Election 2020: Portfolio positioning for November 4th and beyond

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Key takeaways

An election of huge importance, volatile markets, and the backdrop of what has been an unpredictable year… investors have a lot to consider as they look at their holdings and map out what, if any, changes they may want to make as Election Day approaches.

IndexIQ CIO Sal Bruno discusses what he and his colleagues view as the most "resilient" investment approaches and why a vote for resiliency can help mitigate against some of the volatility that may be on the horizon, regardless of the election outcome.

In the remaining weeks before Election Day, former Vice President Biden continues to lead in most polls. But the polls have often proven unreliable, as the last election cycle demonstrated so clearly. At this stage, we view the Presidential race as more of a "toss-up." In down-ballot elections it seems likely that the Democrats will continue to control the House of Representatives while the Senate has moved from leaning Republican to being a much closer call. Whatever the outcome, and whatever your political leanings, we recommend that investors elect to add resiliency to their portfolios in the coming months, since new opportunities (and our old friend volatility) may start to appear.

A democratic white house

In looking at the potential impact of the election on investors and the economy we consider three broad policy areas of policy: taxes, regulation, and fiscal stimulus.

Should the Democrats sweep, we expect to see major shifts on all fronts. Taxes are likely to rise across multiple areas including income, estate, and corporate. New taxes may be introduced on wealth and financial transactions. The so-called "carried interest" deduction will probably be a thing of the past. The regulatory environment may become more restrictive, with new regulations placed on financial markets, among others.

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While these initiatives, if realized, will likely weigh on economic growth, at least in the short term, they are likely to be counter-balanced by more aggressive Democratic fiscal policy. This might include more and longer support for the economy, new social spending, a higher minimum wage, relief for cities and states, and some form of student loan forgiveness. Collectively, this could add trillions of dollars in new stimulus and put substantial new disposable income in the pockets of consumers, which could be a major boon for the economy.

Additionally, there's healthcare, a complex, emotionally charged segment of our economy that has historically been resistant to quick fixes. Should the Democrats prevail – and especially if they capture all three branches of government – we would expect to see movement towards a single-payer system, with enthusiastic support from the Bernie Sanders wing of the party.

An incumbent victory

If Trump rallies to win, it's reasonable to assume he will view the election as a mandate to continue the policies of the last four years, meaning more pressure on China and trade, more deregulation, a continuation of the "America first" approach to international relations, modest healthcare reform, and another round of tax cuts. We would expect a smaller contribution on the fiscal side.

Positioning for November 4th

For investors considering how to position for the post-election world there are a few things to consider. First, fiscal policy will have an impact regardless of who wins, at least in the short term. A more aggressive policy should be more supportive of growth; one targeted to lower income people should underwrite additional consumer spending and potentially boost related sectors of the market – consumer cyclicals, for example. Forgiving student debt, or some part of it, would also be stimulative, if it happens, as would increased deregulation.

Investors may be looking at more significant portfolio repositioning should Biden prevail, since that would likely result in a significant change of course from a policy perspective. One example: Environmental, Social & Governance (ESG) strategies that have been gaining assets for some time. These may see further growth should the Democrats prevail as more money flows to "green" industries like solar and wind power.

Trump's election in 2016 shocked the markets and while there were some initial spasms in the markets, things largely settled down pretty quickly and stocks moved on to record highs as employment grew and the economy expanded. More recently, the events of 2020 have clearly had a profound and historic impact on our country and our economy, but they have also proven that the U.S. is resilient, and we have seen stocks perform well under both Democrats and Republicans. But different sectors and asset classes may fare differently.

Building a resilient portfolio

Thinking about resiliency, a few specific investment ideas come to the forefront:

First, higher taxes argue in favor of tax-advantaged investments like municipal bonds. While we often argue in favor of passive approaches to different corners of the markets, the municipal bond space is one where we clearly see the value of experienced active management, where a professional can not only understand the fragmented and inefficient nature of this market, but use it to investors' advantage.

Second, no matter the election outcome, investors will want to keep a close eye out for opportunities to add yield while mitigating volatility. With the Federal Reserve committed to keeping rates low for the foreseeable future, investors have to find ways to gather more income keeping in mind the risks that associated with higher income. As we've discussed before, not all high yield bonds are created equal. In fact, there are opportunities to identify high yield bonds with much less volatility than the broader category, a strategy that could come in very handy with the rest of 2020 being as opaque as it currently is.

Finally, an aggressive fiscal policy puts pressure on the dollar making international investments more attractive. That movement would be further supported by a less confrontational foreign policy, likely to be pursued by a Biden Administration. When looking internationally, however, one cannot forget the impact that currency movements can have on returns. The U.S. dollar has been on a steep decline lately, but there is no guarantee that trend will continue. So we recommend looking internationally, but putting on a 50% currency hedge, something we've long termed "the hedge of least regret."

The two parties do have a few initiatives in common. Both favor infrastructure investment, which could be good for real assets like real estate. Both have targeted high consumer drug prices, putting pressure on big pharma and biotechs. Offsetting this is investment in coronavirus research, also likely to be a priority of both administrations, and support for the repatriation of parts of the pharmaceutical manufacturing chain.

This will be, no doubt, a hugely consequential election but to a large extent it's been overshadowed to date by concerns over COVID-19 and the ongoing protests for racial justice that have swept the streets of so many cities and towns. But now that we are post- both parties' conventions, things are likely to change as we approach November with the media, and voters, focusing more closely on the candidates and their policies. Given the range of potential policy outcomes, we expect to see substantial volatility in the markets between now and Election Day. For investors, this may make low volatility investments more attractive, and it argues in favor of diversifying a portfolio through the use of liquid alts and other similar asset classes.

Unpredictable and unprecedented. Two words we may need to retire after 2020 finally draws to a close, but not until we've made our way through the upcoming election. Yet for all the unpredictability, opportunities remain. So we recommend that investors vote for resiliency as they consider their options for the rest of this year and beyond.

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