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[INTRODUCTION]
Darius McDermott (DM): Good morning, I'm Darius McDermott from FundCalibre and I'm joined by James Ashley from Goldman Sachs for an early morning reaction to the US election and more importantly how this potentially plays into stock markets and investors. It's 9am (GMT) on Wednesday just after the US election.

[INTERVIEW]
[0:20]

DM: James, we wake up to uncertainty and unclear direction going forward. What's your early take?

James Ashley (JA): Yeah good morning. Thanks for having me on. Uncertainty. It seems bizarre the day after the election to say it's too close to call, but it's too close to call. I think the key States that we're still watching right now are Wisconsin, Michigan, and Pennsylvania. Maybe the latest today we get Wisconsin and Michigan. It seems more likely we don't get Pennsylvania until perhaps even Friday. So I think we've got a couple of days of uncertainty before we have any clarity on the presidential results. And of course, in the background we've got the Senate and the House races ongoing as well.

[1:01]

DM: Could you give us just a very brief thought on the role of the House or the Senate? Which ones do you think maybe have more importance or, you know, certainly again from an investment point of view, what some of the political outcomes will be?

JA: Yeah. I think that the House has been solidly Democrat for couple of years now and I think is expected to remain so, the race for the Senate is much more interesting. There, it looks as though the Democrats might pick up a couple of seats. The Chamber of course is 100 seats. The Democrats started this week on 47, they needed to get to either 50 or 51 to gain control depending on the

outcome of the presidential race. And the Senate is really important because if you don't have control of Congress then it's very hard for any president to implement his or her policies in full, they have to be diluted, they have to be subject to horse trading and negotiation. So the race for the Senate is really, really important in the sense that if you have, if we end this week with a Biden presidency, and that's only still a possibility, if the Democrats don't also have control of the Senate, then whatever Biden's policies are, are likely to have to be diluted. And many of them may have to be postponed depending on what the outcome for Congress is.

DM: Yeah they're going to be watered down, aren't they?

JA: Right.

DM: And one of the big areas for Biden is sort of the green technology, the environmental play, and I think it's quite clear if he doesn't have total control that that won't be implemented in its full. Just to give one example.

[2:33]

So I also wonder about stock markets and the implication as we sit here, the broad US indexes are flat to slightly down, yet the NASDAQ, which is the technology dominated index is actually up 1.5% to 2%, these are only the futures because the market doesn't open till later. What do you think that tells us? I think the tech, the breakup of big tech or further tech regulation is something I think our investors will be interested from, you know, that point of view, tech's been a very popular sector and high-performing.

JA: So I think what you've seen over the past few weeks consistently with the way the opinion polls have been evolving, is that more and more investors have been pricing in a blue wave. In other words, pricing in not only a Biden presidency, but also Democrat control of the Senate. And as we speak today, the probability of that has fallen quite significantly. It's still possible, but it's much lower than perhaps it appeared just 48 hours ago. And part of that I think is reflected in what you see in the equity market, where you see the tech heavy NASDAQ trading higher, because the probability of tech regulation has diminished. I'm not saying it's gone to zero, but it has diminished in conjunction with the reduced possibility of a Democrat wave.

I think what you're seeing in markets generally at the moment though, is two distinct factors, that overlap but I think it's important to try and disentangle the two. One is just risk off. We have heightened uncertainty. We don't know what the outcome is going to be. And in that environment, what you do, well you go to safe haven assets. So we see the dollar strengthening, we see treasury yields coming down, that's a risk off play. But at the same time, I think you do see the unwind to some extent of the Democrat trade, the Biden wave trade. And that's consistent with what you're seeing in equity markets. So there's two distinct elements there and whether or not one or the other

will dominate for a prolonged period of time depends on when you think we'll get a result coming through and what you think that result look like.

[4:31]

DM: Yeah. I mean tech has been so strong, we've been through a sort of amazing year with COVID dominating the world, yet those sort of five and, big five tech companies have dominated the performance in the S&P, that's been 23%, 25% of the S&P. And the US market has been the strongest market from the lows, or the COVID lows, in mid-March. I know our listeners are going to be interested in the tech sector. I think it's, clearly we don't know the outcome, so it's hard to make strong predictions, but I mean, do markets even care? Is the stimulus from the Fed under Trump or fiscal stimulus under Biden, not more important than who actually wins?

JA: So I think what you've seen throughout this year is that policy has been absolutely pivotal in supporting the market. The mantra throughout this year has been don't fight the Fed.

DM: Yep.

