Q4 2020

QUARTERLY OUTLOOK

By #SAXOSTRATS

The US Election

SAXO GROUP

Q4 2020

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Q4 brings us a US election cycle like none we have seen in our lifetime

By Steen Jakobsen

We fear that the US election is the biggest political risk we have seen in several decades, as the end of the economic cycle meets inequality, social unrest and a market feeding frenzy driven by the policy response to this deep economic crisis: zero interest rates, infinite government and central bank support. The massive official backstop, with guarantees for demand and jobs in a world of state capitalism, means that markets and individual freedom have never been more under attack.

In nature, a pandemic or ecological crisis would have resulted in adaptation. But in our human systems, we are providing all manner of artificial injections of stimulus in a vain effort to pretend that things can stay the same. This is brutally reflected in the two choices for US President American voters are presented with in the November 3 election: very old men with no vision for the future.

> **"We get the feeling that a large majority continues to 'feel' and think President Trump will come from behind once again"**

Being more practical at Saxo Bank Group, we see three distinct paths and probabilities between now and the Inauguration day on January 20 2021:

1) A contested election – probability 40%
Results:
- Spike in volatility
- Sell off in equities due to uncertainty
- Weaker US Dollar
- Strong Gold

2) A clean sweep by Biden – probability 40%
Results:
- Sell off in equities, particularly in technology (tax increases, focus on monopolies)
- Rally in green stocks
- Higher interest rates as 'power of the purse' in controlling both houses of Congress creates fiscal bonanza

3) A win by Trump – probability 20%
Results:
- Volatility increases – four more years of disruption to global order
- Increased China vs. US tension
- Relief rally
- Two houses most likely split, which will mean little fiscal stimulus ability

At the time of writing, our probabilities are at odds with both polls and bookmakers. The Biden-Harris ticket is odds-on to win the White House, and potentially even get a clean sweep by winning both the Senate and Congress. The math is seriously stacked against President Trump, even more so than it was in 2016, but when talking to investors around the world we get the feeling that a large majority continues to 'feel' and think President Trump will come from behind once again.

We need to side with science, although this kind of science is flawed. Our job is to define consensus vs. reality and here we feel that the market is not properly pricing in both the risks of a contested result – the biggest risk for the markets, whether as a result of the contest itself or Trump's objections and attempts to cry foul – or a clean sweep by Biden. Since both are a risk, this means volatility could rise dramatically.

The US uses a system of Electoral College votes where the winner

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needs 270 votes out of a total of 538 to be elected (with two small exceptions, the majority winner in individual states wins all of the electoral votes for that state, which is how Trump won the 2016 election despite losing the popular vote). Presently, the polls indicate that Biden is at 210-230 electoral votes, with Trump at a sure 110 and the remainder in so-called 'battleground stakes'.

President Trump should not be written off as he can make another comeback if he wins the critical states of Wisconsin, Pennsylvania, Florida and Michigan. Some observers say the election is so close that the ten electoral votes in Wisconsin could make all the difference.

I need not warn you on polls and the dangers of those, which badly missed the final results in key states in 2016. But as Anders Nysteen explains in his election polls rundown, pollsters are supposedly tweaking their techniques this time to adjust for under-represented demographics such as uneducated white males. Time will tell whether the polls prove more accurate this time – one certain difference is that Trump is far more of a known quantity now.

The US election will be determined by how many voters turn up on election day. Remember, only about 55% of Americans vote in US elections. Should women and, especially, young people – now an even larger demographic than in 2016 – decide to register and then show up to vote, we see the Biden-Harris ticket's chances rising significantly, similar to the strong results for Democrats in the mid-term elections of 2018.

Our main message is that the US election will come with increased volatility and risk. Whoever wins will not change the US direction much in aggregate. Both would spend huge amounts of money, both would lean on the Fed for supporting easy financing conditions and neither of them would seek deep reform. So to a large extent, the two Presidential candidates are the diametric opposite of what the US needs.

The US election of 2020 is the sunset of a political cycle driven more by central banks' ability to maintain the status quo through zero interest rates and negative real rates than real political reform. Central banks are increasingly impotent, which will mean that politicians will be in the hot seat for bringing the structural changes that a world of too much debt and inequality require. Neither of these two candidates and their intended policy mix is up to the task, but change will come whether they like it or not, and this is certain to prove the last US election in which a non-visionary President prevails.

My hero Groucho Marx defined politics the best: 'Politics is the art of looking for trouble, finding it everywhere, diagnosing it incorrectly and applying the wrong remedies'.

Do enjoy my talented colleagues' contributions on the US election.

"To a large extent, the two Presidential candidates are the diametric opposite of what the US needs"

Steen Jakobsen, Chief Economist & CIO

Steen Jakobsen first joined Saxo Bank in 2000 and has served as both Chief Economist and Chief Investment Officer since 2009. He focuses on delivering asset allocation strategies and analysis of the overall macroeconomic and political landscape as defined by fundamentals, market sentiment and technical developments in the charts.

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USD bulls and bears may be in for a rough ride in Q4

By John J. Hardy

The backdrop going into Q4 looks challenging for any smooth continuation of the USD sell-off. US political dysfunction and the risk of a contested US election will have the market holding its breath until election day. Post-election uncertainty, meanwhile, could drive a fresh spike in two-way volatility across markets and lead to many a false start for USD bull and bears, possibly into the New Year.

In Q2, the Fed and the US Treasury's twin howitzers of easing and enormous cash drops on the US economy helped turn a spiking USD back lower, and early Q3 saw a continuation of that move. That took the US dollar to levels around 2-3% below its pre-virus range. The USD sell-off began easing in late summer, though, as the Fed stopped growing its balance sheet on a surprising strong growth rebound and the path to further fiscal stimulus was blocked by US political dysfunction. This theme is likely to persist for much, if not all, of Q4. Another contributor to USD resilience in Q3 was that the US found itself with plenty of company as Covid-19 resurgences popped up nearly everywhere, especially in Europe, threatening renewed anti-virus measures there and hampering tourism for Club Med.

> **"A potential government shutdown and weak risk sentiment both tend to support the US dollar"**

As Q4 rolls into view, the spectacle of the US election dominates the horizon for traders across asset classes. The lessons of 2016 are preventing strong market confidence in the outcome – with trust in the polls one very prominent issue, as Anders points out in his excellent piece. The novelties of this election include its patchwork of different state voting systems – many of which will be expanding mail-in voting far beyond their accustomed capacity – as well as the unknown of how virus considerations will impact voter turnout across different demographics.

USD bulls and bears may be in for a rough ride in Q4

One thing that is less likely to repeat this time around is the decisive clarity that emerged in a matter of pivotal minutes on election night in 2016. Then, it became clear that Trump would win the election and both houses of Congress, which would enable him to pursue a full-fledged anti-regulatory, tax-cutting, growth agenda.

Between now and election day, it will be supremely difficult to extract a signal from the noise and for the market to put much confidence behind its election predictions or US-dollar view. This could lead to choppy trading until at least election day, with the strong risk of a contested outcome – and the back forth headlines that would come with it – amplifying volatility until a victor emerges.

Poisonous partisan politics is holding up new stimulus for those who have lost the most in the 'K-shaped recovery', and are at risk even on the level of food security and eviction from their housing. As we are writing this outlook, the showdown over whether Trump will nominate a very conservative new Supreme Court Justice to replace the liberal Ruth Bader Ginsburg is even threatening a disastrous government shutdown.

These disruptions, when the economy and so many of its participants are dependent on support, are negative for the greenback and invite further Fed easing. But then again, a potential government shutdown and weak risk sentiment both tend to support the US dollar. The JPY might be a strong winner across the board in the worst-case scenarios for the US election, and showed signs of coming to life after a long period of dormancy with the announcement of Shinzo Abe's exit in September.

Contested election or a strong Biden win?

The chief difficulty when analysing the market impact of the 2020 US election is that no scenario leads to an immediately obvious outcome.

Some might see the reaction to a Trump victory echoing what unfolded in 2016, when the USD surged on the anticipated pro-growth agenda, as such an outcome avoids any threat of heavier regulation or the raising of corporate tax rates that Biden has promised. But if Trump wins by a narrow margin with a repeat of 2016's popular vote loss, it could lead to social unrest unprecedented since the 1960s. Democrats could cry foul over charges of voter suppression and Trump's style of zero sum politics, which has supercharged animosity on the progressive left. The backdrop of 'choose-your-reality' media outlets and toxic social media also weighs in the mix.

Equally, a Biden victory without the Democrats taking the Senate – entirely possible if Biden's win is a narrow one – will keep the partisan stand-off firmly in place and prevent Biden from realising any portion of his party's platform.

So, a contested election is neither here nor there for the USD but gets more USD negative if the situation turns ugly and spills into 2021. And a narrow victory by either party without both houses of Congress is also USD negative as Congress won't pass anything and the Fed will have to challenge the outer extreme of its mandate – and beyond – to support any recovery.

As of writing in late September, a strong Biden victory and the return of the US Senate to Democratic hands does appear to be the most favoured scenario, even if an overwhelming margin of victory is likely needed to avoid a week or more of Trump contesting the election.

Here, the reflexive logic that Biden with both houses of Congress is bad for the USD may not prevail. Select US assets will be hit negatively by a Biden victory, as discussed by Peter Garnry in his outlook for US equities. But a Democratic clean sweep is likely to lead to a very powerful fiscal impulse that will drive the detmand side of the US recovery far more than Trump-style deregulation and tax cuts ever could. This approach eventually drives inflation and even stagflation, but could actually lead to a stronger US dollar for a quarter or two first. Biden has promised tax raises for corporates and high earners, and we shouldn't forget that Democrats have been far more fiscally prudent than Republicans in recent decades.

Aside from the intense focus on the US election and its implications for the US dollar, the dominant issue hanging over everything is of course Covid-19. Specifically, whether the coming of fall and winter will bring an resurgence in infections and whether a younger demographic, better treatment or a mutating virus are the drivers of the apparent reduction in the fatality rate.

