Introduction

The US presidential election is just 9 weeks away. Voters in the United States must now decide whether to keep President Donald Trump in office or choose former Vice President Joe Biden. Just as it has done for most parts of society, the COVID-19 pandemic has disrupted the course of the 2020 race, altering everything from each candidate’s campaign strategy to the actual method US citizens might use to cast their vote in November.

Although we entered the year with President Trump well positioned for a second term, the polls have shifted in favor of a Biden administration. Prediction markets now see a roughly 60% chance of a changing of the guard in 2021, and even a roughly 50% chance of a Democratic sweep of the House and Senate as well. Flagged for potential change weeks can be an eternity in a national election, so we are reluctant to predict the winner and advise investors against making abrupt portfolio adjustments at this time. However, the two candidates do have drastically different visions for the United States, and to an extent the country’s relations with European economies, so it is important to understand the potential impacts of their policy agendas. In our 6 July ElectionWatch report, “Preparing Portfolios for November,” we outlined the US macro impact of the four scenarios we see plausible. They are listed in Fig. 1.

As we’ve said in prior publications, most national elections are not global events. The US election is the exception, and this election matters for Europe via two main channels. The first is trade, as the US accounts for some 14% of all euro area exports. The second is foreign policy. Whether the US continues down a more unilateral path or returns to a more multilateral approach in tackling the world’s problems—from trade to geopolitics—will have ramifications for US-Europe relations and their respective economic progress.
This report highlights the detailed investment implications for the European asset classes under the different potential outcomes of the US presidential election. In summary, we anticipate the dollar to continue to weaken against the euro, but at a faster pace under a Democratic outcome. European equities generate 20% of revenues in the US, and thus are exposed to currency and tax changes, but potential impacts on specific industries are likely to be greater. Meanwhile, European credit is less likely to be impacted by the election outcome. And some long-term themes, such as enabling technologies, are also likely to endure whatever the US political landscape.

Whether you want to take a view on the election outcome, hedge particular exposures, or position for all outcomes, this report provides investment views for the various scenarios.

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**Figure 1**

US election and policy scenarios

<table>
<thead>
<tr>
<th>Foreign policy &amp; trade</th>
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</thead>
<tbody>
<tr>
<td><strong>Blue Wave (DDD)</strong></td>
</tr>
<tr>
<td>Slightly positive for economic growth as higher taxes and a more stringent regulatory environment are offset by higher fiscal spending. Meanwhile, rates and inflation could rise faster due to stimulus.</td>
</tr>
</tbody>
</table>

| **Biden (DRD)**         |
| Neutral to slightly negative for growth as policy through regulation would likely increase. Fiscal stimulus is restrained with no substantive change in tax policy. Rates and inflation expectations would remain mostly unchanged. |

| **Trump (RRD)**         |
| Status quo. Neutral for growth as deregulation continues, but uncertainty remains high. Geopolitical tensions could rise as trade disputes fester. Rates and inflation expectations would be largely unchanged. |

| **Red Wave (RRR)**      |
| Slightly positive for growth with a potential for additional tax cuts and infrastructure spending. The regulatory environment remains lenient. Rates and inflation expectations could rise slightly faster as the deficit increases. |

**Legend:**

DDD = Democratic President, Democratic Senate, and Democratic House  
DRD = Democratic President, Republican Senate, and Democratic House  
RRD = Republican President, Republican Senate, and Democratic House  
RRR = Republican President, Republican Senate, and Republican House
Introduction

Economy

Scenarios and implications

The US presidential election could affect the Eurozone and UK economies via two key, increasingly linked channels. The first is trade, as the US accounts for some 14% of all euro area exports. This number rises to 16% when we look at the share of the domestic value added through exports to the US, making the US the single most important trading partner for the Eurozone. For the UK, this relationship with the US is also important, as 16% of the domestic value added from exports also comes from trade with the US.

The second channel is foreign policy. The less multilateral approach adopted by the US to tackling the world’s problems, from trade to geopolitics, has left Europe somewhat isolated. Whatever path the US decides to take in the future will likely have important ramifications for US-Europe relations and their respective economic progress.

In a Blue Wave scenario, we expect an easing of recent US-Europe trade tensions. Auto industry threats could abate and steel tariffs could reverse. However, the positive economic benefit of this would be marginal, in our view. Swift progress toward a US-EU trade deal appears unlikely, though a UK-US trade deal is more likely (that said, the UK economic gain would be offset by increased frictions in UK-EU trade).

A more multilateral approach to global affairs, especially concerning NATO and the WTO and the issue of digital tax, is also more likely under this scenario.

In a Red Wave scenario, US-EU trade tensions will likely remain, but increased tariffs are unlikely in the near term. Digital tax will be pursued by Europe alone.

The US administration is likely to keep pressure on the EU to support NATO, and less willing to work with Europe to engage with China.

Further fragmentation in global trade is also possible. This would, at the margin, be bad for both the EU and the US.

Divided government

This scenario is likely to lead to more of the status quo in Europe-US relations. Concerns around risks to economic growth via a trade dispute will remain. Given that the US president has large control over trade policy, the eventual holder of the office will be the key determinant of the most likely path ahead.

