Global Markets Commentary
Election and COVID — A One-Two Punch

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“It’s not the voting that’s democracy; it’s the counting.”
Tom Stoppard

On November 3, two seasoned fighters entered a ring where they would compete for the title of President of the United States. The entire globe was watching, transfixed because the stakes were high not just for the combatants but also for the democratic process itself.

This marquee event followed a fierce U.S. presidential battle marked by eye-popping, record-breaking early vote totals and a campaign transformed by the pandemic. Partisan passions and the prospect of a contested election weighed heavily on equities.

Four days after polls closed in this extremely tight race, the election was called in favour of former Vice-President Joe Biden. Pennsylvania’s 20 electoral votes put him over the magic 270-vote threshold needed to win the Electoral College and the presidency. Yet, President Donald Trump refused to concede. His team’s lawsuits and demands for vote recounts could leave us in suspense for the next month or so. In addition, we still don’t know whether Republicans or Democrats will control the powerful Senate. If the Senate ends up with a 50-50 split, Kamala Harris would have the tiebreaker vote as the Vice-President. Two Senate run-off races in Georgia are slated for January. This pair of run-offs could ultimately decide whether the Democrats seize a Senate majority and achieve the blue-wave victory that pollsters predicted.

Meanwhile, global efforts to contain COVID-19 have been failing. No surprise that risk assets reacted negatively to looming economic shutdowns as case counts mounted around the world.

For the second month in a row, stocks declined in major North American and European markets. This happened despite favourable economic data and a positive start to the Q3 earnings season. Even with robust earnings, technology stocks couldn’t sustain their strong price performance. Equities started to sell off on fears that future numbers would hit the mat during an uncontrollable pandemic second wave.

Following this two-month sell-off, early election results produced a stock rally. Two factors likely triggered the run-up: an unwinding of defensive, bearish positioning ahead of November 3; and optimism that Republicans would keep control of the Senate and support the status quo through congressional gridlock.

Canada – Bobbing and weaving
Canadian markets intensely focused on the U.S. election after four years of strained trade relations, plus fears about the impact of a blue-wave U.S. energy policy on our energy sector. They cheered Mr. Biden’s win, hoping that trade policy would improve; however, the impact on our energy sector will remain unclear until after January’s Senate run-offs.

Economic growth slowed from May and June’s dramatic levels; August rose just 1.2% above July. Estimates for
September growth were also a modest 0.7% over August. The Canadian economy is tracking at about 4% below pre-COVID levels.

Sectors that enjoyed a strong summer recovery – restaurants, entertainment and the arts – will likely take a hit from second-wave containment measures. We continue to believe that it will be difficult for the economy to expand in the final quarter of 2020, even though the Bank of Canada is forecasting 1% growth. Because of the moderating recovery, interest rates for Canadian government bonds rose, but less than U.S. Treasury bond rates.

In October, Canadian stocks suffered along with global equities. The S&P/TSX Composite fell 3.4%, bringing the two-month sell-off total to exceed 5% for Canadian equities. Information technology was the worst performing sector last month; this high-flying group took a breather from its upward climb that lasted for most of 2020. Canadian stocks rallied with global equities after the October sell-off.

New Finance Minister Chrystia Freeland confirmed that the Liberal government will continue to spend to get through the crisis, but added that “our fiscally expansive approach to fighting the coronavirus cannot and will not be infinite.” Brushing aside this reassurance, the Canadian dollar traded lower by one cent after her comments. It sits at about two cents lower than its peak recovery level.

Last month, bond markets had started to predict that the eventual fiscal stimulus and government spending would lead to inflation down the road. Interest rates rose in response, and that caused bond prices to fall. The 10-year U.S. Treasury note ticked up almost 20 basis points in October from near record lows. As expectations rose for a continuation of a divided Congress, interest rates started to retreat and bond prices rallied.

The S&P 500 fell 2.8% in October, reflecting a sharp sell-off in equities for the second consecutive month. The technology-heavy Nasdaq Composite fared slightly better with a 2.3% tumble in October. COVID-19 created a shift in business and consumer behaviours that benefitted the tech sector. We expect these companies will continue to outperform broader markets while the pandemic forces people to work and learn from home, get their entertainment from the couch, and buy online.

