# US asset markets and electability

- **Little US election concern is evident in asset markets**
- **Online markets suggest that the most electable Democrats are the most moderate**
- **Asset markets may respond sharply, if a more progressive candidate rises in electability**

## Investors may discount candidates seen as less electable

**Steve Englander**
+1 212 667 0564
Steve.Englander@sc.com
Head, Global G10 FX Research and North America Macro Strategy
Standard Chartered Bank NY Branch

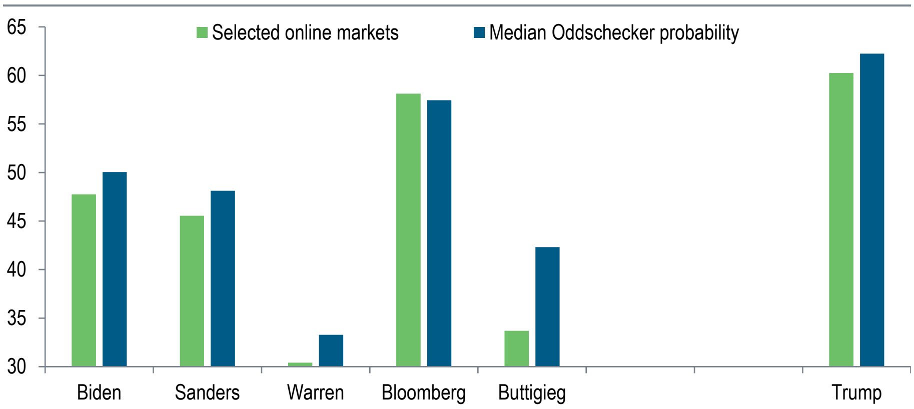
**Geoff Kendrick**
+44 20 7885 6175
Geoffrey.Kendrick@sc.com
Global Head, Emerging Markets FX Research
Standard Chartered Bank

Asset markets are not showing much concern about election risk, despite polls showing that most Democratic candidates would beat President Trump on both a national level and in battleground states. So far this has not visibly affected asset markets. Investors may see these polls as overstating the risk that a candidate who is not sympathetic to asset markets will be elected. This would explain why asset pricing is so robust, but it could mean that asset markets could shift rapidly if candidates less sympathetic to asset markets looked as if they could win. Below we use the term electability to refer to the probability of winning the presidential election, conditional on winning the nomination.

Our interpretation of online market pricing is that Bloomberg is viewed as having the highest chance among Democrats of beating Trump, if nominated (Figure 1). But his nomination probabilities are currently running just over 10% (Figure 2). Biden lags Bloomberg in terms of his conditional electability and Sanders may be slightly behind Biden. Warren and Buttigieg look to have relatively low odds of beating Trump, if nominated. President Trump remains the overwhelming (90%+) favourite to get the Republican nomination and is priced for a 55-60% chance of winning if nominated, ahead of all the Democrats.

Among investors, Bloomberg and Biden are probably viewed as the most asset-market friendly among the Democratic candidates, so their greater implied electability may be why US assets are not showing more stress. Sanders' nomination probability has risen in online markets, but Warren's decline may have matched or exceeded his move. Were online markets to indicate more confidence in Sanders' electability, asset markets could show more uncertainty. Trump appears to be rising both in his conditional electability and in online markets' assessment of his absolute electoral odds (Figure 3), so investors appear to have rising confidence that policy will remain market-friendly.

**Figure 1: Probability of winning presidency, conditional on nomination**
%




Note: Selected online markets if the probability implied by the average of Betfair and Smarkets. The median Oddschecker probal probability implied by the median Oddschecker quote. Source: Betfiar, Smarkets, Oddschecker, Standard Chartered Research

## Backing out conditional probabilities

### A special case of Bayes Theorem

*We calculate election probabilities conditional on nomination*

Our approach uses online markets to back out which candidates are viewed as most electable. Many online markets look at candidate' odds of winning the nomination and of the election. We use the relationship

$$p(E \mid N) = p(E) / p(N) \qquad (1)$$

where p(N) is the probability of winning the nomination, p(E) is the probability of winning the presidential election and p(E | N) is the probability of winning the election contingent on getting the nomination.

