A contested election

After weeks of deliberation, the Democratic National Committee abandoned its plan to convene the party faithful in Milwaukee this week. Former Vice President Joseph Biden will participate remotely, as will the delegates, and will accept his party’s nomination from his home state of Delaware. The Republican Party will nominate President Donald Trump for a second term next week, but the GOP convention also will be scaled back due to restrictions on large gatherings in North Carolina. The president recently floated the idea of accepting his party’s nomination from the White House or from another location.

The advent of “virtual” conventions is yet another example of the degree to which COVID-19 has undermined the economy and disrupted the usual rhythm of presidential election campaigns. While the US economy has rebounded from the unprecedented decline in employment in March and April, the rate of improvement appears to have slowed in the wake of renewed mobility restrictions in some areas of the country. Those same mobility restrictions have also affected the manner in which the two candidates are campaigning and the process by which many citizens will cast their vote.

The home stretch

With fewer than 80 days to go before the election, President Trump is now faced with the task of rejuvenating his campaign for a second term. While his political base appears steadfastly behind him, recent polls show that he remains relatively unpopular with the broader electorate (Fig. 1, next page). The pandemic has forced the president to retool his strategy that was focused on the economy. Instead, he will argue that he built the greatest economy in modern history and will do it again. Further, we expect him to emphasize public safety and a more adversarial posture vis-à-vis China. Whether or not the policy pivot will be effective with voters is uncertain, but it’s worth noting...
that the odds placed on his reelection in prediction markets have bounced off their lows in recent weeks (Fig. 2).

The president may be able to improve his position in advance of Election Day, but the prevalence of early voting poses a challenge. Thirty-eight states allow traditional early voting in advance of the election, some as early as a month in advance. Additionally, this year many states that do not traditionally allow early voting will allow voting by mail due to the pandemic, effectively implementing early voting, so the runway grows shorter with each passing day. The president’s favorability ratio has also flattened in recent weeks, suggesting that fewer independents are sitting on the fence.

Without delay

In a tacit acknowledgment that his candidacy for a second term faces stiff headwinds, the president raised the possibility of delaying the election until the safety of voters at polling stations could be assured. His suggestion, which came in the wake of an unfavorable economic report, was rejected by a bipartisan group of lawmakers. The date of the presidential election was established by Congress in 1845 and any postponement would require congressional legislation, which won’t advance under the current circumstances. Thus far, the rhetoric from the president has failed to persuade most voters. Three recent polls in the past week reached the same conclusion; most Americans are opposed to any delay. Moreover, a postponement would not alter the constitutional requirement that the president’s term of office ends at noon on the 20th day of January.

Going postal

President Trump has been a vocal critic of relying on the US Postal Service to deliver election ballots. He has drawn a distinction between absentee voting with a valid excuse, which he exercises regularly, and universal access to mailed ballots. However, his ability to demand that voters appear in person at polling stations is limited. Individual states, not the federal government, are entrusted with the responsibility of managing elections. The president has suggested that exclusive reliance on mailed ballots will inevitably lead to a) more voter fraud and b) a delay in the reporting of results. There is scant evidence to support his first allegation, but the second will occur.

The practice of allowing individuals to vote by mail began during the Civil War when soldiers on both sides of the conflict were allowed to record their votes in home state elections from their respective encampments. The first civilian absentee voting laws were passed by various state legislatures two decades later. Voting by mail is now a common practice across the country, and more than 75% of Americans will be eligible to do so for the 2020 election. According to the National Conference of State Legislatures, the District of Columbia and 29 states already offer their citizens the option to vote by mail without providing any excuse or otherwise consider COVID-19 a valid excuse. Five other states now hold their elections exclusively by mail.

A surge in the COVID-19 infection rate has led additional state legislatures to contemplate the universal use absentee balloting. While the issue has become highly polarized, there is little evidence that the practice results in pervasive fraud. In one study undertaken by the Heritage Foundation and subsequently reviewed by Brookings, there were fewer than 50 instances of voter fraud in a sample of the five states that use mailed ballots exclusively.
Patience is a virtue

The president has also expressed concern over possible delays in the reporting of results. Indeed, more people than ever are choosing to vote by mail and many state governments are ill-prepared for the resulting deluge in mailed ballots. Look no further than two recent Congressional primaries in New York City, where the Board of Elections took six weeks to identify the winner. Results from the GOP gubernatorial primary in Utah were also delayed, albeit for only a few days, as absentee ballots were counted in a close contest.