Equity markets shrugged off the uncertainty of the presidential race. Instead, they cheered on the prospect of a divided Congress that would result in gridlock and likely block some of the market-unfriendly policies that investors feared.

**Europe and the U.K. – Fighting a losing battle**

European equities (measured by the MSCI Europe Index) fell 5% in October, making the region’s equity market one of the worst performing in the developed world. This was despite the European Union’s 12.1% GDP rebound in Q3.

Europe once again appeared to be losing its fight against the coronavirus. The continent’s case levels rose at a faster pace than U.S. levels, prompting fresh lockdowns. The European Union and U.K. registered almost 200,000 daily infections over the final week of October. In some regions, hospitals are close to capacity, which is prompting governments to impose tough new restrictions.

European Central Bank President Christine Lagarde hinted at another round of stimulus in December to counter the eurozone’s deteriorating economic outlook.

British Prime Minister Boris Johnson announced a second nationwide lockdown in England as COVID-19 cases soared. For four weeks, non-essential retail stores must close; bars and restaurants will be take-out only. People will be ordered to stay home except for work, essential shopping and exercise. Schools will remain open. This broad response poses a threat to the country’s economic recovery.
Britain and the EU continue to strive for a breakthrough in Brexit talks as a self-imposed deadline looms in mid-November. After months of discussions, they have stalled on key issues. Down-to-the-wire negotiations are not unusual for trade treaties, so it’s still possible to avert a drastic rupture. Brexit remains a dark cloud hanging over the region’s economy.

**China – Keeping up their guard**
China’s diligent approach to containing COVID-19 has prevented a second wave and allowed the Chinese economy to reopen. When new cases emerge, Beijing moves aggressively to shut down regions and test millions of people.

This vigilance helped the economy expand at a rate of 4.9% in Q3, following an increase of 3.2% in Q2. Unemployment dipped to 5.4% in September, down from 5.6% in August. At this rate, China will be the only major world economy to enjoy growth in 2020. South Korea, Taiwan and Japan have also used this rigorous approach to controlling virus spread and have lessened its negative economic impact.

Strong economic growth has fuelled a recovery for Chinese stocks. They ducked a sell-off that threw cold water on European and North American equities. The Shanghai Composite ended flat for October.

**Japan – Rolling with the punches**
Japan has been largely successful at avoiding a second infection spike. As a result, the nation announced it would maintain its domestic travel campaign launched last summer in a bid to aid economic recovery. Japan’s economy will also benefit from China’s recovery thanks to strong trade ties between the two countries. Japanese equities were hit with a minor sell-off as the Nikkei contracted -1% in October.

The Bank of Japan kept rates on hold and reduced growth and inflation forecasts for 2020. Nonetheless, it offered a more optimistic outlook for recovery and indicated that no further monetary stimulus is needed right now.

New Japanese Prime Minister Yoshihide Suga indicated he would make a formal announcement about a fresh round of fiscal stimulus in early November. That package will likely be worth around US$95 billion, far lower than the combined US$2.2 trillion rolled out in two earlier stimulus packages.

**Our strategy**
As we projected, economic recovery has moved into a more challenging stage in most regions of the world. We can expect a broad-based roll-back of openings, and not much chance that the travel and leisure sectors can safely restart without widespread vaccine availability.

Our base case still assumes that the recovery will moderate in Q4 and interest rates won’t go materially higher, despite the likelihood of more fiscal stimulus. Equities have responded positively post-election, but may suffer some blows because of the temporary uncertainty around the election outcome. Expansionary monetary and fiscal policy will continue to support risk assets and ultimately drive up equity returns.

Other risks to our base case scenario arise from the U.S. government entering a policy vacuum from here until inauguration day, plus the potential worsening of COVID-19 cases and more aggressive lockdowns.

**The last word**
The U.S. presidential election was a title fight that gripped our attention for much of 2020. It began with sparring at last February’s Democratic primary and moved on to a boxing match between incumbent and challenger. Now that the bout has gone a full 12 rounds, and a winner has been declared, we can turn our attention elsewhere. We will focus on the factor that we believe will have the biggest impact on asset classes over the next year, namely the coronavirus pandemic. Approval of a vaccine is the knock-out punch for COVID-19 that we are betting on to engineer a comeback for the global economy.

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