JA: I mean, it's been pretty straight forward. The fundamentals have been disastrous. If you look at what the state of the economy was in Q2, it was horrific, and of course we've had a strong rebound in Q3, but we're still well below where we started the year in terms of activity levels, where the unemployment rate is and so on and so forth. So from a perspective of macro fundamentals that doesn't support where equity markets have got to, what supports it is very much a function of policy, both fiscal and monetary.

Now where the election's importance I think, is in determining what form of support policy will take in the future. I think if you have a Democrat wave, if you have a blue wave, then you're much more likely to get aggressive fiscal stimulus and in that environment you probably get less monetary support from the Fed. So as we talk right now, prior to this, this outcome that we may be getting over the next 24 or 48 hours or perhaps longer, but right now our base case would be that the Fed isn't hiking rates, perhaps until sometime like 2025. But then if you have this huge fiscal stimulus that might be associated with the Biden administration and a Democrat controlled Senate, then that timeline for monetary stimulus is brought forward. You might be taking a couple of years off, that it might be 2023. So we're still talking about super supportive monetary policy for a really long period of time. But the timeline is shortened quite considerably, it’s quite sensitive to the outcome for this election. So I guess the question for the market is, does the market care what form the stimulus takes, whether it's more monetary or more fiscal, or is it just, we want a given amount of stimulus and we don't really care which way it comes from.

DM: That's exactly my observation. I mean, the old adage of markets not liking uncertainty, we could have expected minus three to minus five on the US futures across the board this morning. Yet

they appear moderately flat to slightly down, almost ambivalent. And as I say, I think we've learned it a number of times in the last four or five years, but I think it is don't fight the Fed and whether it's don't fight the Fed or the fiscal stimulus, it does appear that that is a dominating factor over which of these candidates win and where the stimulus comes from.

JA: That makes sense to some extent, if you just see how aggressive the Fed has been. So just take a step back, I know the focus for this conversation is US politics, but just leave the politics to one side. If you've got a central bank that is nailing interest rates the floor, and is explicitly saying both in terms of state contingent and time contingent forward guidance, we're not raising rates for years into the future. And at the same time, they're expanding their balance sheet by trillions of dollars. I mean, they've added UK GDP to the Fed's balance sheet this year. That's a G7 economy, they just dumped onto the Fed's balance sheet. So if you're going to be that aggressive in terms of monetary policy, and you're going to get a fiscal stimulus at the same time, it surely can't be a surprise that the market looks at that and says, okay, it's time to be risk on.

[8:17]

DM: And you know, you mentioned some of the size of some of these, the stimulus', yet Apple's peak market cap was as big as the whole of the Russell 2000 and the whole of the European stock market. That's one stock. So there are some crazy numbers out there that's for sure. And I think what, hopefully people who listen to the Investing on the go podcast cares what does it mean for their investments and how can they benefit? I don't think we would expect short-termism from investors, but you might've seen a big pullback in technology and maybe people looking to add to technology holdings if they thought that was a blip.

JA: Yeah. I mean, one point that you mentioned, Apple, look, I'm not qualified to talk about any individual stock or company. So I have nothing to say about any individual name, but you also mentioned earlier the concentration of the S&P the fact that, you know, the five largest companies now account for about 23.5% of it, what that does do, irrespective of what your personal views are on the individual names there. It creates a concentration which creates a fragility, creates a vulnerability. If you believe that any one of those mega cap companies is going to see a correction in its price, either because earnings will disappoint or because they're going to face higher tax rates, or there's more regulatory scrutiny or whatever it might be, if just one or two of those mega cap companies correct. Well, that's got enough weight now to be market moving in its entirety.

So I think for investors, our message would be that there are still enough supportive elements to be constructive on equities, whether it's from the incremental improvements in terms of fundamentals, the ongoing monetary support from the Fed, the potential for some fiscal support or questionable timing and magnitude, but we'd like to get something further, there's enough reasons to be constructive on it, but that concentration should make you very thoughtful about being selective in terms of where your exposures are. This isn't a market where we would say you should be passive,

you've got to be very, very thoughtful about where you are exposed and what underlying risks are you taking in your portfolio.

[10:26]

DM: Yeah, absolutely. And as we sort of wake up in the UK, hoping for some clarity, whichever way I suspect we don't have that today. Yet we can take positives from this election - the engagement from US voters that the voting numbers are up, quite substantially. Our own Staci West has encouraged more of her family to vote and they have done. So there are positives there. I suppose, given Donald Trump's quite explicit promises to bring the Supreme Court into this, before today, and he has reiterated that this morning, before we recorded this podcast. That we may well see the result being uncertain for an undefined period. I think it's going to be probably weeks rather than days, but from an investment point of view, I suppose some of the old adages apply, potentially buy the dips. Markets are supported by this stimulus, wherever it may come from that we've already discussed.

