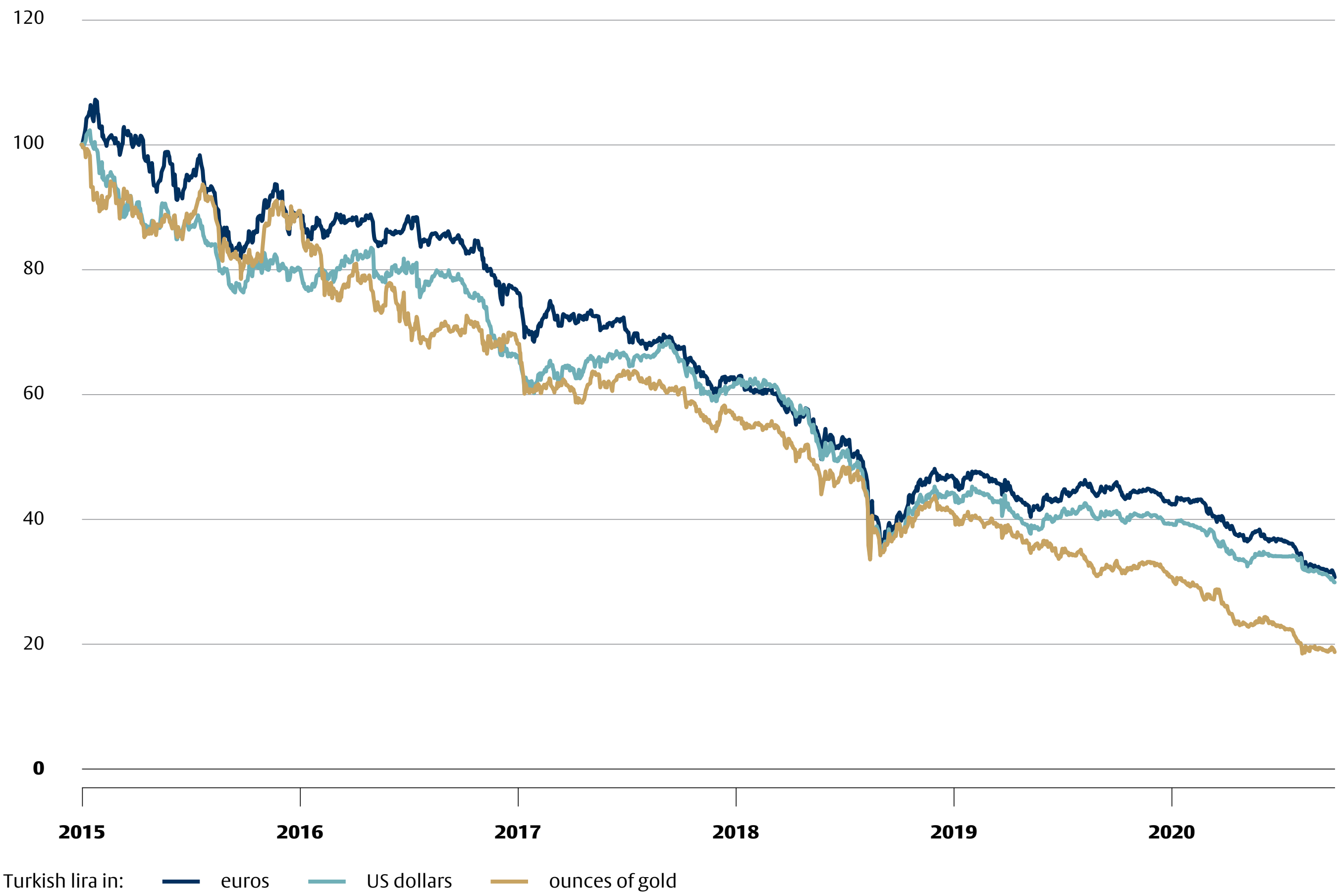
levels similar to those on the Bosphorus in the near future: the euro will not become the Turkish lira. However, Turkey serves as a cautionary example to remind people how quickly they can lose confidence in their currency if they fear that central banks are unable to make money stability their main objective.

A central-bank policy that is too lax on a permanent basis could provoke precisely that, especially if the monetary policy measures become more and more – as the saying goes – "creative". To give two examples: "helicopter money" and direct loans from the central bank. The fact that the US Federal Reserve officially announced at the end of August that it would tolerate significantly higher rates of inflation in the future as long as the average values appeared acceptable from its point of view, is a further indication of the "creativity" that exists in practice. It is very likely that the ECB will follow suit. Its president, Christine Lagarde, has already expressed an interest.

This is not good news for all Europeans who deposit their money mainly in interest-bearing accounts. Therefore, our conclusion remains: there is no way around first-class tangible assets in the long term – US election or not.

Figure 5 **Loss of monetary value in Turkey** – Performance of the Turkish lira since 1 January 2015 (all indexed to 1 January 2015 = 100)



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Publisher Flossbach von Storch Invest S.A.
2, rue Jean Monnet, 2180 Luxembourg, Luxembourg
Telephone +352. 264. 584-22, Fax +352. 264. 584-23
info@fvsinvest.lu

Executive Board Karl Kempen, Markus Müller, Christian Schlosser
VAT Number LU 25691460
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Commission de Surveillance du Secteur Financier (CSSF)
283, route d'Arlon, 2991 Luxembourg, Luxembourg

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