Punter Southall Wealth

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Brief View from Punter Southall Wealth

"More of the Same"

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The events of the 3rd and 4th November were a perfect example of this year so far. Unpredictable, emotional, exhausting and with a market response that nobody predicted. Like many of you, I'm sure, we are entering the late stages of this year with a desire for a fresh start in 2021.

Now that we are getting closer to knowing the end results of the US election, it is obvious that it won't be the "fresh start" that so many were expecting (we are assuming here that any expected legal challenges by Trump fail). The "Blue Wave" forecast by nearly all commentators and analysts crashed upon the rocks of reality, with a very close call in the presidential election and a split government, as we had forecast. The "pollsters" and the main media stations were once again wildly errant in their predictions and forecasts, taking another beating after other recent high profile "misses". The truth was that there were an underreported cohort of "shy conservatives" who voted for the Republican candidates, leading to a close presidential race, a Senate that has remained under Republican control and a number of unexpected successes for the Republicans in the House of Representatives (the latter of which remains under Democrat control, as expected). On the whole, despite the victory for Biden, the 3rd November was a disappointing night for the Democrats and far below most expectations.

What does this mean for the US economy? "More of the same" would be our view. It is going to be challenging for the Biden administration to achieve anything structurally significant with the Senate in the grips (just) of the Republicans. Indeed, there is every chance that the opposition tries to foil everything they can in the next two years (until the US midterm elections), just as the Democrats themselves did when they were in opposition and Trump was in power. It might be wise to turn off the TV for the next few years. All things being equal and taking in to account some early assumptions, this will translate into expected growth rates that are lower than most expected only a few weeks ago, for reasons we will go on to discuss.

Normally, the "split government" is perceived to be a good thing, as it makes it very hard, particularly in today's world of polarised politics, to make structural changes and for government to get in the way of the private sector. Our take is that this is in part an explanation for what we have experienced in financial markets over the last few days, as fears have subsided of the Democrats radically changing tax policies or reversing the Trump administration's trend of reducing bureaucracy. Therefore, the healthcare and technology sectors were the obvious winners in the aftermath of the election night excitement.

However, there are other bigger short- and medium-term consequences. The first is the immediate threat around COVID-19; a "joined up" government might have produced "joined up" thinking around the COVID-19 response, which might now be an impossibility, just as a third wave of infections starts to rise in the US. This could lead to structural damage in the US economy and lingering uncertainty. This was another reason why healthcare and technology performed well, as they are presumed "stay at home beneficiaries".

Perhaps more important, from an economic perspective, is the expectation that the financial response to COVID-19 will also be less impressive, as there will be a clash of views on the size of the fiscal stimulus and the end targets of the cash. It could well be that the end result is "too little, too late" and, while that might not be sufficient to drive a "double-dip" recession (as we are sadly likely to see here in the UK), it could lead to expected growth rates for the US economy being ratcheted down for the coming six months. All things being equal, less stimulus will translate into less inflationary pressures in the immediate future, even if we remain of the view that inflation uncertainty for the middle years of this decade remains elevated. The expectation for a reduced fiscal stimulus package was another reason why we saw the dynamics in markets that we did as the election results became clearer, with defensive growth companies performing well and economically sensitive companies lagging (in truth, only a reversal of what we had seen in the days leading up to election day, as everyone jumped on the "Blue Wave" bandwagon).

Another guaranteed consequence of the likely reduced fiscal impact is that the Federal Reserve will have to continue their Herculean efforts of stabilising markets and trying to promote an era of unending financial calm. The Federal Reserve have made clear that there are limits to the efficacy of their actions and that they needed to pass the baton of responsibility to the government for further action, but the spotlight is now firmly back on them. Again, this is therefore a "more of the same" situation. We will have to wait and find out what the central bank of the US can dream up next, but it is clear that we can forget the "Blue Wave" and that the only "wave" that matters after the election is the "wave of liquidity" that the Federal Reserve continues to create to keep asset prices elevated.

It is too early to say whether the "more of the same" mantra is also equally applicable to markets, but that is the indication from the most recent moves we have seen. It is also the view that we are leaning towards when we think about asset allocation. If the dominant trends of positive but low growth, positive but low bond yields, positive but low earnings growth and moderate inflation remain the structural story of the coming decade, then it is highly possible that market trends remain similar to what we have seen over recent years. This is one of the reasons why we have been using up cash allocations in recent months, putting money to work in new investments but without radically shifting the overall risk in our portfolios. These decisions will have helped in recent days, as will our decision to sell out of a fund that was poised to benefit from a structural trend towards higher growth, higher inflation and a major market rotation.

Of course, the immediate post-election trends might reverse themselves and we might start to have a clearer view of major market changes, such as the much-discussed rotation from growth to value themes in equity markets. However, for now we think we must consider that "more of the same" is the most likely outcome from the US election; we are not making any major changes based on the election and are confident in our current investment selections and overall strategy.

We also need to realise that, while the US election is important, the immediate risk of COVID-19 and the uncertainty brought about by extraordinary monetary policies, unprecedented government spending, geopolitical angst and deglobalisation are also key factors to determine how the future of the world and financial markets will play out through the "Turbulent Twenties". I don't know about you all, but personally I'm hoping for "less of the same" as we head towards a New Year. That's probably wishful thinking.

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