USD bulls and bears may be in for a rough ride in Q4

If vaccine candidates are not beginning to show promise at the end of 2020, we risk a deepening second dip in the global growth outlook. This will put an enormous dent in the reflationary narrative that purred to life in Q3, amid recovering commodity prices and support for commodity-linked currencies in EM and DM.

The path to a traditional global reflation trade, driven by a weaker US dollar and fresh credit cycle, will be frustrated as long as the virus continues to hold back the demand side of the economy and as long as fiscal authorities fail to force inflation high enough to outpace the real load of global debt. The initial policy response to the Covid-19 crisis only added perilously to the growing pile.

Brave new world of FX?

That brings me back to some thoughts I aired in April, when outlining a framework I described as the 'brave new world of FX'. I tried to anticipate what would move exchange rates over the medium to long term in a world where central banks have flattened rates more or less to zero, and where they are even threatening – or have already started – yield curve control (YCC) on top of QE.

The point of a QE-plus-YCC policy mix is the avoidance of price discovery for the price of money. It is the great enabler of fiscal policy to do whatever it wants, only limited by inflation, as governments will increasingly discover. In that future, the chief fundamental that matters is the real interest rate – which goes negative when inflation exceeds interest rates on government paper. With no price discovery in government bonds (central banks must always ensure that governments can fund themselves as an all-important first priority), discipline is only enforced by the exchange rate – perhaps the last valve for price discovery down the road. In short, in a world of fiscal forcing, FX volatility could expand significantly.

> **"With no price discovery in government bonds, discipline is only enforced by the exchange rate"**

As a footnote, the Fed's new 'Average Inflation Targeting' policy is a preannouncement of its own irrelevance and really just what it thinks it should have done in the last cycle. The US government and other governments globally will begin to flex their MMT muscles to deal with the ongoing fallout from the Covid-19 disaster, only stopping when inflation and exchange rate considerations become too painful to bear. A country that doesn't want to play the game suffers the consequences of excessive currency strength: eventual erosion of export industries, domestic asset bubbles and more. Welcome to the brave new world of FX.

@Johnjhardy

John Hardy, Head of FX Strategy

John Hardy joined Saxo Bank in 2002 and has been Head of FX Strategy since October 2007. He focuses on delivering strategies and analyses in the currency market as defined by fundamentals, changes in macroeconomic themes and technical developments.

How to structure your equity portfolio post US election

By Peter Garnry

The second economic crisis in just 12 years, coming just as the wound from the first crisis has healed, has pushed policy to the event horizon of macro. Never in history have global interest rates been pushed so hard towards zero across so many countries, with massive increases in fiscal deficits on top of historically high debt levels.

What lies on the other side of all this? Nobody really knows. But the world is likely in for some exciting and unpredictable years, not least because of the US Presidential election on November 3.

Global equities need a significant jump in earnings

Aggressive policy action in the first half of the year by central banks and governments has engineered a strong rebound in equity markets and a general belief that the world will overcome the Covid crisis with less damage than from the 2008 financial crisis. Global equities have fully recovered their losses during the pandemic's first wave, despite global corporate earnings collapsing by 56% – catapulting the P/E ratio to 27.7x at current price levels.

Expectations are high going into the third quarter earnings season, with estimates suggesting a 106% jump in quarterly earnings, which will then continue to climb until reaching a new all-time high in the fourth quarter of 2021. If the corporate sector delivers this rebound in earnings, the global equity market will be valued at 19.3x earnings in 2021. Not an unreasonable valuation given the alternatives in bonds.

SOURCE: BLOOMBERG AND SAXO GROUP

How to structure your equity portfolio post US election

So how likely is it that corporate earnings will rebound so strongly? The New York Fed Weekly Activity Index, a real-time tracker of US economic growth, has shown a strong V-shaped recovery since late April: although it is still at -5% as of mid-September. At the current trajectory, the world's largest economy will be back into growth territory before year-end.

The number of permanent job losses has jumped from 1.2 million before Covid to 3.41 million in August 2020, which is high but still nothing compared to 2008, where the number jumped from 1.49 million to 6.82 million (and that was from a lower labour market size than today). According to CPB, world trade volume rebounded 7.6% m/m in June and is on track to continue rebounding. This indicates that things are normalising, even though global trade is in its worst period since the GFC.

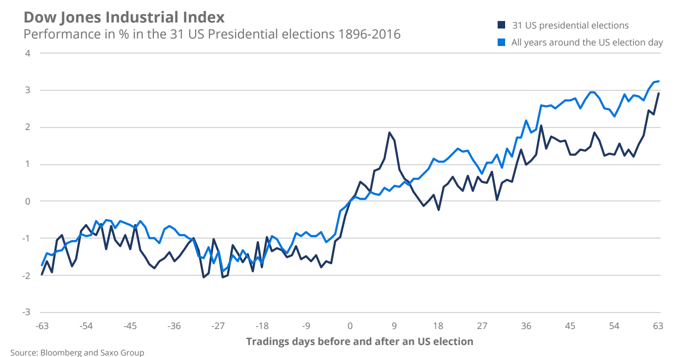
> **"The two most important factors for investors over the coming decade will be inflation and volatility in both financial markets and the economy"**

The various data points that we have at this point skew the probability towards a rebound of corporate earnings to pre-Covid levels within the next 18 months, but the long-term growth rate from that point on is much more uncertain. The two most important factors for investors over the coming decade will be inflation and volatility in both financial markets and the economy. These subjects will be covered in detail in the coming quarterly outlooks.

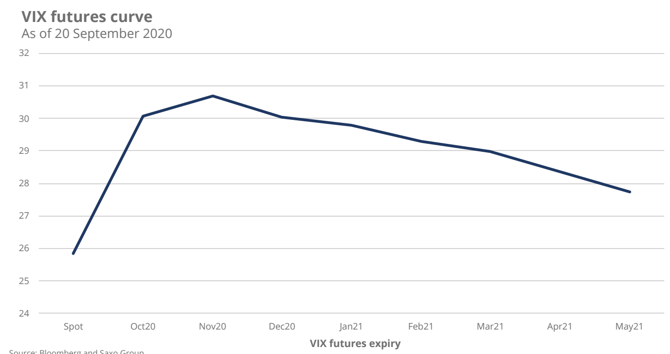
US elections have little impact on equities but the VIX curve says this one is different

We have looked at all 31 US presidential elections in the period 1896-2016 to make sense of US equity market performance before and after an election. On average, the US equity market measured by the Dow Industrial Jones Index is flat ahead of US elections and then tends to rise around 3% after.

If we measure US equity market performance in all years during the period 1896-2016, including US presidential election years, then we observe the same average tendencies. A rising US equity market post elections is therefore most likely not a function of election outcomes or related sentiment thereof, but potentially a seasonal effect in the months November, December, and January. However, if one draws 29 out of the 31 elections at random, occasionally the 'seasonality' effect disappears. In other words, the statistical robustness of this effect is fragile to sampling.



We also looked at daily volatility during the 63 trading days before and after each US election. In the 31 presidential elections from 1896-2016, we observed an average daily volatility of 0.98% before an election and an average daily volatility of 1.01% after. This difference is not statistically significant, however, and as thus we cannot say that elections add to volatility.



The daily volatility of 1.01% after US elections corresponds to around 16% annualised, and is therefore much lower than the current implied volatility measured

How to structure your equity portfolio post US election

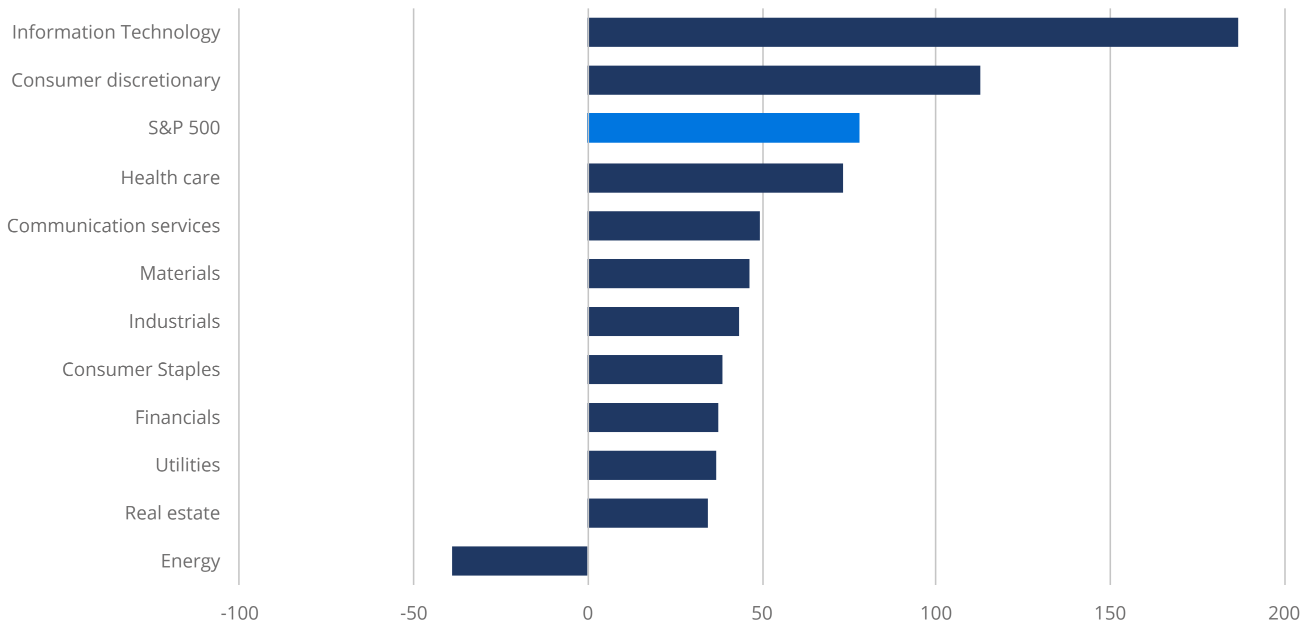
by the VIX futures curve. Here, we observe implied 30-day forward volatility annualised above 30 for the months October, November, and December. Only the elections in 1916, 1932 and 2008 have seen higher realised volatility: implying that current VIX pricing discounts a true tail-risk scenario. In the event of a contested election, or if Biden wins, it could very well turn out that volatility was in fact cheap prior to the election.