Are there any other sort of last economic or, you know, you did touch on the dollar and treasuries in the short-term of uncertainty. Do you think that we might see short or medium term moves in those assets?

JA: Well, just two things, one on the underlying politics, which you referenced, and then let's focus on the investment implications. But just on the politics, you mentioned the increased political engagement. I think it's absolutely right. And we can surely all agree, that having people politically engaged is a good thing. But I think a lot of that comes down to the polarisation of US society that people are engaged, because they see such a stark divide in terms of what the two candidates offer, and that creates uncertainty in itself. You're not talking about a gentle shift of the political pendulum from centre right to centre left.

DM: No.

JA: You're talking about some very substantial changes to the continuity of policy is not there. For example, if you have a Biden administration, he's talking about increasing the corporate tax rate, which is an unwind of what Trump did in his first term. So you don't have that continuity and that creates uncertainty for investors. And that creates volatility.

The second point in terms of where do we see the impact on the market right now? One of the things we haven't mentioned is worth touching on just briefly is emerging markets. I think one of the elements that we saw as a result of the polls over the past couple of weeks is markets saying, well, we're less likely to see renewed trade war hostilities between the US and China under a Biden administration. There are all sorts of areas where you might see US/China conflict, with regards to all sorts of political issues. But when it comes specifically to trade, which has been the dominant

element for the past few years between the US and China, the likelihood that we would have as aggressive - I'm not saying no trade wars - but as aggressive a trade war under a Biden administration, the market perceived rightly or wrongly to be somewhat lower. Whereas now the market's saying, well, hang on, we might get a second term of Trump. In which case we need to be thinking about 2021 perhaps being a reignition of those trade conflicts once again.

So that's why I think we're starting to see some weakening in the renminbi. And I think emerging market assets, more generally, in this kind of environment where you have heightened uncertainty and moves towards risk off, they might see a bit of downside in the short-term. But I emphasise that, going back to what I said, there's two distinct elements here. One is uncertainty and the move toward risk off. And one is the repricing of the likely final outcome. But in the short term, as we talk right now, I think the risk off sentiment is going to be important for thinking about emerging market assets in the short term.

[14:11]

DM: Yeah and it's really interesting because the recent statistics released by the Investment Association, the IA, actually show that UK investors have been flowing to Asia and Japan, particularly, which wouldn't be deemed risk on asset, sorry, they would be deemed risk on assets rather than risk off. Certainly I don't know if it was the last month or the last quarter that they were far less interested in developed markets than they were Asia and emerging markets and big chunks of Asia still have COVID problems, but big chunks of Asia have sort of contained COVID and they seem maybe a safer bet from the COVID sort of angle, which we haven't really touched on because this is a US election outcome.

JA: But I think that's really important. So, and what you just said there, the final comment that you just made that I think is really critical. We have a tendency to look at things through the prism of a particular topic. So today we're talking about US politics, for most of this year it's been about COVID.

DM: Yeah.

JA: But you can't think of these things in isolation. You've got to marry all together, right? So right now, as we have people listening to this podcast, it's going to be all about what do we think the US election is going to do to the market, but you don't operate in a bubble. The COVID story is still going to be hyper important for a really long period of time. So if we relate that back to the Asia conversation we were just having, which regions of the world are going to be least worst effected by COVID? I mean, we're all worse off. We know we're all worse off as a result of this. But who is least worst off? And I'm thinking on balance, a lot of emerging Asia, led by China, are going to be…

DM: China, yeah.

JA: At least certainly when you compare it to the situation in large parts of Europe right now, even large parts of the US, so why have we seen capital flows into large parts of emerging Asia? It's COVID.

DM: Yeah.

JA: It's not just COVID, it's about the yields that are on offer, it's about the market pricing, central bank reactions. Again, you know, where do we have the China 10 year trading relative to the US 10 year, for example. So there's all sorts of elements there. But if we take a step back and say, it's not all about US politics, it might feel like that this morning, but it's not. If we think about COVID once again, I think emerging Asia comes out on a relative basis ahead of Europe and ahead of the US at the end of 2020.

DM: James, thank you very much. I think that's an excellent summary that it isn't just about the US election. There is a lot of stimulus in global markets still being pumped in and investors should think about long term. So thank you very much, James, for your thoughts this morning. If you'd like to subscribe to the Investing on the go podcast, please visit your usual podcast subscriber.