BERGOS BERENBERG

MARKET COMMENTARY

Zurich, 24 September 2020

US ELECTIONS AND CONCERNS ABOUT TIGHTER COVID-19 RESTRICTIONS TO CAUSE VOLATILE SIDEWAYS MARKETS

Both the stock market and the economy are recovering more quickly in the United States than in Europe. The US consumer as the engine of the global economy is holding up well. Nevertheless, the possibility of more stringent Covid-19 measures remains a major risk for markets. Moreover, the upcoming Presidential election in the United States is likely to result in increased volatility over the coming weeks. The death of Supreme Court Justice Ruth Bader Ginsburg has brought a new issue to the forefront of the election campaign.

The V-shaped progression of the US equity market in the past months signals the expectation of a rapid economic recovery. And in fact, the macro data are already improving. According to estimates by Bergos Berenberg, US economic output will only shrink by a little less than 4 percent in 2020, meaning that the experts are less sceptical now than they were in the Spring. "In the United States, the decline could be made up in one to one and a half years; we do not see the same rate of recovery in Europe at this time. The recovery is proceeding more slowly here," said Till Christian Budelmann, capital markets strategist at Bergos Berenberg. The equity market also reflects this expectation: European equity indices are still far below their pre-crisis levels.

US RETAIL SALES ALREADY BACK TO PRE-CRISIS LEVELS

The US consumer is still an important indicator not only for the US economy, but the global economy as well. While monthly retail sales fell sharply at the start of the "Great Covid-19 Recession", the August number was already slightly higher than the February number. This recovery can also be credited to the quick government coronavirus aid for private households. The V-shaped recovery only took five months. In the 2008/09 global financial crisis, the pre-crisis level was regained only 40 months later. The current recovery is not progressing equally in all retail sectors. Winners include online sales, food and beverage, and building materials. Bars and restaurants, gas stations, and the textile sector are among the losers.

"Covid-19 and above all the possibility of additional government measures to contain it remain the primary risk for equities. Particularly in Europe, the consideration of renewed tough restrictions are already causing concerns in the equity markets", Budelmann said. He therefore anticipates a volatile sideways pattern in global equity markets over the coming weeks, at least into November. The prospect of unsettled markets can also be attributed to the most important event in the near future: the upcoming US Presidential election on 3 November.

US ELECTIONS: CLOSE PRESIDENTIAL RACE, DEMOCRATS TO RETAIN CONTROL OF THE HOUSE OF REPRESENTATIVES

In national surveys, support for the Democrat candidate Joe Biden is currently at 49 percent, ahead of the Republican incumbent Donald Trump with 43 percent. "However, these numbers must be taken with a grain of salt", Budelmann warned, adding: "It is not the most votes that decides the election, but the votes of the electors from the individual states." Budelmann cited a rule of thumb for converting votes to electors: "Biden needs a vote lead of about 3 percentage points to draw even." Another factor to consider is the usual margin of error in surveys. "We compared the polling average on the evening before the election with the actual results of Presidential elections since 1980. The average error rate was 2 to 3 percentage points. All things considered, the two candidates are very close", Budelmann said. On the other hand, the Democrats will certainly keep control of the House of Representatives, in his opinion.

This means that a re-elected Trump would not be able to push through further tax cuts. He could be expected to continue the trade dispute with China in the same manner as before and possibly even extend it to Europe. This would be negative for international equity markets. By contrast, a President Joe Biden would not resolve the trade conflict with China, in all probability, but would pursue it with a more objective and moderate tone, which would be less negative for equity markets. The same cannot be said of his tax plans: If the Democrats win the House of Representatives and the Senate, Biden could partially reverse Trump's tax reform. "The corporate income tax, which was reduced from 39 percent to 26 percent on average under Trump, could be raised again to around 33 percent. This would burden after-tax profits of companies and therefore also impact equity prices", Budelmann explained.

SUPREME COURT TO INFLUENCE THE ELECTIONS

A major new issue became the forefront of the election campaign with the death of Ruth Bader Ginsburg at the end of last week. This event is more likely to benefit the Republicans than the Democrats. The liberal icon Ginsburg was a Justice on the Supreme Court, which now has only three liberal judges and five conservative judges. Trump has already announced that he will quickly nominate a successor, who will then have to be confirmed by the Senate. There was a similar situation four years ago. The conservative Supreme Court Justice Antonin Scalia died in February 2016. The Republican-dominated Senate refused to confirm the successor nominated by the Democratic President Barack Obama before the elections.

"That benefited Trump and likely gave him the decisive votes. Republican voters who were uncomfortable with Trump in 2016 voted for him anyway because he would at least nominate conservative judges." Also now, Republicans hold a slim majority in the Senate and chances are fairly good that Trump's nomination will be approved before the elections.

The Supreme Court is extremely important in the United States and it can even affect the outcome of a Presidential election. The disputed election result in 2000 was finally settled by the Supreme Court, where conservative Justices had a majority of five to four. One of the important decisions in this case was decided along these lines and the Republican George W. Bush was ultimately confirmed as President. "The Supreme Court has now emerged as another major issue along with the coronavirus pandemic and its impact on the economy and domestic security", Budelmann said.

T I L L C H R I S T I A N B U D E L M A N N

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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MEDIA CONTACTS

public imaging
Finanz-PR & Vertriebs GmbH
Goldbekplatz 3
22303 Hamburg, Germany

Caroline Chojnowski
Senior PR-Beraterin
Tel: +49 40 401 999 23
Mobil: +49 151 20 83 1542
caroline.chojnowski@publicimaging.de

Kathrin Heider
Senior PR-Beraterin
Tel: +49 40 40 19 99 26
Mobil: +49 151 113 627 22
kathrin.heider@publicimaging.de

GLT Communications
Kommunikationsberatung & PR
Utoquai 37
8008 Zurich, Sswitzerland

Jörg Röthlisberger
Founder & CEO
Tel: +41 44 396 90 90
Mobil: +41 75 44 88 000
jr@glt-communications.ch