US equity market during the Trump years and Biden's potential tax drag on earnings

Wall Street analysts got it all wrong arguing in 2016 that a Trump victory would be bad for equities. The US equity market has done quite well during the four years with Trump, despite increasing tension between the US-China that has caused friction for US companies around their global supply chains.

Most of the gains have come from only three sectors: information technology, consumer discretionary and healthcare. These sectors, together with communication services (which were expanded to include social media companies in September 2018), benefitted the most from Trump's corporate tax reform in 2017. Traditional sectors such as energy, financials, and real estate that one would have thought would have done great under Trump have been among the worst performers. Energy is in fact the only sector with negative returns during the Trump years.

Trump's corporate tax reform is also key to understanding why a re-election is likely the best option for the equity market. Market participants are now used to Trump's persona and the corporate sector has, in many ways, benefitted from Trump's policies of lower taxes and less government oversight. Even the US-China relationship is to some extent predictable for companies and investors under a Trump administration.



SOURCE: BLOOMBERG AND SAXO GROUP

How to structure your equity portfolio post US election

A Biden win, on the other hand, could become a headwind for equities as Biden has proposed to hike the statutory tax rate from 21% to 28% on corporate income and increase the GILTI (Global Intangibles Low-Tax Income) tax from 10.5% to 21%. In addition, Biden has proposed to hike the minimum corporate tax rate to 15% and add a social security payroll tax on high earners. Combined, it is estimated that these tax changes would create a 9% drag on S&P 500 earnings – and that is before second-order effects, including change in investor sentiment, potentially hit valuations.

> **“There are reasons to suspect that momentum could reverse on Biden’s tax changes”**

The two tax changes with the highest impact are the statutory and GILTI tax hikes. These would hit communication services, healthcare and information technology the hardest, as those companies have the lowest tax rates in general and are big users of intangible assets. As these sectors have fueled the equity market, there are reasons to suspect that momentum could reverse on Biden’s tax changes. The open question is whether Biden dares implement the tax changes during a weak economic backdrop.

US election baskets

The table shows our current best guesses on the market impact in the event of a Biden or Trump win on November 3. Overall, it probably does not make that big a difference whether Biden or Trump wins longer term. It matters more if the Democratic Party makes a clean sweep.

Despite the overall picture, some industries are likely to thrive depending on which candidate wins. These are our best guesses at present and could change as the market reveals the true Trump/Biden trade post the presidential debates.

Equity impact post US elecion if...

Biden wins	Trumps wins	Contested
Green energy much higher	Oil & gas industry will jump	Broad equity sell-off
Oil & gas will be lower	Small-caps will outperform	Higher volatility
Technology to suffer (GILTI, tax)	Infrastructure stocks higher	Lower valuation multiples
Infrastructure will get a boost	S&P 500, Nasdaq 100 in relief rally	High beta stocks are worst perfomers
Financials could suffer	Chinese technology could sell off	
Marijuana stocks higher	Health care stocks could sell off	

Source Saxo Group

Peter Garnry, Head of Equity Strategy

Peter Garnry joined Saxo Bank in 2010 and is the Head of Equity Strategy. In 2016 he became responsible for the Quantitative Strategies team, which focuses on how to apply computer models to financial markets. He produces trading strategies and analyses of the equity markets as well as individual company stocks, applying advanced statistics and models to beat the market.

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The US election, Covid & commodities

By Ole Hansen

As we head into the final quarter of a year that many may wish never happened, the global pandemic will continue assert a major influence on the performance of different sectors: from energy and metals to agriculture. With the pandemic still developing and a vaccine probably months away, the only thing that remains certain is the uncertainty. It will continue to create volatile and unpredictable market conditions, while geopolitical risks add another layer – not least considering what lies ahead, with the US Presidential election on November 3 probably much closer than what the polls can measure.

Never in history have global interest rates been pushed so hard towards zero across so many countries simultaneously, with massive increases in fiscal deficits on top of historically high debt levels in the global economy. Add to this government attempts to support growth through the spending of money that needs to be printed first, and the outlook for precious and some industrial metals continues to look supportive into Q4 and beyond.

“Never in history have global interest rates been pushed so hard towards zero across so many countries simultaneously”

The combination of central banks actively supporting the return of inflation and the potential for the dollar to weaken further remains key to our general bullish outlook for commodities, especially those that historically have helped preserve wealth during times of raised uncertainty and inflation.

The year to mid-September performance among some key commodities tells a story about strong demand for precious metals amid the global collapse in rates and the rising risk that inflation will emerge to render government bonds already trading near zero or below useless as a means of safe haven.

The US election, Covid & commodities

Commodity Performance in %

Year to mid-September

Precious Metals
Industrial Metals
Grains
Softs
BBG Comdty Index
Energy Sector
Silver
Gold
Cocoa
HG Copper
Soybeans
Wheat
Sugar
Cotton
Aluminum
Platinum
Corn
Live Cattle
Arabica Coffee
US Natural Gas
Brent Crude Oil
RBOB Gasoline
ULSD (Diesel)
WTI Crude Oil

-80% -60% -40% -20% 0% 20% 40% 60%

Source: Bloomberg Commodity Subindices, Saxo Group

China got the virus first and have subsequently managed a strong, debt-fueled recovery similar to the one seen following the 2008 Global Financial Crisis. The combination of Covid-related supply disruption, financial speculators looking for an inflation hedge and not least very strong demand from China driving down global stocks, have supported a strong year for industrial metals led by copper.

Eventually, we see the steep uptrend in HG Copper from the April low being broken, leading to a period of consolidation which we believe may occur in Q4. On that basis we see the short-term upside for copper as limited, with the potential driver for an extension being a renewed promise of infrastructure spending from the next US President – similar to the one Trump promised, but failed to deliver on, four years ago.

Following a year where gold is up more than 20% and silver double that, it is a bold call to look for further gains, at least in the short term. However, the powerful combination of rock bottom rates, rising demand for inflation hedges and the potential for a weaker dollar all point to further gains. Following a prolonged period of consolidation around and mostly above $1920/oz, we see gold eventually moving higher to finish the year at or near $2000/oz.

Considering we have entered unchartered territory, it is difficult to provide a price estimate for 2021. However, using the decade-old price channel, the target for 2021 could be somewhere between $2400 and $2500/oz, some 20% above the mid-September trading area.

The US election, Covid & Commodities

SOURCE: SAXO GROUP

SOURCE: SAXO GROUP

Silver has struggled to outperform gold after the ratio between the two metals returned to its ten-year average close to 70 ounces of silver to one ounce of gold. Given our positive outlook for gold, we see silver continuing higher, perhaps with a slight underperformance given our neutral view on industrial metals. Platinum's record discount to gold may eventually attract some renewed investor interest, not least considering the outlook for the market moving into a deficit this year. A break below two in the gold-platinum ratio could potentially signal a move to 1.8, a 10% outperformance.

The crude oil market is likely to remain stuck, with Brent crude spending most of the final quarter trading in the 40s before eventually moving higher into the 50s during the first half of 2021. On that basis, we raise our Q3 range by three dollars to a $38-$48 corridor.

The battle between OPEC+ production cuts and an uncertain demand outlook escalated in September, with Saudi Arabia showing their growing frustration about crude oil's inability to rally further. It led to strong verbal intervention by the Saudi Energy Minister, who blamed cheaters and short sellers for the lack of progress. While cheating is a clear problem that needs to be addressed and short sellers may move the market for a short period of time, fundamentals which are currently weak amid an abundance of fuel and low demand will always be the main driver.

We remain cautious about crude oil's short-term ability to rally much further, unless OPEC+ surprises the market by abandoning its planned 2 million barrels/day production increase set for January. While the U.A.E, a major recent laggard, will cut production again, some concerns linger with regards to Iraq, a notorious cheater, and Libya, which will try to increase production following its ceasefire announcement.

"The crude oil market is likely to remain stuck, with Brent crude spending most of the final quarter trading in the 40s before eventually moving higher"

Ole Hansen, Head of Commodity Strategy

Ole Hansen joined Saxo Bank in 2008 and has been Head of Commodity Strategy since 2010. He focuses on delivering strategies and analyses of the global commodity markets defined by fundamentals, market sentiment and technical developments.

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Sovereign debt bubble poses threats amid US election and rising inflation

By Althea Spinozzi

Central banks worldwide are increasing their accommodative measures, in the form of quantitative easing and helicopter money, to resolve deep economic problems. To date, this has contributed to high stock markets and low interest rates both in Europe and in the United States. Even though an investor might have benefitted from the bullish market this year as the coronavirus pandemic was losing steam, there will be a reckoning.

The reckoning is going to stem from the US election and inflation, and bonds will be the first assets to suffer from it. Now more than ever, it is crucial to think about portfolio allocation and inflation hedges, to defend capital while we are witnessing to a debasement of fiat currencies.

> **“Buying government bonds today means locking in such a low yield that, if inflation rises, the bond’s value will fall”**

Sovereigns – a pressure cooker about to explode

Because near-zero interest rates don’t give any protection against rising inflation, sovereigns are the worst assets you can hold in your portfolio right now. Buying government bonds today means locking in such a low yield that, if inflation rises, the bond’s value will fall. It won’t help to hold the bond until maturity, because inflation will eat up the small coupon that one is receiving together with the principal.

At the same time, government bond volatility worldwide is at its lowest point in history. This makes these securities even harder to trade – because in order to benefit from a one-basis-point shift, one needs to leverage their position massively.

