Rathbones
Look forward

Review of the Week

12 October 2020

Predicting the unpredictable

Biden has taken the edge in the polls but previous experience begs the question: do polls really matter? Our chief investment officer, Julian Chillingworth, mulls the possible outcomes of the US election and the effectiveness of the UK government's spending packages.

It's been a busy couple of weeks for US President Donald Trump but not altogether productive. After an acrimonious start to the presidential debates, he contracted and then reportedly recovered from COVID-19 in record time with little regard for his mask even whilst undergoing treatment. The public hasn't been too impressed by the President's indifference to spreading the virus among his inner circle and his Democratic rival Joe Biden has increased his national lead to 9.8 points, which is the highest his lead has been this year.

Although winning the national vote doesn't mean winning the Electoral College, on this front the latest breakdown from the polls is also suggesting Mr Biden is well ahead. Voter turnout will be crucial and this year that's harder to predict than normal. There have already been over 9.4 million ballots received which is considerably higher than the 75,000 received by the same point in 2016. But late, absent and rejected ballots could cause havoc to the numbers. In 11 of the battleground states, 26% of Democrats say they'll vote in person versus 56% of Republicans. Will those voting in person be better able to make their votes count by completing the form successfully? There were already a lot of unknowns this year before the second presidential debate, a virtual one scheduled for Thursday, was cancelled after the President refused to take part unless it was in person.

In the meantime, a second fiscal package remains in doubt with the three sides no closer to reaching an agreement. Pelosi is steadfast in her offer of $2.2 trillion, which has been lowered from $3.4 trillion. The White House upped its bid from $1.6 trillion to $1.8 trillion. Senate Republicans initially put their bid at $500 billion but then raised it to approximately $700 billion. Both Democrats and Republicans have baulked at the latest White House proposal.

A Biden or Trump victory, paired with a Republican-controlled Senate, could mean this fiscal stalemate continues well into 2021. But if Democrats take the Senate, there'll be a substantial stimulus package early next year and greater infrastructure spending which we believe could lead to a weaker dollar and possibly an uptick in inflation.

Even though any form of fiscal stimulus is looking less likely before the election, hopes of a large package after the election if Biden wins have supported markets and last week the US posted strong gains. Recent surveys suggest economic activity is now back to 80% of pre-COVID levels. It's very hard to say how this is all going to play out, but a key indicator to watch will be unemployment.

Tough to swallow

After all the support the UK government ploughed into the hospitality sector over the summer, they will have been disappointed by the services numbers out last week. Economists had been predicting 5% growth in services in August but the number actually came in at 2.4%. Manufacturing didn't come out much better, growing 1% versus an expected 3% and construction grew just 3% instead of an expected 5%. Looks like all that eating out didn't help out all that much.

Some economists expect the Bank of England to step up economic support this year and the chitter-chatter of negative interest rates is back. We think this is unlikely and if more support is needed, the BoE will find an alternative way to encourage spending. The Chancellor has been finding support where he can, including extending several emergency loan programmes, the temporary VAT cut for hospitality and the wage subsidy scheme, set to cost about 0.2% of GDP in total. Economists have lowered their projections for Q4 unemployment from 9% to 7%, but that would still mean a large rise from the current 4.1% rate. Although supportive, the new subsidy scheme is less generous than its predecessor and leaves workers on relatively low hours exposed. The The Office for National Statistics estimates that around 3 million workers were still using the current furlough scheme either fully or partially through to early September.

The second wave is seeing new lockdowns and some Conservative MPs are questioning whether Boris Johnson is the right person to lead the country through these challenging times. Today, the UK government will introduce its much-discussed three-tier restriction regime and with Mr Johnson under pressure from his backbenchers to consult with local officials about how to impose lockdowns regionally. Many of these same backbenchers also view the Chancellor as a better option to lead their party.

It's highly likely Liverpool will be placed on the highest tier of lockdown with pubs, gyms, betting shops and restaurants all shut. There's always a tough trade-off between science and economics and every decision has negative consequences for someone, but the fragility of our economy is undeniable as we saw in August's GDP, which came in last week at 2.1% versus the 4.6% forecast. These are tough waters to navigate.

There's also another long-awaited Brexit milestone on Thursday when European Union (EU) leaders meet and talks are due to conclude. Both sides are sounding more optimistic about a deal but we think they are unlikely to reach one before late November. As we discussed in our latest Quarterly *InvestmentUpdate*, the poor performance of the UK since the referendum is well known, as is the high likelihood that leaving the EU with or without Mr Johnson's deal will make the UK relatively worse off. But today, the crucial question is: will the UK's already rather poor economic performance become so much worse relative to the rest of the world that its exchange rate looks overvalued? Our analysis suggests not, but exchange rates are volatile beasts. There's certainly a significant risk that the pound would fall further in the near term if a 'no-deal' Brexit were confirmed. But on a longer-term basis, we think there is enough bad news already in the price and more room on the upside than the downside for sterling.

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