Policy, Politics & Portfolios

THE SWING OF THINGS

Paul Christopher, CFA
Head of Global Market Strategy

Tony Miano
Investment Analyst

Gary Schlossberg
Global Strategist

Michael Taylor, CFA
Investment Strategy Analyst

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Will the 2020 presidential race come down to a six-state “battleground state” race for the electoral vote? Recent polls show former Vice President Joe Biden ahead in the popular vote, masking closer tallies in four of the six “swing” states that could influence the key electoral vote. This could become significant if the presidential race tightens between now and the November election, increasing the chances of a split electoral-popular vote decided by the state-by-state tally for the third time in the last five contests.

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While the eyes of the public are focused on the race toward the presidential finish line, savvy political minds are looking to the often-overlooked congressional elections. This year, the congressional elections are shaping up to be every bit as exciting as the presidential one.

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Lawmakers worked judiciously to pass relief measures in an effort to offset the pandemic’s economic fallout. At first glance, May’s upside labor market surprise might indicate that the relief packages were largely effective. Yet, caution is in order as the economy mends from unprecedented unemployment levels. While the economy appears poised to recover, the timing is unclear, and the path is likely to be full of twists and turns. We believe voter perception of how President Trump manages the reopening remains key to his reelection bid.
A six-state presidential race in 2020?

States’ rights

Current front-runner Joe Biden has built up a sizable, nearly double-digit lead against President Trump in presidential polls (Table 1). However, our June 9 report titled, “Weighing the Impacts of a Potential Watershed Election” cautions that polling in the run-up to presidential elections should be scrutinized less for popular support than for the vote’s geographical distribution, because of the electoral vote’s importance. Electoral, not popular, tallies decided the winner in two of the last five presidential elections, including the last one in 2016. Our June 9 report also cautions that swing-state math could be swept aside by groundswell support in a heavy voter turnout. In fact, turnout by 56% or more of eligible voters has led to single-party control of the White House and Congress in every presidential election since 1960.3

True, polling results in states favoring President Trump are narrower than the lead he enjoyed in the 2016 election.4 And RealClearPolitics showed Biden with an advantage in all six hotly contested “swing” states of Arizona, Florida, Michigan, North Carolina, Pennsylvania, and Wisconsin. Together, these states account for 101 of the 270 electoral votes that are needed for victory. Yet, Biden’s lead is narrow, at 3 percentage points or less in four of those states, accounting for 75 of those 101 electoral votes. In sum, Trump’s electoral path to a second term is narrowing, but it still is open if the contest turns out to be closer than it now appears.

Table 1. A closer election than it seems?

<table>
<thead>
<tr>
<th>State</th>
<th>Electoral votes</th>
<th>Percentage margin (candidate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>National</td>
<td>270*</td>
<td>9.8% (Biden)</td>
</tr>
<tr>
<td>Texas</td>
<td>38</td>
<td>1.5% (Trump)</td>
</tr>
<tr>
<td>Georgia</td>
<td>16</td>
<td>1.0% (Trump)</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>20</td>
<td>0.1% (Biden)</td>
</tr>
<tr>
<td>North Carolina</td>
<td>15</td>
<td>0.5% (Biden)</td>
</tr>
<tr>
<td>Florida</td>
<td>29</td>
<td>2.5% (Biden)</td>
</tr>
<tr>
<td>Arizona</td>
<td>11</td>
<td>3.3% (Biden)</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>10</td>
<td>6.2% (Biden)</td>
</tr>
<tr>
<td>Michigan</td>
<td>16</td>
<td>7.6% (Biden)</td>
</tr>
</tbody>
</table>

1 A swing state, or battleground state, is deemed to play a key role in the presidential election outcome, because it is one in which both Democratic and Republican candidates have similar support levels, so a “swing” in votes could clearly affect the end result.

2 Voter turnout of 56% or more has been associated with “one-party” government since 1960. Sources: “Weighing the Impacts of a Potential Watershed Election,” Wells Fargo Investment Institute, June 9, 2020; Dr. Michael McDonald, U.S. Election Project, University of Florida, June 1, 2020.

3 Ibid.

4 RealClearPolitics, June 17, 2020.

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Battle for the “battlegrounds”

Biden’s swing-state lead, if it is maintained, provides numerous paths to an election win. However, a Trump victory in hotly contested Arizona and other Republican-leaning battleground states could pave the way for the third split popular-electoral vote since the 2000 election and the fifth dating back to 1876.5

The most visible issues contributing to Biden’s widening lead over Trump are concerns over the economy, along with the president’s handling of the pandemic and nationwide race-related protests. However, the economy still could favor the president in swing states and elsewhere if a strong, initial rebound from the second quarter’s free fall extends through October. That could ease dissatisfaction in swing states over employment declines exceeding the national average in the past year. And what some view as Trump’s hardline position on June’s racial protests could favor the president in conservative battleground states—all eight battleground states, excluding Michigan, are viewed as being to the right of the national average based on recent elections and polls. The pandemic’s effect on swing-state voting patterns remains unclear, given the uncertain trajectory of infections, hospitalizations, and coronavirus deaths. It will be important to monitor increased hospitalizations since Memorial Day in Texas, North Carolina, and Arizona—which could pose problems for the president if the trend continues and expands to other battleground states.