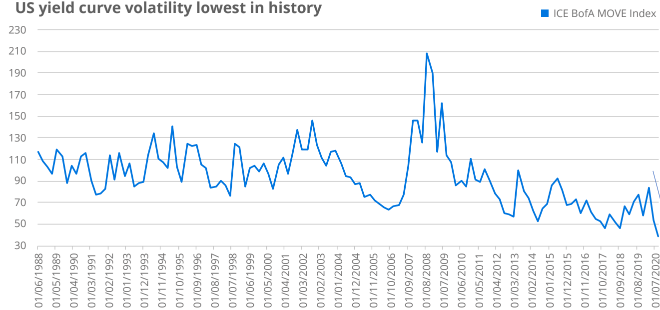
We believe that US Treasuries today are the biggest mousetrap of all time. They do not provide any long-term upside, and the yield curve is doomed to steepen faster than expected due to inflation. Within the context of the US election, however, there might be space for short-term trading opportunities. We anticipate a bull-flattener US yield curve if Biden wins, and a bear-steepener if Trump wins.

We are quite solemn about inflation. There is so much focus on reviving it that at a certain point, it will rise. And when it is on the rise, it will be

Sovereign debt bubble poses threats amid US election and rising inflation

unstoppable because monetary policy will be the only tool to slow it down. Central banks cannot count on fiscal policy, because it is political.

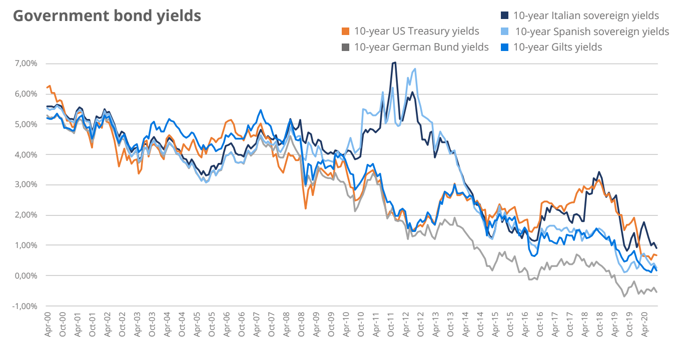
What is happening now is that the US government is putting money directly in the pockets of families to avoid a blown-out crisis amid the coronavirus pandemic. Families that need money spend money as they receive it. Thus, inflationary pressure increases. If inflation is suddenly on the rise, what can the next US President do? He can't take the money that has been given to families back, because this would make him extremely unpopular. So helicopter money will stay, inflation will continue to rise, and the Fed alone will be trying to stop it.



SOURCE: BLOOMBERG AND SAXO BANK

Even though there is a chance inflation will remain subdued in the last quarter of the year, we have to consider that volatility might rise amid a second wave of Covid-19, which may affect sovereigns' performance. While the coronavirus pandemic has been beneficial to US Treasuries and the Bund, the yields of riskier sovereigns jumped significantly. The most remarkable example is Italy, which at the moment is offering the lowest yield it has ever paid since joining the euro. Before coronavirus, the 10-year BTPs were offering around 1% in yield. At the peak of the pandemic, they were offering close to 2.5%.

Italian sovereigns are perceived as a risky asset by the market, so whenever there are troubles, investors sell BTPs and buy the Bund. Now that Italian BTPs have tightened to pre-pandemic levels, we believe that there is more downside in holding these securities than upside. When trading, it is crucial to understand when to take profit and when to take a loss. Now that the market is high, it is time to sell in order to reposition for what's to come. We believe this is especially true for sovereigns from the European periphery: Spain, Italy, Portugal and Greece.



SOURCE: BLOOMBERG AND SAXO BANK

Credit deterioration means downgrades and defaults are on the way

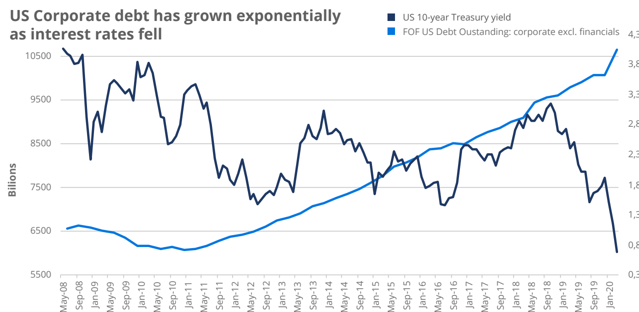
Since the 2008 financial crisis we have seen central banks all around the globe trying to contain market volatility. Unconventional tools have been implemented to guarantee both liquidity and favourable economic conditions. None of these policies succeeded in treating a sick economy. With the advent of the coronavirus pandemic, central banks that were hoping to tighten the economy instead had to stimulate it even further.

> **"Investors are getting more and more attracted to risk. As credit deteriorates worldwide, this behaviour will have severe consequences"**

Over the course of the last decade, more and more corporates have been taking advantage of the economic situation by gearing up their balance sheet. Financing is getting cheaper and cheaper, and investors are getting more and more attracted to risk. As credit deteriorates worldwide, this behaviour will have severe consequences in the corporate space. We believe that a second wave of coronavirus pandemic and the US election could be the triggers for a large number of corporate downgrades and defaults. This is the reason why we recommend

Sovereign debt bubble poses threats amid US election and rising inflation

investors to be cautious and cherry-pick risk as we enter the latest quarter of the year.



SOURCE: BLOOMBERG AND SAXO BANK

US election: predicting US corporate bond performance in the last quarter of the year

Trump wins

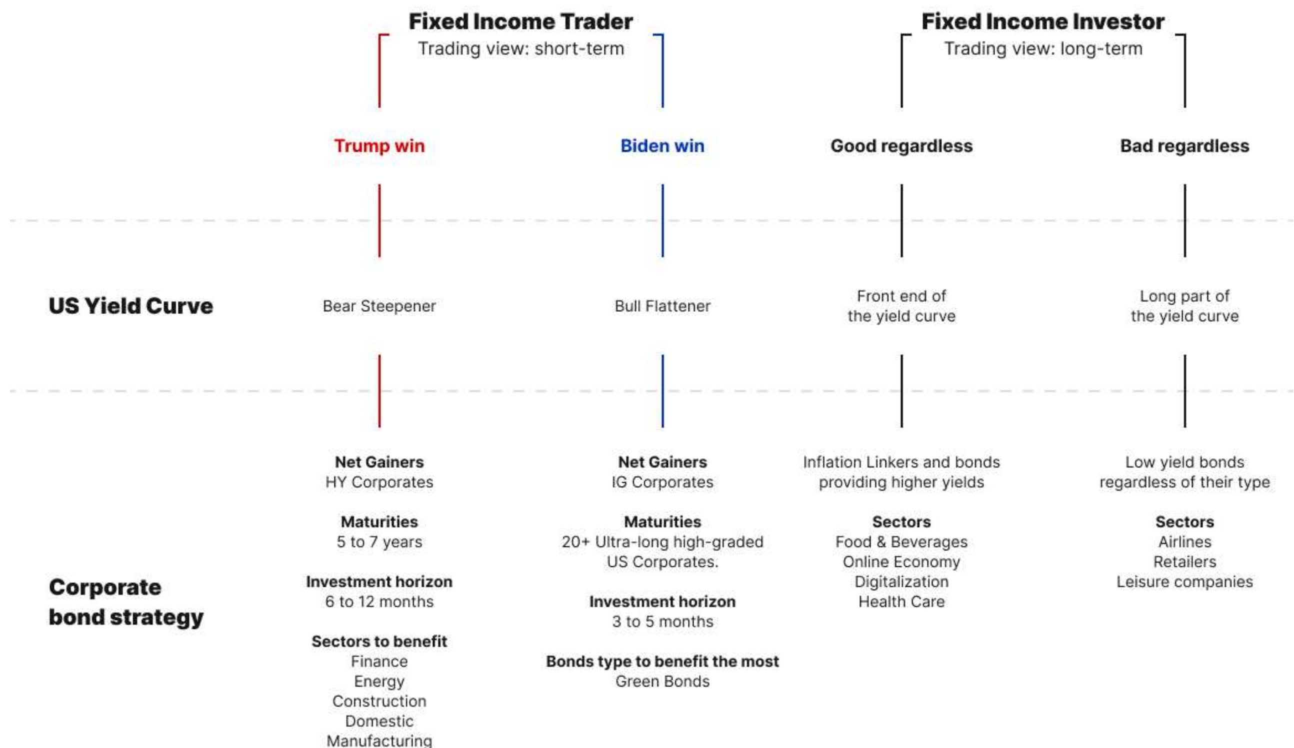
We can expect a copy and paste of what we have seen in the past four years: deregulation, lower corporate taxes and a focus on domestic production. In this context, we favour financials, infrastructure, energy and domestic industrials and manufacturers. Junk bonds have a higher upside potential. However, even though we don't mind lower-rated bonds, we still prefer mid-term maturities up to seven years to limit inflation headwinds.

Biden wins

The market will perceive a Biden win as a credit negative. We expect weakness in the sectors that have benefitted from deregulation and low corporate taxes under the Trump administration. In this scenario, we prefer higher-quality bonds to take advantage of short-term volatility that will induce investors to fly to safety. We believe that the market has not priced a Biden win yet – this is why volatility will be high. But this situation will not last for long. Investors looking for longer-term investments should explore opportunities in the green bond space.

Contested election

Because this year will see a rise in postal ballots due to the coronavirus pandemic, there is a high probability of a contested election. In this scenario, safe-haven assets will be in the spotlight and will surge in value for as long as there is no clear winner. In this context, ten-year Treasuries and long-term, high-quality investment-grade bonds are the ones to benefit the most. Once there is a clear winner, we can expect the bond market to behave as we have indicated in one of the scenarios above.