President Trump’s razor-thin margins of victory in three Midwestern states in 2016 offers a cautionary note for the upcoming election. If the popular vote in battleground states is close, it is reasonable to presume that some states will be counting absentee ballots well into the evening and the following day. A handful of battleground states, such as North Carolina, Iowa, and Ohio, only require that the ballot be postmarked by Election Day and received shortly thereafter to be counted.

Mail-in voting rules

Which states allow voters to submit ballots by mail/absentee?

Figure 3

Source: NCSL, UBS, as of 12 August 2020
Note: Updated to include new guidance from Massachusetts and Connecticut. Some states require an explanation regarding underlying health conditions in conjunction with COVID-19.
This year’s election is likely to be the most litigated in history. By one count, plaintiffs have already filed 192 lawsuits in at least 41 states across the nation arising from changes to voting procedures in the wake of the pandemic. Other lawsuits, still unresolved, predate the appearance of the coronavirus and push the total to more than 200.

**Investment implications**

We have set forth our perspectives on the investment implications of various election outcomes in our 6 July ElectionWatch report, “Preparing portfolios for November”. But what happens in the event of a delay in announcing the winner of the election? If history is any guide, we would expect to see some initial equity market volatility as investors grapple with the resulting policy uncertainty.

The events surrounding the US presidential election of 2000 are instructive. Governor George W Bush lost the national popular vote to Vice President Al Gore on 7 November 2000 but retained a narrow lead in the State of Florida. As many readers will now recall, the subsequent recount was exceptionally time-consuming and eventually halted by the US Supreme Court, which awarded Florida’s electoral votes to Bush. Gore conceded on 13 December, six weeks after the election.

US equity markets initially reacted negatively to the absence of a clear winner. London’s FTSE surged on news that Mr. Bush had won but gave up the gains on news of the planned recount. The Dow Jones Industrial Average declined by more than 5% in the two weeks following the election as litigation threatened to prolong the uncertainty. Subsequent academic research has suggested that most of the adverse market reaction plays out in the first four trading days following an uncertain election outcome.

Current polls and prediction markets suggest that former Vice President Biden has a commanding lead. The next critical test will come after Labor Day in the US when the two candidates face off in three separate debates. To the extent that President Trump makes up ground and the election is close, the prospects for a delay in an announcement of the winner becomes a real possibility.

Fortunately, while equity markets are likely to react to the resulting policy uncertainty, we expect that the volatility would be relatively short-lived. The UBS Chief Investment Office has published a list of “Campaign warriors”, whose performance should be better insulated than other securities regardless of the outcome...or a delay. Gold prices did rise in the wake of the inconclusive 2000 election but retraced the gains in subsequent weeks.

In sum, investors should be prepared for volatility in the event of an inconclusive result. Markets abhor uncertainty, so it is reasonable to expect safe havens such as gold and US government securities to offer some refuge. However, it is too early to adjust portfolios in expectation of a close contest in battleground states. And it is also worth noting that any initial volatility should dissipate over time.

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2The 20th Amendment was passed by Congress on 2 March 1932 and ratified on 23 January 1933. The 20th Amendment changed a portion of Article I, Section 4, and part of the 12th Amendment. It states, in part: “the terms of the President and the Vice President shall end at noon on the 20th day of January, and the terms of Senators and Representatives at noon on the 3d day of January, of the years in which such terms would have ended if this article had not been ratified; and the terms of their successors shall then begin.”
3Elaine Kamarck and Christine Stenglein, “Low rates of fraud in vote-by-mail states show the benefits outweigh the risks”, Brookings, 2 June 2020. The authors used the Heritage Foundation database. See also Justin Levitt, The Truth about Voter Fraud, The Brennan Center for Justice, 2007.
4Elaine Kamarck and Christine Stenglein, “Low rates of fraud in vote-by-mail states show the benefits outweigh the risks”, Brookings, 2 June 2020. The authors used the Heritage Foundation database. See also Justin Levitt, The Truth about Voter Fraud, The Brennan Center for Justice, 2007.
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