Economic summary

Economically, the US presidential election could have an impact on the EU in the years ahead, but any change will be marginal, in our view. Of greater importance will be the EU’s domestic agenda, which has recently seen progress after European governments took a historic step to bolster their union. For the UK, managing its relationship with the EU will also likely be of greater significance.
Currencies

Scenarios and implications

Our base case is a normalization of global growth in 2021, which will benefit the euro as an exporters’ currency. We also expect a recovery in the British pound, which has been under severe pressure due to complicated Brexit negotiations in the UK in the last couple of years and a more fragile COVID-19 situation than in continental Europe. In this recovery path, we assume that the blue-versus-red outcome will affect the speed of the depreciation rather than the direction of the greenback.

A Blue Wave scenario would likely to continued US dollar weakness. The US currency is strongly overvalued against the euro and the pound—much of this has to do with the current policy mix under President Trump. Rolling back the Trump stimulus will create uncertainties with investors, and potential new policies might imply less stimulus. Both are likely to promote more US dollar weakness.

Global trade will remain a hot issue, but measures other than tariffs could be expected. Meanwhile, global exports could recover as the removal of the current uncertainty would promote investment plans in and outside the US.

A Red Wave scenario would be more friendly to the US dollar than a Blue Wave. This would likely challenge our view of a rise in the euro or the pound against the greenback every now and then.

Trump’s presidency has led to a significant stimulus program that included tax cuts, reduced expenditures, repatriation of foreign earnings, and deregulation of many industries—all advantages for the dollar versus European and other currencies. Strong equity markets and attractive interest rates have also been factors supporting the greenback. One may question the sustainability of the policy mix as current debt projections have been worsening, but the dollar has not been hurt by worries around financial stability in the US.

Another element that strengthened the greenback is the unilateral imposition of tariffs and trade barriers. Such measures lowered the margins of foreign producers, and a stronger dollar compensated them for that potential loss.

Currency summary

We expect the greenback to continue to weaken regardless of the election’s outcome. We assume that the Blue Wave versus Red Wave outcome will affect the speed of the depreciation rather than the direction of the greenback. Even in a Red Wave scenario, the US economy and households will ultimately recover from the COVID-19 recession. This means we can also expect negative real yields to persist, further hurting investor sentiment and the dollar. On the balance between debt sustainability and immediate stimulus, however, we can expect a stronger concentration on the latter under a Red Wave. In such an environment, we expect the cycle of US dollar weakness to end sooner.
Equities

Scenarios and implications

The result of the elections will have an impact on certain sectors, but any broad-based effect on the European equity market would likely come from changes in trade policy, currency exchange or taxation rates. If, for example, Biden should win the election and corporate tax rates were raised from 21% to 28%, it would reduce UK and European profits by low-single-digit percentages.

The biggest sector winners in a Blue Wave scenario would be autos (through lower tariffs and supportive electrified vehicle policy) and utilities (through growth in renewables).

Energy, meanwhile, would face tougher regulations that, in our view, are only partially priced in now.

Healthcare could suffer from bipartisan drug pricing rhetoric in the run-up to the vote, but should see a relief rally afterwards, even in a Blue Wave.


Energy stands to benefit the most from a Republican White House and legislature, and autos would be the biggest loser. By contrast, utilities should be less affected.

The main thematic beneficiary is “Automation and robotics” published 26 February 2020, since new trade tariffs could accelerate the reshoring trend, where foreign companies bring aspects of their operations back or closer to home.

Sector overview

Fig. 3 provides an overview of our expectations on the impact on various European equity sectors under a Blue Wave or Red Wave outcome.

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**Equity sector overview**

Impact on European equity sectors of Red Wave and Blue Wave outcome

<table>
<thead>
<tr>
<th>Sector</th>
<th>Blue</th>
<th>Red</th>
</tr>
</thead>
<tbody>
<tr>
<td>Energy</td>
<td>![positive]</td>
<td>![neutral]</td>
</tr>
<tr>
<td>Automobiles</td>
<td>![positive]</td>
<td>![negative]</td>
</tr>
<tr>
<td>Utilities</td>
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<td>![negative]</td>
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<tr>
<td>Healthcare</td>
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<tr>
<td>Financials</td>
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<td>![positive]</td>
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<tr>
<td>Banks</td>
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<tr>
<td>Chemicals</td>
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</tr>
<tr>
<td>Staples</td>
<td>![neutral]</td>
<td>![negative]</td>
</tr>
</tbody>
</table>

*Note: Under a Red Wave, IT sector impact is neutral but the “Enabling technologies” theme should benefit

Source: UBS, as of 24 July 2020
Equities

Relatively unaffected by the election outcome

Enabling technologies
Election predictions have a mixed track record, and other factors will influence markets between now and 3 November, including the pandemic and fiscal and monetary policies. Many long-term themes such as “Enabling technologies” are attractive in either outcome.

• “Enabling technologies” should be relatively unaffected by the US election outcome, and their structural drivers are so enduring that we believe they will outweigh other factors in the long run.