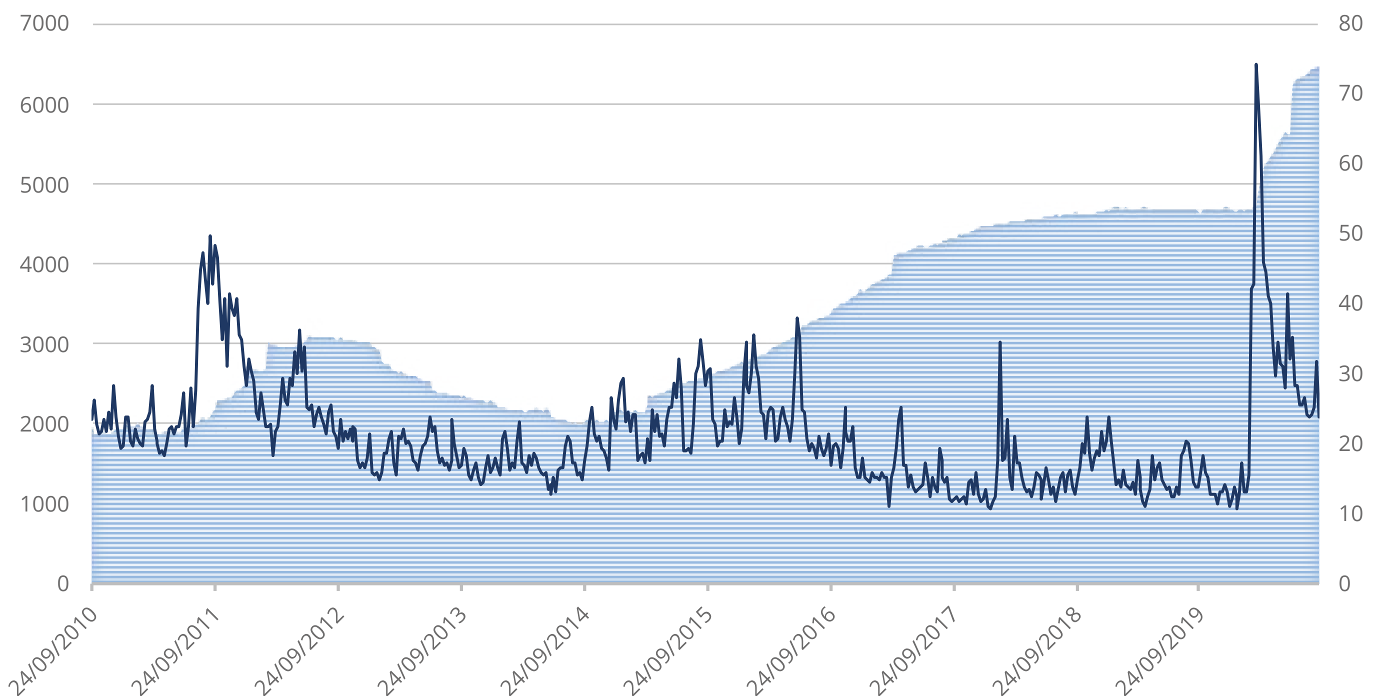
Sovereign debt bubble poses threats amid US election and rising inflation

EU corporate bonds – beware the second wave of coronavirus

There are compelling opportunities both in the investment-grade space as well as the high-yield space within European corporate bonds. As a matter of fact, corporate spreads have tightened since the coronavirus pandemic, but continue to be wider than pre-crisis. It is important, however, to locate bonds that will prove to be resilient amid the second wave of Covid-19. We find the lower investment-grade space and better rated high-yield corporates to be the most interesting. A combination of central bank stimulus and economic recovery will favour bonds of those sectors that have been harshly hit by the pandemic.

In a complex fixed income market, cherry-picking and caution will reward investors

Although we see numerous challenges in the fixed income world, we believe that investors can still be successful in trading bonds. We recommend investors to select risk carefully as there are clear signs of weakness in the market. In this environment, it is crucial to choose duration carefully as credit spreads might tighten further in the short term, but surprise negatively in the long run.



Source: Bloomberg and Saxo Bank

Althea Spinozzi, Fixed Income Strategist

Althea Spinozzi is a sales trader at Saxo Bank, and specialises in fixed income products within the global sales team. Spinozzi joined Saxo Bank in 2017 and maintains an active approach in bond trading focusing on maximising total return. Because of her background in leveraged debt, she is particularly focused on high yield and corporate bonds with attractive risk and return.

@Altheaspinozzi

Getting green done

By Christopher Dembik

For the first time in the US Presidential election, climate change is emerging as a major theme – along with the economy, racial tensions and police brutality. Public awareness has been raised by growing evidence of man-made climate change in the recent period. In the month of August alone, the United States recorded an average temperature higher than the 100-year average. In the past September, dramatic fires have devastated acres of forest and homes in the eastern United States. Climate change-related events are becoming more frequent and more violent.

There is no longer any question of denying climate change and even President Trump, who has been quite skeptical in the past, is keeping a low profile. Climate change is now a political issue that can generate substantial change on election day, which was not the case in previous presidential elections. According to political science professor Jon Krosnick from Stanford University[1], who has been working on election polls for over twenty years, 25% of Americans will vote for a candidate based on their climate change agenda: a record high for the issue. Only abortion is viewed with more importance, with 31% of voters basing their decision on it.

> **"25% of Americans will vote for a candidate based on their climate change agenda: a record high for the issue"**

On the sole issue of climate change, the Democrats are better positioned than the Republicans. In mid July, Joe Biden presented his ambitious climate plan worth about $2 trillion, or 2.5% of GDP, over four years. Here, we discuss in a Q&A format the details of the plan – and its implications if Biden is elected.

Q.
What are the main proposals of Biden's $2 trillion climate plan?

A.
For the Democrats, the $2-trillion climate plan is both a way to address the impact of climate change on daily life and to create new jobs to offset losses from the pandemic. Its core goal is to reach carbon neutrality no later than 2050, with better energy efficiency and increased electricity generation from nuclear and hydropower. It also plans to create millions of jobs by making infrastructure more resilient to natural disasters (i.e. coastal restoration, large-scale tree plantings, renovation of bridges and roads, etc.).

[1] Krosnick J. A. & MacInnis B. (Aug. 2020). *Climate Insights 2020. Surveying American Public Opinion on Climate Change and the Environment.* Resources for the Future. https://media.rff.org/documents/Climate_Insights_Overall_Trends_Final.pdf

Getting green done

The plan does not include a carbon tax at the federal level to contribute to reducing greenhouse gas emissions, as that is still object of debate within the Democratic Party. But Biden does want to recommit to the 2015 Paris agreement, which aims to prevent the global temperature from rising more than 2°C above pre-industrial levels this century.

Q.
After almost five decades of hesitation, the Democrats have finally embraced nuclear energy as a way to fight climate change. Why is this revolutionary?

A.
Because this is a major change of heart. This is the first time since 1972 that the Democrat electoral platform refers positively to nuclear energy as a way to be less dependent on fossil fuels. The Democrats have finally adopted a pragmatic approach, recognising that current renewable energy technology is simply not up to the task and that the nuclear energy, which is carbon-neutral, is part of the answer to mitigate climate change.

Going green with nuclear energy often raises public concerns about global safety (in link with the Three Mile Island accident in 1979 and the more recent Fukushima Daiichi nuclear plant disaster) and some question whether it is green enough to be part of a green new deal. For Biden's team, the answer to that question is yes.

Regarding safety, the Democrats are counting on new, more secure technologies – such as reactors using molten salts or liquid metals – to win public support. However, there is still a long road ahead to transform this support into new investments to extend the life of existing reactors and create new ones (two reactors are currently under construction).

Q.
The Democratic green platform sets an objective of producing 100% of electricity without fossil fuels by 2035. Is it realistic?

A.
As of today, two thirds of US electricity comes from fossil fuels, versus 20% from nuclear (which accounts for nearly 63% of carbon-free electricity generation) and 18% from renewable. Reaching the threshold of producing 100% electricity without fossil fuels on such a short timeframe is ambitious, and supposes constant electricity demand and a massive increase in capital expenditure – notably in the field of nuclear energy, where investment have severely declined since 2015.

> **“Under Biden, we see the emergence of new incentives to move towards stronger requirements, as is already the case in the EU”**

Q.
What are the implications for the Fed and the financial markets?

A.
Addressing climate change implies setting up the base of a green financial system that will be able to directly finance the Democrats' ambitious green platform. Today, most ESG-related policies and regulations remain voluntary (“comply or explain”) and are largely dependent on assets owners' views on ESG investing. Under Biden, we see the emergence of new incentives to move towards stronger requirements, as is already the case in the EU (with the EU Action plan on sustainable growth and the EU taxonomy which specifically addresses the issue of green bonds and low-carbon benchmarks).

The Federal Reserve will have a very specific role to play in this new financial infrastructure and may integrate climate change across its mandates more explicitly – a process that has already started. It could take steps to favour green transition as part of its oversight of financial institutions, for instance via raising capital requirements for fossil energy project loans or lowering requirements for green ones.

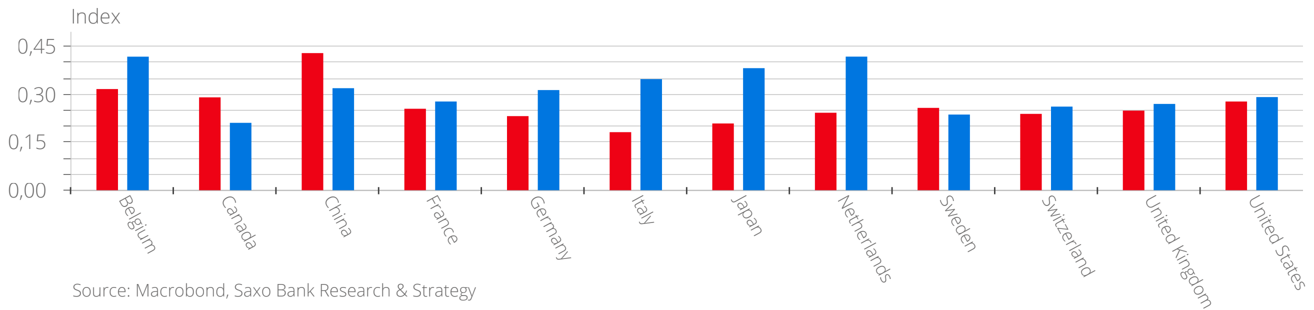
Getting green done

Appendix:

