

What Biden's historic election decision means for markets



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Biden leaves the race

President Joe Biden's late withdrawal from the presidential race creates a number of significant unknowns.

Federal Reserve

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Earnings season

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Media coverage of the US presidential election reached a fever pitch over the weekend with President Joe Biden's announcement that he would withdraw from the race. I expect this late-in-the-race turmoil to ramp up short-term market volatility — but I'm also staying focused on next week's Federal Reserve (Fed) meeting, as I believe the Fed matters a lot more to markets. And I'm watching the results of earnings season for signs that market performance may be broadening from the domination of the "Magnificent 7" stocks.

US election turmoil: Three market implications

Before we explore the market implications of Biden's decision, I think it's important to note that this is not the first time that an incumbent president has decided not to pursue another term. In the twentieth century, it has happened three times: Calvin Coolidge, Harry S Truman, and Lyndon B. Johnson all decided not to seek reelection. However, what's different today is the timing; an incumbent has never withdrawn from the presidential race so close to the election. Coolidge decided not to seek reelection in August 1927, more than a year in advance of Election Day, while both Truman and Johnson made their decisions in March of the presidential election year — a good four months ahead of when Biden withdrew from the race.

In other words, a withdrawal in late July is very unusual and creates many unknowns. It limits the ability of the Democratic Party to decide upon a new ticket (since primary season has already ended) and it dramatically shortens the amount of time that the new ticket has to campaign before voters go to the polls. In addition, it could open the new ticket to legal challenges to appear on the ballot in some states (although most legal experts believe any legal challenges will not succeed).

So who's likely to be on the Democratic ticket? Support seems to have coalesced around Vice President Kamala Harris to be the presidential nominee. It's worth noting that she has seen a significant inflow in donations in the 24 hours following Biden's announcement, after they dried up in the weeks following Biden's debate performance. Plus, Biden has given her his endorsement. So it seems likely she will be at the top of the ticket.

The vice president pick is also critical. Democrats need to win over independent voters, who likely view Harris as farther to the left than Biden, so they need a VP nominee who appeals to independents. An "out-of-the-box" VP pick such as billionaire businessman Mark Cuban, an independent and fiscal conservative whose name has started to come up in these conversations, would not only appeal to independents but would inject far more excitement into the election season, suggesting it's not just politics as usual. It would also focus attention on important issues like the growing national debt. However, that seems rather unlikely at this juncture; it's far more likely that Harris will choose a more moderate governor, likely from a swing state. I will be eager to see what the ticket will ultimately look like.

So what are the market implications at this point in time?

- Obviously, this is expected to add to volatility in the shorter-term as the significant uncertainty about the new Democratic ticket might not be resolved until the party's convention in August. (There has been a big pickup in volatility in recent days,¹ but I expect that will only increase now.)
- We're likely to see stronger market reactions to Donald Trump's statements in the near term, as we have seen in the last several weeks, given that markets began to assume in recent weeks that he would now win (betting odds on Predictit.org show wagers significantly in Trump's favor now after indicating a Democratic win in April). However, in spite of the market's current assumptions, an argument could be made that this development injects new life into the election season and could increase the odds of a Democratic win. But, as discussed above, so much depends on who is on the party's ticket.
- We've seen some market impact from "Trump Trades" as traders position their portfolios for what they would expect from another Trump administration — notably, we've seen a steepening in the yield curve and an increase in bitcoin prices.² But that impact may be partly rolled back depending on what happens in coming weeks with the Democratic ticket. (Although, I expect the likely start of Federal Reserve interest rate cuts to support a degree of yield curve steepening.³)

The Federal Reserve may be getting closer to rate cuts

The media focus on the presidential election is taking our attention away from what I believe matters a lot more to markets — the Federal Reserve. A number of different Federal Open Market Committee participants have said in recent weeks that the Fed is getting closer to feeling confident about starting rate cuts. Just last week, Fed Governor Christopher Waller shared that the Fed is "getting closer to the time when a cut in the policy rate is warranted."⁴

While few expect a rate cut at the Fed's meeting next week on July 30 and July 31, probabilities could increase following the release of the upcoming Personal Consumption Expenditures (PCE) report on Friday. While still very unlikely, I think the Fed would be more likely to cut in July if it sees signs of greater deterioration in the economy, especially in the labor market. One other impetus could be growing uncertainty that leads to a drop in spending. The Federal Reserve Beige Book released last week indicated expectations were for slower growth in the coming six months because of uncertainty around the upcoming election, domestic policy, geopolitical conflict, and inflation.

In Fed Governor Adriana Kugler's speech last week, she articulated the importance of using private sector data to complement official government data in gauging the state of the economy and inflation because it offers greater timeliness and higher frequencies. She explained, "When we look at economic turning points, it is also important to consider reports on expectations and anticipated outcomes from nongovernment sources. Those include surveys of expectations of future inflation, anticipated hiring or layoffs, and consumer and business sentiment on the economy or the path of the economy."⁵ In discussing recent data, she downplayed official statistics on housing costs because they are not timely (more recent private sector housing data shows costs have fallen).

I appreciate Fed Governor Kugler's interest in looking at a variety of sources of information, including private ones, about the state of the economy. I certainly look to earnings reports for information about the health of the economy. One company that I view as a bellwether of consumer health, Synchrony Financial, reported earnings last week. It shared that its consumer delinquency rates had risen materially but that there was a significant difference between higher-income consumers and lower-income consumers with the latter feeling economic pressure. This confirms my general view that no alarm bells are ringing yet but cracks are starting to form in the US economy, and the Fed needs to act sooner rather than later.

