Weekly Digest

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A Country For Old Men

If you like your presidents to be white, septuagenarian men, then the United States of America is the place for you. Today, the race for the White House kicks off in earnest with the first caucus* of the campaign in Iowa. It will be followed by a primary* in New Hampshire next week, then weekly contests in Nevada and South Carolina. In a month's time we will be treated to Super Tuesday, on which day the Democratic members of sixteen states will declare their allegiance – a day that 28.5% of all delegates that will be sent to the Democratic Convention in July will be determined.

*State caucuses and primaries have the same objective and result, which is to choose the candidate that will be backed by that state, but the methodology is very different. Whereas a primary is run on a familiar tick-in-the-box ballot basis, a caucus (of which there are many individual local ones) involves party members showing their support by gathering together with like-minded voters in one corner of the room. As candidates drop out owing to insufficient support, their supporters can then realign themselves to different groups. It looks to me like a cross between musical chairs, a barn dance and the old kids' TV programme Runaround (but without Mike Reid's dulcet tones to animate the proceedings).

Why all the excitement about Iowa, a state that will return fewer than 1% of the party's delegates to the national convention? It stems back to 1976, when an unheralded Jimmy Carter came from nowhere to win the state and carried that momentum all the way to the White House. Since then, Iowa has a good record of choosing the final candidate, and so, possibly falling victim to the age-old fallacy of conflating causation and correlation, political analysts and newshounds have set disproportionately great store by the result.

Neither can we be certain about the next correlation that I am going to mention. This is the fact that, according to data compiled by Capital Group, during presidential election years going back to 1932 the S&P 500 Index of leading US equities has, on average, produced a negative return during the primary season, which they take to be the first five months of the year. In non-election years the average return is around 6%.

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As with all such observations, it makes some sense. The third year of a presidency tends to be a good one for markets as the incumbent primes the pump ahead of the election and investors begin to anticipate the rewards. Much of this can be priced in by the time we get to election year. Perhaps more importantly, the primary season exposes investors to the uncertainty of the presidential race, with a much wider range of potential future policies to grapple with.

This seems especially to be the case this year, with a wide gap between the ideologies of Joe Biden, Michael Bloomberg and Pete Buttigieg towards the centre, and Bernie Sanders and Elizabeth Warren out on the left. From a market perspective, Biden/Bloomberg is deemed to be the acceptable face of the Democratic Party, whereas Sanders/Warren would be entirely unwelcome, holding the threat of a reversal of Trump's corporate tax cuts, greater wealth redistribution and an "anti-business" agenda including far more stringent regulation of the Technology and Banking sectors as well as aggressive measures to protect the environment. (Remember that we are not here to make moral pronouncements on the policies and outcome, but that our task is to anticipate the effects on investment assets and to position portfolios accordingly).

With all the current fallout from the Chinese coronavirus (more on which below), it is difficult, if not impossible, to disaggregate the market's current reaction to the Democratic race. However, the fact that Sanders is leading the polls in both Iowa and New Hampshire will be unsettling, so it will be very interesting to see exactly what the voting margins are and how investors react tomorrow. It is entirely plausible that the party will fail to find a clear winner before heading to the convention in July, which leads to the intriguing possibility of a rare "brokered convention", last seen in 1952, when the delegates themselves choose the candidate. Many experts are of the opinion that this would favour Mike Bloomberg, he of the eponymous trading and data terminal. Suffice to say that markets would probably not be enamoured of such a long period of uncertainty.

Whoever wins the race, it is almost 100% probable that he - yes, it will be a he, by the looks of things – will face Donald Trump on November 3rd, especially now that the impeachment process is, to all intents and purposes, dead in the water. Then it comes down to who has the best chance of beating the president.

There are fears within the Democratic Party that a Sanders/Warren ticket will end up "doing a Jeremy Corbyn" and making itself unelectable in the eyes of what is, generally, a moderate electorate. There are plenty of twists and turns left in this race, and no shortage of potential market volatility associated with it.

We need to provide a quick update on the coronavirus situation. The role of the host of our morning meeting has become something of a grim (reaper) one, announcing the latest numbers of infected patients and fatalities. Again, while being hugely sympathetic to all those affected, our professional responsibility is dispassionately to evaluate the facts and to invest accordingly. Nothing has really surprised us so far. Markets are lower, with China itself, which re-opened for business this morning, the most impacted. Much of this was already baked into, for example, the discount on China-related investment trusts. The rising incidence of cases is no worse than might have been expected, and, so far at least, the fatality rate of around 2% is encouragingly low. The reaction of the Chinese authorities in terms of policy response is also a positive factor, as is the level of international cooperation in terms of developing tests and vaccines. But we also recognise that we will need to see a reduction in the daily rate of growth of cases before confidence can begin to return and economists and analysts can draw a line under the worst-case scenarios. We are not there yet.