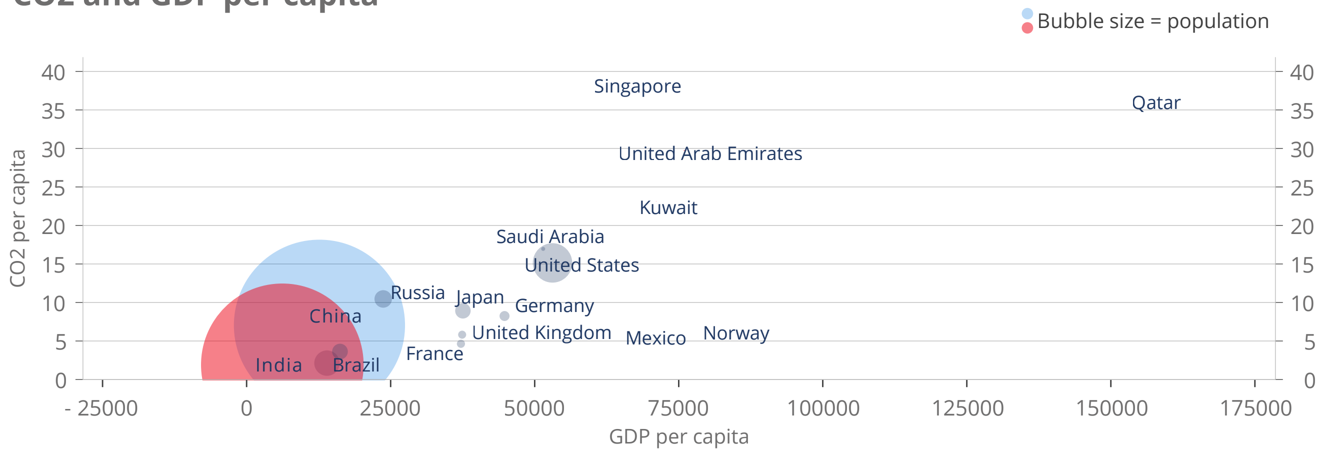
ND-GAIN country index for the G10 countries + China

■ Adaptative Capacity: Availability of social resources for sector-specific adaption.

■ Sensitivity: Extent to which a country is dependent upon a sector negatively affected by climate hazard, or the proportion of the population particularly susceptible to a climate change hazard.

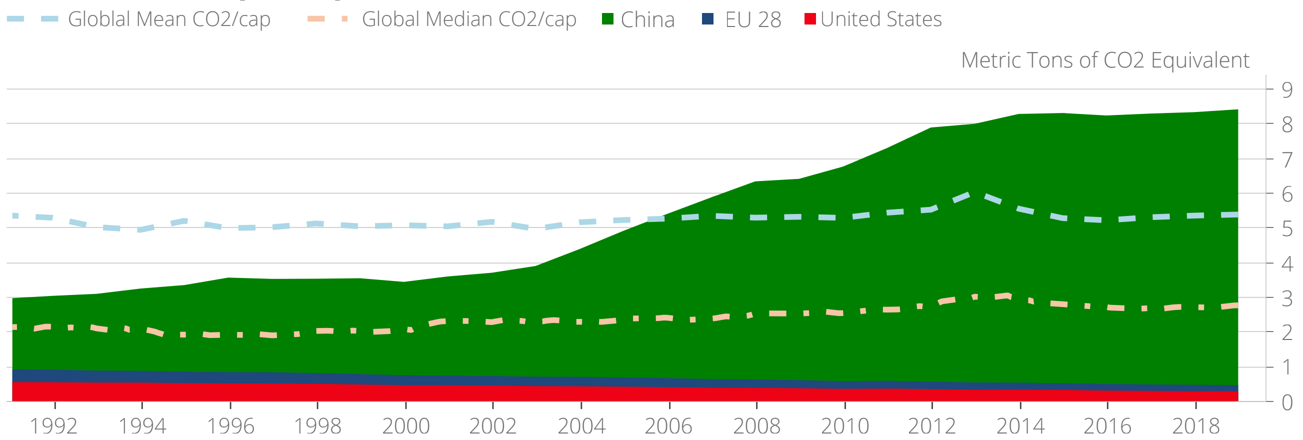


CO2 and GDP per capita



Source: Macrobond, Saxo Bank Research & Strategy

CO2 emissions per capita since 1991



Source: Macrobond, Saxo Bank Research & Strategy

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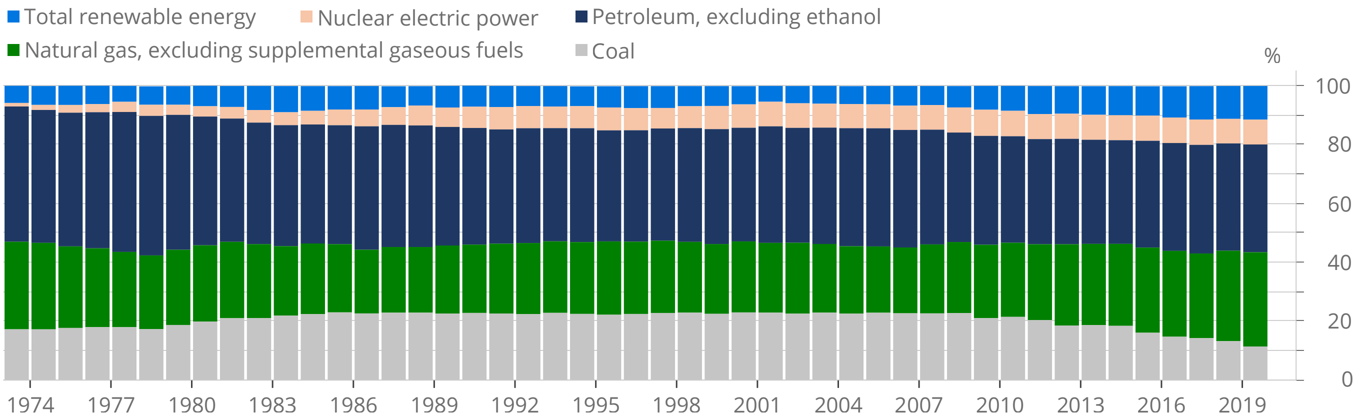

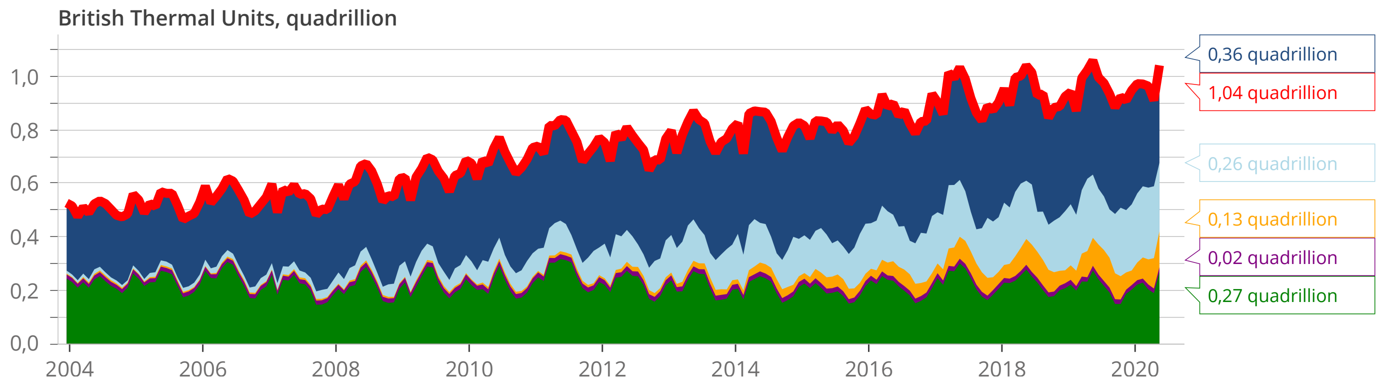

Christopher Dembik, Head of Macro Analysis

Christopher Dembik joined Saxo Bank in 2014 and has been the Head of Macro Analysis since 2016. He focuses on delivering analysis of monetary policies and macroeconomic developments globally as defined by fundamentals, market sentiment and technical analysis.

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Godzilla has left the building...

By Kay Van-Petersen

Japan's one and only true modern-day Shogun in decades, Shinzo Abe – a scion of a powerful political family full of former PMs – resigned in Q3 citing health.

In addition to being Japan's longest serving PM, Abe's legacy will be centred around the orchestrated 'Abenomics' from late 2012. This triad of structural reforms, huge fiscal spending and Godzilla-sized monetary easing saw:

- **Japan get back to inflation, growth and stability** after years of deflation and rotating PMs
- More women joining the workforce (more Japanese women work than their US peers) and increased access for foreign workers
- **USD JPY go from around 77-78 in late 2012 to a high of 125-126 in mid-2015, a ~62% unlevered move** in a G10 currency
- The Nikkei go from **8500 to 21000** in three years
- The BoJ's BS/GDP go from 30% to today's 120%
- **The BoJ taking ownership of** the **majority of all Japanese government bonds** and an estimated **10%-30% of all Japanese equities**

All of this is important in determining two key things. Firstly, despite what policymakers may say, with debt-to-GDP ratios of over 300% and the BoJ's BS/GDP ratio of 120%, the bang for yen has expired way past its due date – especially considering Japan's deflationary forces of a declining population and silver-haired demographics. Negative rates and YCC finally saw the yen cross the line.

At 106, USD JPY today is around 15% below its all-time highs, but still some 35% up from the start of Abenomics. My view (in addition to be a mega-cyclical USD bear) is that for USD JPY, the highs are over and we are more likely to be below 100 (high 90s) than back above 110 before Q4.

Could we see USDJPY in the 85 to 95 range by the end of 2021, as Abenomics unwinds?

Godzilla has left the building...

But the icing on the cake is that having short USD JPY exposure could potentially also be a great hedge if we run into market volatility linked to the US elections.

Secondly, structurally speaking, Japan and the BoJ are at the endgame of what everyone else (including the Fed) is doing. The only difference is that the US is four times the size of Japan, the Fed's BS/GDP ratio is currently around 30% and the USD is a dominant global reserve currency.

> **"Short USD JPY exposure could potentially also be a great hedge if we run into market volatility linked to the US elections"**

All this implies that we could be in for a greater than 150% run in the S&P and a much deeper depreciation in the USD, perhaps up to -30% from the 103 highs of the DXY over the next few years.

