

**US PRESIDENTIAL ELECTIONS POSE THE GREATEST
RISK FOR EQUITY MARKETS**

Social unrest, the coronavirus pandemic, and enduring tensions between the United States and China: The global economy and capital markets are exposed to many risks. However, Till Budelmann, the Capital Markets Strategist of the Swiss private bank Bergos Berenberg, believes that the upcoming US Presidential elections, which promise to be a very close race, will be the biggest issue in the second half of the year. The election outcome will be highly relevant for the future course of the US economy and therefore also for the rest of the world.

A glance at the sharp rebound of equity markets would lead one to think that the economy is recovering everywhere and nothing can stop it. “However, there are several risks for the world economy and global equity markets that must be properly understood. It is important to view these risks with a dispassionate eye”, said Till Budelmann.

One of the risks currently being discussed by market participants centres on the unrest in numerous US cities following the death of African-American George Floyd at the hands of police officers. However, the effects on capital markets should be limited as long as the situation does not devolve into something resembling a civil war. The Covid-19 pandemic remains another risk. This situation appears to be easing somewhat in the developed world. “Even in the hotspot United States, daily deaths have declined rather steadily since the peak in April. However, the risk of a second wave of restrictions imposed by governments around the world remains and a renewed shutdown of the economy would be extremely detrimental for individual markets”, said the capital markets strategist of Bergos Berenberg. However, US Treasury Secretary Steve Mnuchin has already proclaimed that there will not be another lockdown in the United States, at least.

A third risk is the trade dispute between the United States and China. “The rhetoric has recently become much more belligerent, which is opportune for both sides. In view of the upcoming elections in America, it pays to project strength and this also makes sense for China’s President”, said Budelmann, who does not, however, expect the dispute to escalate to the level of new tariffs. That would not be advantageous for the leader of either country in the current economic situation. Moreover, Budelmann sees a very low probability that all three risks would escalate at the same time given that they are negatively correlated with each other.

M A R K E T C O M M E N T A R Y

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Nevertheless, these risks will not dissipate in the second half of the year. In his view, however, the US election campaign will be the biggest issue: “The future occupant of the White House and the parties holding majorities in the Senate and House of Representatives are highly relevant for the economy and equity markets not only in the United States, but worldwide.”

T H R E A T O F T A X I N C R E A S E S V S . T R A D E T E N S I O N S

The President, a new House of Representatives, and a third of the Senate will be elected in November. Donald Trump is running for the Republicans, Joe Biden for the Democrats. Biden represents the moderate camp of the Democrat party. Two issues of lasting concern for equity markets are taxes/regulation and the trade dispute with China. Equity markets have cheered Trump’s tax cuts and reduction of regulations. On the other hand, the trade tensions that Trump has repeatedly stoked have unsettled markets. If Trump wins another term, the trade stress would probably persist and possibly be exacerbated by a serious dispute with Europe. If Biden becomes President, on the other hand, he will try to raise taxes and increase regulations. That would be rather negative for the US stock market in particular. Democrat voters are also not particularly China-friendly, but would probably be more restrained, which would be more pleasant for global equity markets. “While the Presidency is important, the distribution of power in the Senate and House of Representatives is just as important. For example, the approval of both chambers would be needed to enact a tax reform”, Budelmann explained.

P R E S I D E N T I A L E L E C T I O N : T R U M P A N D B I D E N A R E C U R R E N T L Y H E A D - T O - H E A D

Basically, there are four conceivable scenarios for the election outcome. In the first two scenarios, the Republicans control the Senate and the Democrats control the House of Representatives, as now. In the first scenario, Trump is President, in the second Biden is President. In the two other scenarios, one of the two parties holds the Presidency and controls both houses of Congress. “Above all, the scenario in which the Democrat Biden has a free hand and can therefore enact his party’s planned tax increases could adversely affect the markets and even make US equities less attractive compared to the rest of the world”, Budelmann predicted. The probability of this scenario coming to pass is not so low at all at the moment. According to Bergos Berenberg’s in-house tool, the probability of Trump or Biden winning the race is currently about 50:50, although Trump’s popularity has decreased a little in recent weeks. The probability of the Democrats retaining the House of Representatives is 80 to 20. By contrast, the race for control of the Senate will be very close, with a small number of states determining the outcome, as in the case of the Presidential election. The elections in Iowa, Maine, and North Carolina will be particularly decisive.

HOW THE ELECTION OUTCOME WILL AFFECT
DIFFERENT SECTORS

The election outcome will affect individual sectors differently. If Trump's tax reform can be reversed, sectors such as basic consumer goods and communication services, including companies like Alphabet and Facebook, will suffer given that they have benefitted the most from the reduced corporate tax rate. Energy plays an important role in the campaigns of both parties. If the Democrats are in charge, renewable energy would benefit and conventional US energy stocks would suffer. If the Republicans are in charge, the situation would be the exact opposite. Moreover, pharmaceuticals and tobacco would probably come under pressure if the Democrats take power.

Budelmann expects that the perception of Trump's crisis management will be a major election issue. The economy and healthcare will also be important. A V-shaped economic recovery would probably elevate Trump's prospects. However, stock market prices are important for voters in the United States (unlike the case in Germany) because the retirement savings of many Americans are tied to the stock market's performance. Budelmann concludes: "All things considered, a very close race can be expected at the present time and the balance of power in the Senate is a matter of great interest to equity markets, along with the Presidency".

TILL CHRISTIAN BUDELMANN

As capital market strategist of the private bank Bergos Berenberg, Till Christian Budelmann regularly comments on events on the international capital markets and examines them in the context of economic and political trends. Since 2004, Budelmann has been responsible for various investment strategies and sits on the bank's Investment Committee. He has been Managing Director since 2013.

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