Isolating the effect of shifting election outcome probabilities on market pricing may be a bit easier over the next two weeks, even though there are key macro risk events. (UBS)

Waiting to exhale

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The New York City Marathon takes place next Sunday, 3 November. It's an exhilarating experience to watch more than 50,000 people from around the world run through all five boroughs, while being cheered along the entire route.

Anticipation might be for investors, and since there's not much that they dislike more than uncertainty, knowing the outcome of a race that's been close to a toss-up almost all year may allow them to finally exhale. Our latest and final **ElectionWatch** report before 5 November laid out the various election scenarios, policy implications, and likely economic and market impact. Here are additional quick market-specific thoughts.

First, the "Trump trade" has been the dominant market narrative in recent weeks, but its true impact is very hard to disentangle from economic data. While there is clear evidence of the trade—baskets of Trump beneficiary stocks have significantly outperformed Harris beneficiary baskets—much of the cross-asset performance also clearly reflects the upturn in US economic data, especially relative to other regions. Indeed, the surge in prediction market probabilities of Trump winning to over 60% has tracked economic surprise indices higher. Plus, the rise in the 10-year Treasury yield and the USD began with the data improvement and before Trump's probability of winning really took off.

Second, the preceding suggests that a "red sweep" outcome is not yet fully priced, but a Harris/divided government outcome is even less priced in and therefore should be more market moving immediately afterwards as Trump trades are unwound. There are suggestions that some investors are already taking profit on their Trump trades, which could lead to pullbacks over the next week, holding other factors constant.

Third, isolating the effect of shifting election outcome probabilities on market pricing may be a bit easier over the next two weeks, even though there are key macro risk events. Specifically, the October payrolls report on 1 November and the Federal Open Market Committee (FOMC) meeting on 7 November. Investors know that payrolls will be hurt by Hurricane Milton and the Boeing strike, and will likely discount its information value for the labor market and therefore the Fed's rate-cutting intentions. On the latter, comments by Fed officials last week before the black-out period reinforced expectations for a 25bp rate cut at the meeting (market pricing is at 93%). Assuming the Fed does cut by 25bps, investors probably won't learn much new over the next two weeks that would alter their near-term macro outlook. Consequently, the election should be the biggest market-moving event during this period, in our view.

Fourth, volatility has risen across markets in recent months, most of which is economic-related, not election-related, since the increase began in the summer. It may rise further after the election if the outcome isn't determined within a few days, but market volatility is likely to decline going into year-end. The potential policy paths should become clearer in the days and weeks after the election regardless of the outcome as some possibilities are eliminated entirely. The Fed's rate-cutting path should also be clearer, especially after the FOMC meeting on 18 December, because there will be two more months of data and the Fed will update its Summary of Economic Projections.

The bottom line: With a week to go to the election and polls indicating a dead heat, investors are unlikely to take on much new risk, and may even prefer to de-risk until the outcome is known. The immediate market response may actually be greater in absolute terms with a Harris/divided government outcome since pricing already leans toward a red sweep. But once the dust settles and the outcome is clear, the macro fundamentals should reclaim their spot in the driver's seat, determining the market direction. While the election will decide which specific fiscal, regulatory, and tariff policies investors should expect, these are more likely to affect the overall macro trajectory at the margin rather than dramatically alter the course. No change to the fundamental outlook that is positive and favorable for risk assets would be a good reason to exhale after the election.

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