Investor patience is advised in the run-up to a potential watershed election still more than four months away and potentially closer than it now appears. It is also unclear whether this fall’s elections will result in a “one-party lead” or in a split-government outcome, with potentially far-reaching policy ramifications on the line. For these reasons, we favor a tilt in diversified portfolios toward high-quality, liquid U.S. assets until election and economic prospects become clearer.

5 Ballotpedia.org, June 2020.
The other election in 2020

The political battlefield—and what’s at stake

While the eyes of the general public turn toward a finalized Democratic nominee and the race toward the presidential finish line, savvy political minds are looking to the often-overlooked congressional elections. Although the president is the executive U.S. policy maker, Congress is a vital part of our system of checks and balances. The congressional elections are shaping up to be every bit as exciting as the presidential one.

The election goals for both parties are fairly clear at this point, with the Republicans hoping to keep both the presidency and Senate control and the Democrats looking to flip one or both. In the Senate, the Democrats would need to net three or four seats to do so (that number depends on a tiebreaking vote from the vice president). Thirty-five Senate seats are up for an election vote, with 12 being held by the Democrats and 23 by the Republicans; this obviously means that the GOP (Republicans) must “defend more territory.” However, The Cook Political Report rates most of the Senate seats as leaning toward the incumbent, with a toss-up for GOP seats in Arizona, Colorado, Maine, and North Carolina, but a GOP lean for the Democratic seat in Alabama.6 If the Alabama seat held by Senator Doug Jones were to flip, that would put the Democrats’ “magic number” for Senate control at four or five seats. The Democrats potentially could sweep the remaining toss-up seats, particularly if Biden wins the presidential race. Even in this case, however, the Democratic majority would be just two seats. Thus, whether the Republicans keep the Senate majority, or the Democrats take over party control, we believe that the grasp of either party on the Senate will be tenuous at best. As such, we would expect more partisan issues to struggle in the Senate.

On the House of Representatives side, the Democrats have a 37-seat advantage over the GOP; this is a lead which seems insurmountable, based on polling data. Average ratings from three of the major election handicappers (The Cook Political Report, Inside Elections, and Sabato’s Crystal Ball) rate 222 seats as solidly or leaning toward the Democrat side, with only 193 for the Republicans and an additional 20 seats as a toss-up.7 This has been amplified by the roughly 18 GOP House members that will be retiring before the 2020 election.8

8 Geoffrey Skelley, “There Are Now 18 House Republicans Retiring. What Does This Mean For 2020?”, FiveThirtyEight, December 5, 2019.
Potential implications

We believe that a divided government should help to moderate legislative initiatives. (Please see our June 9, 2020, Elections 2020 In-Depth report for more commentary on the presidential election.) Table 2 illustrates that polling of consumer sentiment during divided governments has been somewhat mixed since 1969. With a higher result indicating better sentiment, most quarterly average readings were above average but without any apparent pattern. Put simply, divided government has not coincided with higher or lower consumer sentiment during the past 50 years.

Table 2. Average quarterly consumer sentiment during divided governments since 1969

<table>
<thead>
<tr>
<th>Years of divided government</th>
<th>Average quarterly consumer sentiment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-1977</td>
<td>79.4</td>
</tr>
<tr>
<td>1981-1993</td>
<td>85.4</td>
</tr>
<tr>
<td>1995-2003</td>
<td>98.2</td>
</tr>
<tr>
<td>2007-2009</td>
<td>74.7</td>
</tr>
<tr>
<td>2011-2017</td>
<td>82.0</td>
</tr>
<tr>
<td>2019-2021</td>
<td>96.1</td>
</tr>
<tr>
<td><strong>Average since 1969</strong></td>
<td><strong>85.3</strong></td>
</tr>
</tbody>
</table>

Source: “Surveys of Consumers”, University of Michigan, April 2020. Data is through the first quarter of 2020.

Since we are still early in the 2020 congressional campaigns, we favor exercising restraint, and we believe that investors should continue to follow our current tactical guidance and asset allocation preferences. We continue to favor large- and mid-cap U.S. equities over small caps. Among equity sectors, we generally prefer cyclical sectors with strong balance sheets and earnings prospects. We believe that companies in these sectors should be able to absorb potentially negative tax policies, regardless of the election outcome, while still participating in market strength.