US/China, same-same yet different under a Biden administration

A second term for Trump isn't likely to bring too much delta for the Asia Pacific. However, a Biden/Harris win could see two conflicting changes in volatility.

US/CH relations, while unlikely to defrost, are likely to get more stable in regard to agreeing to disagree (meaning lower volatility on trade/commerce). But on the flip side, there could be an increase in volatility from a geopolitical territorial and sovereignty standpoint. A Biden presidency would likely pivot back into Asia – bringing Taiwan, Japan, Vietnam and the Philippines back into focus on their relationships with China.

What tech wars?

The next decade is likely to determine which nations and regions dominate the next big structural upgrade in technology globally. What potentially makes it different this time is the rate of technological advancements – like compounding interest or constantly rising 'tech gamma' in this case – which could lead to a scenario where no one can ever catch up to the number one.

While these leaps are always challenging to conceptualise, try to think about the upgrade of horses in the 1910s to cars, wood to steel tools, oil lamps to electricity.

China seems to be head and shoulders above most of its western peers in understanding that underlying tech infrastructure is going to set the bell curve of a multi-decade competitive edge. And with 1.4 billion people, the second biggest economy in the world and an ability to focus nearly limitless resources, in time this technological shift will be without question.

In essence, in the next decade we are likely to see a fork between a western-led consortium and a China-led consortium on the adoption of NextGen technological architecture. This is the architecture that will power Augmented Reality, Virtual Reality, Artificial Intelligence, Machine Learning and Autonomous Vehicles – in addition to bringing unlimited streaming and cloud software anywhere.

> **"The next decade is likely to determine which nations and regions dominate the next big structural upgrade in technology globally"**

This is likely to have waterfall effects, from chip suppliers choosing sides to beneficiary countries in the likes of Vietnam and Taiwan. While complicated for multinational corporations, from a wider perspective, greater technological competition is likely to be a huge net positive for long-term productivity and quality of growth, as well as acting as a force against the climate crisis.

@KVP_Macro

Kay Van-Petersen, Global Macro Strategist

Kay Van-Petersen joined Saxo Bank in 2014 as a Global Macro Strategist, based in Singapore. He focuses on delivering strategies and analyses across asset classes based on monetary and fiscal policies, global geopolitical landscapes as well as other macroeconomic fundamentals. He also takes into account market sentiment, technical and momentum factors, and corporate bonds with attractive risk and return.

Bubble blowing not the answer

By Eleanor Creagh

This year's US election is all but guaranteed to be chaotic, divisive and unparalleled – not least due to the high probability of a contested outcome, where accusations of fraud from mail-in votes presents legal challenges. The trade then becomes volatility, not direction, as a surge in mail-in voting delays the result, with the added possibility that neither candidate concedes defeat. Under these uncertain scenarios, risk assets will struggle to price the eventual policy path during what could be an extended period of uncertainty.

A lack of courage to address structural inhibitors to diversified inclusive growth in the political sphere is leaving a legacy of worsening inequality and dividing American society. The current platform of 'state capitalism' (or 'corporate socialism') subverting markets in self interest serves an ever-diminishing subsector of the populous. Time is ticking to fix capitalism before calls for socialist experiments grow louder thanks to shifting voting demographics.

From the outside looking in, the question appears to be who to back in a no-horse race? Therefore, the decisive factor lays in the ability to mobilise voters, using turnout as a swing vote.

A lasting legacy of the pandemic has become the entrenchment of prior inequities: worsening income gaps, inter-generational divides and racial wealth disparities. These have laid bare the cost of doing too little.

Neither candidate has a vision that addresses rising inequality. Worse still, both the crisis itself and the policy response have supersized the problem. Not just via asset ownership, but via the pandemic's uneven impact on certain sectors and industries: a dynamic coined the "K-shaped" recovery. Low-skill, low-wage workers who cannot work remotely face a depression-like environment. This is in stark contrast to the highflying technology sector, which has been accelerated by the pandemic.

Winner-takes-all monopsony marketplaces, automation-driven displacement, stagnating wages and the diminishing return of profits to labour over capital already left wealth concentrated in the hands of the few. QE worked (and still is working) to reflate asset prices, but not wages. And the pandemic has disproportionately hit the disadvantaged. Wealth divides are already larger in the US than in any other G7 nation. For the top 1%, incomes have risen by more than 80% (cumulatively) between 1986 and 2016. That has left a hollowed middle, with their contribution to aggregate demand in decline.

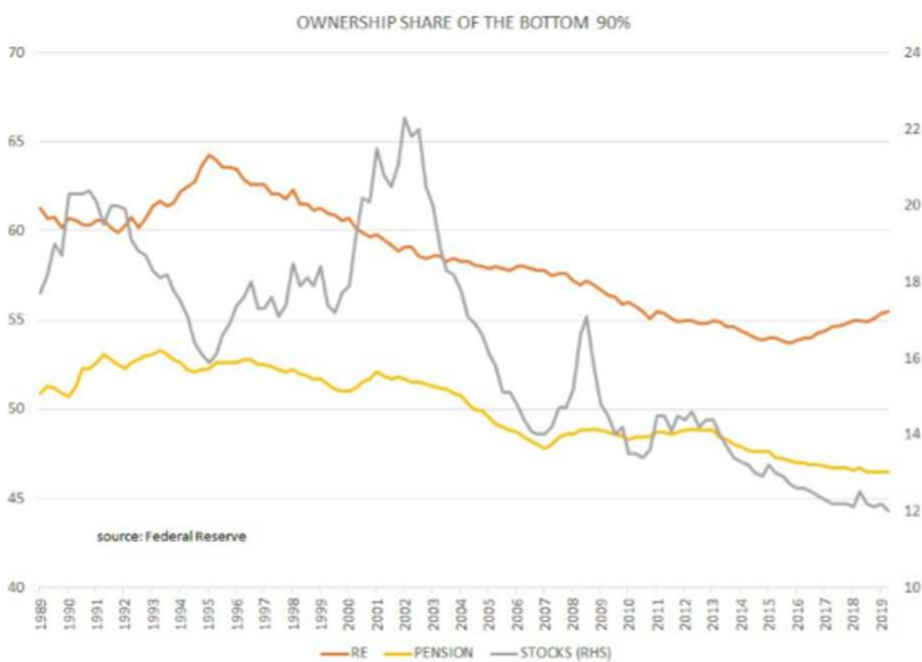
"Time is ticking to fix capitalism before calls for socialist experiments grow louder thanks to shifting voting demographics"

Bubble blowing not the answer

SOURCE: Branko Milanovic https://www.pairagraph.com/dialogue/320a8c4b776b4214a24f7633e9b67795/2

This broken economic model is depicted by fresh highs in stock markets out of touch with reality, contrasted with 'Main Street' where millions of Americans are still receiving unemployment benefits. With the second round of fiscal stimulus MIA, the 'K-shaped' recovery is in full swing – and set to worsen.

Bubble blowing not the answer



SOURCE: Federal Reserve, Bloomberg, A diminishing share of ownership of financial assets fuels wealth disparities

This dichotomy fuels the anger and division that allows politics to be weaponised. Policy makers have become incapable in addressing these problems to promote a more sustainable path; some are seemingly intent on exacerbating them. This can only lead to more volatility and social unrest down the road, and a long volatility stance is a core position.

Unless these structural issues are addressed, income and wealth disparities will continue to spiral – exactly as they did after the global financial crisis – promoting a slower, lower growth path. The cost of a hollowed middle and increased income polarisation is nationwide anger and unrest, increasing stress on economic and political systems. Got gold?

Turnout: the swing vote

The 'have nots' are now left behind by the political ideologies that historically would have supported their cause. The left cosied up with Wall Street and Silicon Valley, forgetting homegrown labour in their pursuit of free trade and open borders. This leaves vast swathes of the electorate feeling abandoned by both parties. In 2016, Trump used this opening to his advantage and adeptly spoke to those who had 'lost their voice', going after the middle of the country as an agent of disruption. Swinging the Electoral College vote, where the system structurally favours Republicans, not the popular vote. With the economic playing field becoming more uneven, we cannot underestimate his capacity to do so once more.

Anger drives turnout, which may swing the result in either direction, regardless of the polling. Therefore, the ability to capitalise on this discontent and win turnout is crucial, given just over half the population vote.

The difference this time is Trump no longer operates as an agent of disruption; he is a known entity. This mechanism in reverse drives voter turnout in support of the Democratic Party. Not necessarily because Biden's platform provides a cohesive vision for the future. But because those who have "lost their voice" with respect to climate action, principles of democracy, international cooperation, and women's reproductive rights, unified by the anti-Trump vote, turnout in force.

A key aggressor could be the capacity of social media to contribute to the increasingly split cultural and political landscape. Social media platforms and their attention-devouring algorithms have become a polarising cesspit of swirling discontent, disinformation, and foreign interference. The "left behind" rust belters pitted against the climate vote, anti-Trumpism and progressives.

In the midterms young people voted overwhelmingly in support of Democratic House candidates. The youth vote provides a crucial swing factor for a Biden victory, amid a concentrated effort by social media networks to re-energise younger voters, where green policy and racial equity are huge drivers. This as Facebook, Instagram, Snapchat, and Spotify have all initiated their own voter registration efforts and

Bubble blowing not the answer

resources in a bid to drive turnout. Although Biden's youth appeal may be less than other candidates, Trump's disdain for climate change stokes anger amongst this voting cohort who demand action on climate policy, leaving them motivated to oust Trump.

However, unless these dynamics can drive a Democratic landslide on election night, the probability of a contested outcome remains high. The problem being, Democrats are far more likely to use mail-in voting. Certain battleground states exclude election officials from beginning to process mail-in votes until election day, therefore Republicans votes are likely to be counted first, leading to a potential election night "red mirage" in which Trump appears victorious before the mail-in ballots are processed.