In short, all signs point to a Fed that will cut before the end of the third quarter.

Earnings season is in full swing

Speaking of earnings, as of Friday, 14% of S&P 500 companies had reported actual results for the fourth quarter. Of those companies, 80% beat earnings expectations while 62% beat revenue expectations.⁶

The blended earnings growth rate for the second quarter is expected to be 9.7% year over year; however, four "Magnificent 7" companies are responsible for a significant portion of that earnings growth. If you were to remove those four companies from the analysis, the expected earnings growth rate would be 5.7% year over year.⁶

What I want to see is a broadening in participation when it comes to earnings growth — that would make this rotation sustainable, in my view. The good news is that current analyst estimates anticipate double-digit earnings growth for the other 496 S&P 500 companies beginning in the fourth quarter.⁶

China provides more stimulus to support the economy

China's Third Plenum, a seminal event typically held every five years, ended last week. And with it came a message that China is focused on embracing technological innovation and increasing reforms. In addition, the People's Bank of China has lowered its short-term policy rate for the first time since last summer. The cut was 10 basis points, but it indicates policymakers' willingness to support the Chinese economy. I view these developments as tailwinds for Chinese equities.

The week ahead

The most important data release next week will be the US PCE Price Index. Core PCE is the Fed's preferred inflation gauge, and there are market whispers that it will come in softer than expected. If this were to happen, it's likely to further support smaller-cap and cyclical stocks and marginally weaken the US dollar.

Also this week, the Bank of Canada (BOC) will meet. Recall the BOC had already begun rate cuts in June. However, I expect it will likely cut again this week as a higher unemployment rate and another decline in consumer discretionary spending indicates that the economy is weakening.

Dates to watch

Date	Event	What it tells us
July 22	China Prime Rate	Serves as a benchmark rate for loans
July 23	US Existing Home Sales	Indicates the health of the housing market
	Eurozone Consumer Confidence (flash)	Provides an early indication of consumer sentiment in the eurozone
July 24	Japan Manufacturing Purchasing Managers Index (flash)	Provides an early indication of the economic health of the manufacturing sector
	Eurozone Manufacturing and Service Purchasing Managers Indexes (flash)	Provides an early indication of the economic health of the manufacturing and service sectors
	UK Manufacturing and Service Purchasing Managers Index (flash)	Provides an early indication of the economic health of the manufacturing and service sectors
	US Manufacturing Purchasing Managers Index (flash)	Provides an early indication of the economic health of the manufacturing sector
	Bank of Canada Monetary Policy Decision	Reveals the path of interest rates
	US New Home Sales	Indicates the health of the housing market
July 25	US Durable Goods	Tracks the value of new orders for long-lasting manufactured goods
	Germany Ifo Business Climate	Serves as an indicator of economic developments in Germany
	US Gross Domestic Product (advance)	Measures a region's economic activity
July 26	Japan Leading Index	Provides an early indication of the health of the economy
	US Personal Consumption Expenditures Price Index	Tracks the path of inflation.
	US Personal Spending	Measures the change in the inflation-adjusted value of all spending by consumers.
	US Personal Income	Measures the income that people get from wages and salaries, Social Security and other government benefits, dividends and interest, business ownership, and other sources.
	University of Michigan Survey of Consumers	Assesses US consumer sentiment and inflation expectations

Notes

¹Source: Bloomberg. The VIX was 12.46 on July 12 but rose to 16.52 on July 19. VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

²Source: Bloomberg, as of July 19, 2024 for both the yield curve and bitcoin prices.

³Note: The yield curve plots interest rates of bonds having equal credit quality but differing maturity dates. A steepening yield curve is one in which the difference between short-term and long-term rates increases. That can be caused by short-term rates falling more or long-term rates rising more – or a combination of the two. Short-term rates typically fall by more than long-term rates when markets anticipate Fed rate cuts. Rising long-term rates can indicate concerns about higher debt levels and/or higher inflation.

⁴Source: Federal Reserve, speech by Fed Governor Christopher Waller, July 17, 2024

⁵Source: Federal Reserve, speech by Fed Governor Adriana Kugler, July 16, 2024

⁶Source: FactSet Earnings Insight, July 19, 2024.

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

Stocks of small and mid-sized companies tend to be more vulnerable to adverse developments, may be more volatile, and may be illiquid or restricted as to resale.

Bitcoins are considered a highly speculative investment due to their lack of guaranteed value and limited track record. Because of their digital nature, they pose risk from hackers, malware, fraud, and operational glitches. Bitcoins are not legal tender and are operated by a decentralized authority, unlike government-issued currencies. Bitcoin exchanges and Bitcoin accounts are not backed or insured by any type of federal or government program or bank.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

Personal consumption expenditures (PCE), or the PCE Index, measures price changes in consumer goods and services. Core PCE excludes food and energy prices.

The Magnificent Seven stocks refer to Amazon, Apple, Alphabet, Meta, Microsoft, Nvidia, and Tesla.

The yield curve plots interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates to project future interest rate changes and economic activity.

If the yield curve steepens, this means that the difference between long- and short-term interest rates increases.

The Federal Open Market Committee (FOMC) is a committee of the Federal Reserve Board that meets regularly to set monetary policy, including the interest rates that are charged to banks.

The Federal Reserve Beige Book is a summary of anecdotal information on current economic conditions in each of the Fed's 12 districts.

A basis point is one-hundredth of a percentage point.

The opinions referenced above are those of the author as of **July 22, 2024**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.