Key takeaways

- The congressional elections are the “other elections” this fall. We don’t expect that party control of the House and Senate following this presidential election is likely to have any immediate market impact.

- Party control of the Senate is likely to follow the winner of the presidential race. Yet, any resulting Senate majority is likely to be a narrow one, making passage of the most controversial legislation difficult to achieve.

- We believe that the close election outlook does not favor making election-related portfolio changes at this time. We favor prioritizing portfolio allocations around the track of the economy.

Fiscal stimulus, coronavirus, and the election

Is more stimulus the key to Trump’s reelection bid?

Since the onslaught of the COVID-19 pandemic, millions of American workers have been displaced. In March and April, the average number of new filers for unemployment benefits exceeded six million per week. Employment fell in all 50 states, and state tax revenues have been slashed. States with large tourist sectors, including Hawaii and Nevada, have experienced significant job losses. By early June, weekly unemployment claims had dropped to 1.5 million—still a sizeable number, but far below the peak of 6.6 million. The decrease in unemployment claims directionally coincides with May’s jobs report upturn, and upbeat hiring plans among some small businesses may be a harbinger of green shoots for the labor market and economy. Yet, currently, more than 20 million workers continue to receive unemployment benefits.

Chart 1. Unemployment rates of key states

May’s upside labor market surprise, coupled with a recent surge in retail sales and consumer spending, reflects the gradual resumption of economic activity—thanks, in part, to massive fiscal relief efforts as states and cities across the U.S. begin to reopen. Yet, we believe that caution is in order, as the economy recovers from unprecedented unemployment levels, and enhanced unemployment insurance for workers starts to wind down, along with the Paycheck Protection Program that supported small businesses. All of this has provided a sense of urgency for further fiscal stimulus. As we approach

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election season, a few questions are weighing on investors’ minds. These include how much relief is needed to continue the economic reopening, and whether it will be sufficient to bolster President Trump’s success in November.

A long road ahead

Lawmakers worked judiciously to pass a series of relief packages to help offset the pandemic’s economic fallout. At first glance, May’s employment data might indicate that the relief packages were largely effective as the economic reopening continues. Yet, the 2.5 million jobs added last month represent a fraction of the jobs lost this year, and the Department of Labor estimates that the unemployment data may have been understated by 4.7 million workers. In fact, the U-6—a broad unemployment measure that includes those who have given up looking for work and part-time workers who prefer to work full time—remained above 21% in May. Moreover, the additional $600 per week jobless benefit will expire in July, and new pockets of COVID-19 outbreaks are emerging in parts of the country. These factors strengthen the case for another round of fiscal stimulus.

We expect a moderate recovery following a strong, third-quarter start. To achieve our year-end forecast of a 9.5% unemployment rate, continued economic reopening is necessary. We believe additional relief is essential to support the reopening, and that is likely to include another round of stimulus checks for consumers and financial support for small businesses, along with liability protection for them. Congress is likely to pass a Phase 4 relief package this summer, but one that is more targeted to the hardest-hit businesses and includes additional aid for cities and states. The size and content of the next relief bill are still under deliberation. House Democrats have passed a $3.4 trillion package, yet the Senate and President Trump are likely to consider only a fraction of that proposal. To date, congressional Republicans and Trump have opposed certain proposed measures that are supported by Democrats, including more relief for states.

Even with additional fiscal stimulus, it is unclear if the economic growth that results will be enough to carry President Trump to a second term. A vibrant economy is generally the most important indicator for an incumbent president’s election win. This may or may not play out this year, given the uncertainty over the success of the economic reopening, coupled with strained U.S.-China relations and widespread social unrest. While the U.S. economy appears poised to recover, the timing remains unclear, and the path likely will be full of twists and turns. We believe voter perception of how President Trump manages the economy’s reopening is key to his reelection bid.

Key takeaways

- May’s upside labor market surprise reflects a gradual resumption of economic activity. Yet, more than 20 million workers continue to receive unemployment benefits.
- Caution is in order as the U.S. economy recovers from unprecedented unemployment levels, while enhanced unemployment insurance and the Paycheck Protection Program start to wind down.
- While the economy appears poised to recover, the timing is unclear, and the path likely will be full of twists and turns. We believe voter perception of how President Trump manages the economy’s reopening is key to his reelection bid.

15 U-3 versus U-6 unemployment rates: U-3 measures workers actively seeking employment, while U-6 includes unemployed, underemployed, and discouraged workers.
Risk Considerations

Forecasts and targets are based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. Stock markets, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. The prices of small- and mid-cap company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

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