The ability to seize upon that lead and sow chaos and confusion, with accusations of fraud surrounding the mail in ballots could then see the outcome contested. Trump has already declined to commit to respecting the integrity of the election results, which raises the stakes on instability and volatility. The polarised environment which

> **"With the second round of fiscal stimulus MIA, the 'K-shaped' recovery is in full swing – and set to worsen"**

has only been worsened by the pandemic has already sown the seeds of democratic decay. Setting the stage for civil unrest across a nation already divided by the poisonous hyper partisan political environment. With factions of the population on either side believing the victory has been stolen.

Regardless of the electoral outcome, America itself is divided, making the current election cycle and next political cycle sure to be turbulent. However, hope remains for the increasing polarisation of outcomes to fuel a level of discourse that eventually drives real reform and social change.

Alternatively, we can tune out the noise and ditch the crystal ball. In 2020 we have been constantly reminded that the future, and any forecast, is fickle, but we can focus on themes that make sense either way:

- Climate change
- Fiscal primacy, move over central banks
- Diminishing policy orthodoxy, with the Covid crisis fuelling the fire
- Death of the 60:40 portfolio
- Deglobalisation
- Inflation
- Climate change
- Big tech regulation, a slow moving but existential risk

Eleanor Creagh, Market Strategist

Eleanor Creagh joined Saxo Bank in 2018 and serves as the bank's Australian Market Strategist, responsible for creating, implementing and monitoring equity strategies and research for traders and investors, as well as developing quantitative models and customised mathematical frameworks for institutional clients. Eleanor holds a double major in Finance and Economics from the University of Sydney.

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Can we trust the 2020 US election polls?

By Anders Nysteen

A look at how pollsters have adjusted their methods for the 2020 election cycle.

The election result in 2016 seemed to show a catastrophic error in the US pre-election polls, triggering a great deal of forensic work on what went wrong. Investigations revealed that the national polls were actually quite accurate and correctly saw that Hillary Clinton would win the popular vote, with only a small deviation from the poll estimate. Specific state-level polls for Pennsylvania, Michigan and Wisconsin, however, were another matter. The polling averages for these three states showed Clinton with a solid lead. But they ended up going to Donald Trump by a razor-thin margin, making the difference in the election outcome.

In nearly all US Presidential elections, the winner of the national popular vote also wins the Electoral College and thus the presidency. This also appeared to be the case in the days leading up to Election Day 2016, where forecasts gave Clinton around a 90% probability of winning the presidency, with a range of 71% to 99%.

Below, we review some of the findings from analysts such as the American Association for Public Opinion Research (AAPOR) and Marist College's Institute for Public Opinion regarding why key state polls underestimated the support for Trump.

“Past election cycles show that significant changes can occur in the final weeks of the campaign”

1. Undecided voters played a significant role

In key states, more than half of undecided votes went for Trump. In Pennsylvania, Michigan, Florida, and Wisconsin, 11-15% of voters made their decision in the final week. On a national basis, 20% of voters in 2016 had not decided three months prior to the election. This time around, things look a bit different. Three months before the 2020 election, only 10% of those polled said they were undecided (or did not care), but analysts still see this as sizeable enough to affect the election.

Undecided voters tend to be heavily affected by events, and studies have shown that negative campaigns and campaign ads may have a bigger effect on undecided voters than positive campaigning. Will Biden's heavy negative ad spending and Trump's recent cash woes tilt the balance for Biden, or can Trump make a sprint to the finish on a bad debate performance from Biden? Past election cycles show that significant changes can occur in the final weeks of the campaign, though the polls have been far more stable in this election cycle.

2. Adjustment for education level

This was implemented in many national polls, but fewer state ones. Voters with higher education levels are more likely to complete surveys compared to less-educated peers. In a survey from 2017 looking at typical national polls, 45% of the respondents had a bachelor's degree or higher, although this number was only around 30% in the general population.

During the two Obama elections, whites with lower educational achievement began tilting more Republican. Furthermore, less-educated voters tend to follow news on a less consistent basis and may thus be more open for persuasion – especially via targeted social media, a possibly decisive factor in battleground states in 2016. Key-states polls in the 2016 election may likely have had an overrepresentation of higher education levels, which were associated with the overestimated support for Clinton.

Can we trust the 2020 US Election polls?

3. Geography

Geography plays a role when drawing representative samples for polls, as certain voter classifications may vote very differently depending on whether they live in urban, suburban or rural areas. Following the previous point, an uneducated white man living in the countryside may have a very different political opinion relative to an uneducated white man living in living in a large city or suburb in the same state.

4. A change in the voter turnout for key demographics

This was another key factor in the 2016 election relative to the patterns in 2012. There was an increased participation among Republicans and rural voters in some key states, while the turnover decreased for some of the core Democratic voters – especially African Americans. The fact that Clinton had a significant lead in the polls may have kept some of the Democratic voters in their couch, feeling that their vote would not matter anyway.

5. Shy Trump voters

Trump voters that did not want to reveal themselves in the pre-election polls may have outnumbered the late-revealing Clinton voters in 2016, although no clear effect has been definitively proven. A recent study by CloudResearch shows that for the 2020 election, Trump voters are half as likely to reveal their true opinion about their preferred presidential candidate compared to Biden supporters.

Adjusting the 2020 polls

Polling organisations conduct surveys in different ways and through different media, and may thus be biased toward certain voter segments. As an example, 10% of American adults do not use the internet – an internet-based survey will underrepresent this group, which stereotypes might describe as a 65+ person with no higher education and low income, living in rural areas. The perfectly unbiased survey will forever remain unachievable, but being aware of these biases can help pollsters adjust for overrepresentations.

Over time, especially due to the internet, the barriers for conducting a poll have been drastically lowered, and the polling landscape is easily polluted by low-quality polls. In many polls, the errors tend to repeat in similar states, introducing a systematic miss, and the correlation between the poll results could easily be underestimated.

> **“Polls which try to ‘overfit’ the 2016 scenario may miss new developments specific to 2020”**

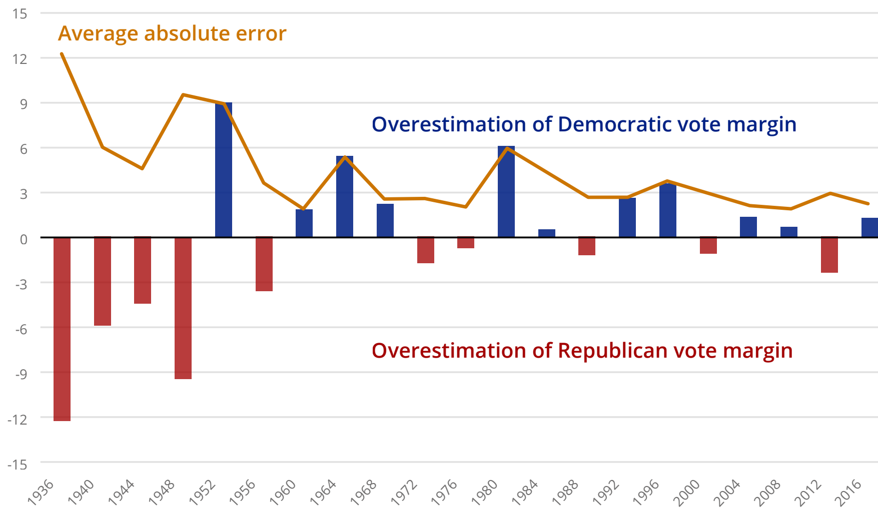
The typical polling margin is ±3% in state polls that can only ask a small subset of the whole population. Recent studies have shown that, when accounting for other possible errors such as the correlation between the state poll errors, the real-world margin of error should be twice as big. In practice, this means that some of the 2016 state polls would not have been able to call a winner within the uncertainty limits of the poll.

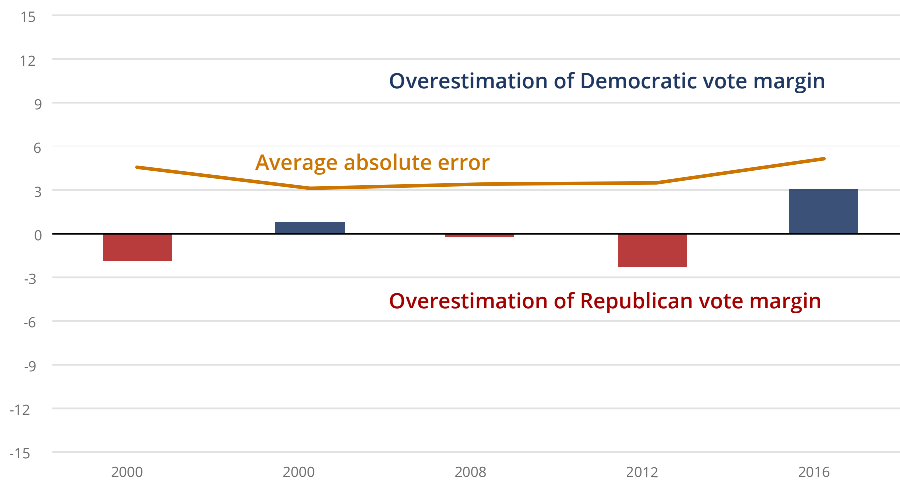
The larger polling organisations seem to be better prepared for the 2020 election, and are trying to learn from the pitfalls of their 2016 misses. Many of the errors above may be addressed by conducting thorough polling. One downside risk to this, however, is that it could result in polls which try to ‘overfit’ the 2016 scenario and may miss new developments specific to 2020. One new challenge is the Covid-19 pandemic, which may affect particular categories of voters more than others and may even lower overall turnout.

So, when analyzing 2020 election polls, one should be aware of i) how the survey group was selected, ii) if the survey is asking for other parameters such as education and geography, and iii) if the polls also report the uncertainty in their predictions. This seems to be a minimum requirement for conducting a reliable 2020 election poll, and if these things are not specified, one should be extra careful about drawing important conclusions.

Can we trust the 2020 US Election polls?

The average error in national polls (first figure) has been in a downward trend and was relatively low for the 2016 election. The average error in state-level polls (second figure) was, however, higher in 2016 than in the past four presidential elections. Figures recreated from AAPOR.





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