• We have identified five mainstream enabling technologies that are set to transform many industries in the coming years: artificial intelligence; augmented and virtual reality; big data; cloud computing; and 5G.

• For further information on this theme, please see our report “Enabling technologies” published 14 January 2020.

Equity summary
Overall, the European equity market may be impacted by changes in currency or corporate tax rates. However, the impacts would be relatively limited in aggregate. At an individual company or sector level, however, we could see some greater impacts.

Under a Blue Wave scenario, we anticipate autos, utilities, and themes such as smart mobility, renewables, and energy efficiency to be relative winners.

Under a Red Wave scenario, energy stocks and the automation and robotics theme could be relative winners.

Equities broadly unaffected by the outcome of the election would include stocks in the area of enabling technologies, as well as those from unaffected industries.
Bonds

Scenarios and implications

The European bond market currently has two dominant performance drivers: global developments around the virus outbreak—with the risk of a second wave in Europe—and the bond purchase programs of the European Central Bank (ECB). With the planned ECB purchases of both government and investment grade corporate bonds potentially exceeding new issuance over the next six months, we expect risk premiums to moderately compress further in the absence of bad news, and to contain their widening in the case of negative surprises. The recent decision on the European Recovery Fund and existing backup facilities like the European Stability Mechanism provide additional support to risk premiums of peripheral countries such as Italy and Spain, which were hit particularly hard by the virus and whose debt sustainability may be challenged again in the future.

Credit

In our view, the US election should not be a major driver for European corporate credit spreads.

While the US election should not be a major driver for European corporate credit spreads, one source of uncertainty may emerge from potential US healthcare policy reforms. Drug pricing rhetoric ahead of the elections could create some uncertainty in the pharmaceutical sector, given the importance of the US market.

Another source of uncertainty may arise from renewed trade tensions, which in our view appears more likely under a Trump presidency. The imposition of higher tariffs is likely to pressure export-oriented industries, including certain car, luxury, and spirits companies.

Rates

- Under either a Blue Wave and Red outcome, we expect an only slightly faster rise in US interest rates and inflation expectations, while the two middle scenarios are unlikely to have a meaningful impact.

- In any case, we think interest rates will remain very low for several years, and we expect little inflation pressure.

- Longer maturities should be anchored by a combination of central bank asset purchases, high levels of private debt, low inflation, financial repression, and an extended period of low policy rates.

- Rates in major developed economies are typically closely correlated, but we think any move higher would be less pronounced in Europe. Even in the remote prospect of the Federal Reserve raising interest rates, such an action would likely be even further away for the ECB.

Bonds summary

We think the US election will have little impact on interest rates, which should remain very low for several years, and we expect little inflation pressure. The development of the pandemic, the economic recovery, and the ECB’s corporate bond purchases should be more relevant drivers for corporate credit spreads over the coming months than the outcomes of the US election. Corporate fundamentals remain challenged for many issuers in Europe, and many credit rating downgrades have occurred already. These are mostly related to the immediate consequences of the economic lockdown, hitting various cyclical sectors such as automotive, transportation, capital goods, industrials, and travel, or banks with large lending exposure to such borrowers.
Bonds

**Bond strategy**

The dislocations in some market segments as a result of the pandemic and economic downturn also provide some opportunities; however, investors need to be very selective in light of the deteriorating corporate fundamentals and the various sources of risk, including a potential second wave of COVID-19 infections, renewed trade tensions, and Brexit. Given the limited tightening potential from current levels, we like select BBB exposure to issuers in the slightly more defensive sectors as carry opportunities. In the more cyclical segments, we continue to like select bonds of mining, industrial, and capital goods issuers, focusing on the stronger and better diversified names in this space. In the financial segment, we continue to like select “bail-in-able” senior bonds of issuers we see as well positioned at their current rating level.
Conclusion

The domestic and foreign policy agenda may be affected by the US election outcome. We highlight investment opportunities for those wishing to take positions on a particular outcome, as well as opportunities for those wishing to navigate the US election irrespective of the outcome.

Figure 7
Summary of what the different US election scenarios mean for European assets

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Implications</th>
</tr>
</thead>
</table>
| **Blue Wave**     | • Dollar to weaken faster  
                      • Autos and utility stocks are relative winners  
                      • Energy stocks relative losers  
                      • “Smart mobility,” “Renewables,” and “Energy efficiency” are attractive themes |
| **Red Wave**      | • Dollar to weaken more slowly  
                      • Energy stocks are relative winners  
                      • Auto stocks to be relative losers  
                      • “Automation and robotics” theme could be accelerated if trade tariffs lead to greater onshoring |
| **Unaffected**    | • Election agnostics: European bonds (with the exception of a few sub-sectors such as luxury, autos, spirits and healthcare)  
                      • European fortress equities  
                      • Long-term themes such as “Enabling technologies” will endure under either outcome |

Figure 8
The 2020 countdown

This report was published on 1 September

The first presidential debate is 28 days away

The vice presidential debate is 36 days away

The second presidential debate is 44 days away

The third presidential debate is 51 days away

Election Day is 63 days away
Appendix

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