We obtain p(E) and p(N) from online market prices and back out p(E | N) from equation (1). We show p(E) and p(N) in Figures 2 and 3. We use two approaches for these calculations. The first averages the probabilities published by two online markets that have relatively tight bid and asked spreads for each candidate's probability of winning and losing. We calculate the midpoint probability implied by the bid and asked spreads, averaged across the two markets. The second approach takes the median probabilities based on a wide range of online markets for winning the nomination and the presidency and solving for equation (1) above.

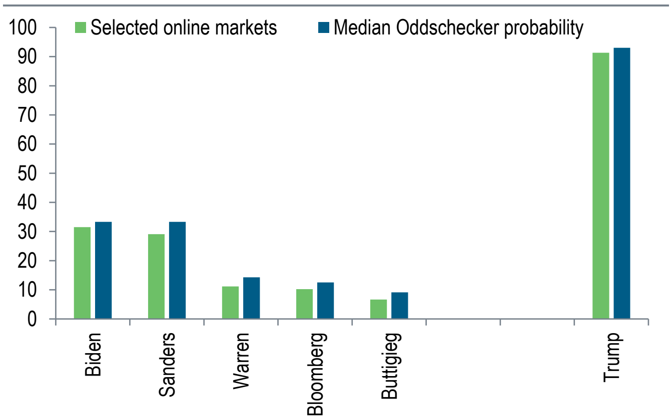
*Online markets can be off, just like polls*

The weakness of online markets is that they are not nearly as deep as financial markets. This makes the probabilities subject to a wide error band. The advantage of the online markets that we used is that their bid-asked spreads were relatively narrow, so the mid-point probably gauged pricing reasonably well. Still, it was clear that once the candidates' winning probabilities fell below 5%, pricing quality could slip. This is one reason we considered only the five major Democratic candidates.

We avoided online markets whose probabilities were difficult to interpret. One market (that we did not use) had the combined probabilities of the five leading Democratic candidates winning the presidency well exceeding the probabilities on the same site that any Democrat won[1]. We use online markets but are mindful of their limitations. The views expressed though the markets may be wrong (just as polls often are) and the probabilities they generate may not be reliable if the markets are relatively thin.

**Figure 2: Nomination probabilities from online markets**

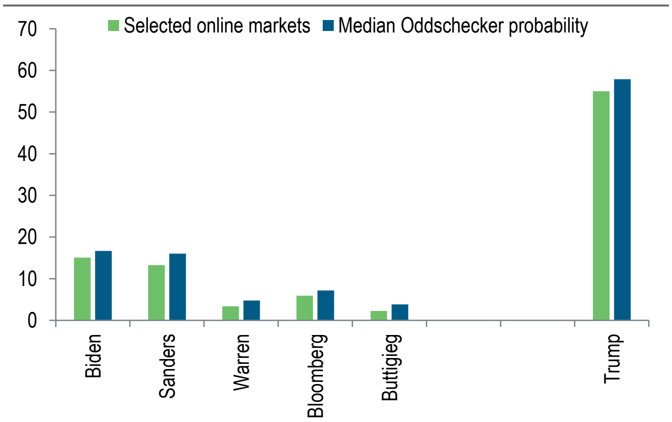
*%*




Note: Selected online markets if the probability implied by the bid-ask midpoint of Betfair and Smarkets. The median Oddschecker probability is the probability implied by the median Oddschecker quote.Source: Betfiar, Smarkets, Oddschecker, Standard Chartered Research

**Figure 3: Presidency probabilities from online markets**

*%*




Note: Selected online markets if the probability implied by the bid-ask midpoint of Betfair and Smarkets. The median Oddschecker probability is the probability implied by the median Oddschecker quote.Source: Betfiar, Smarkets, Oddschecker, Standard Chartered Research

1 The combined probability that one of the five major Democratic candidates won the presidency was far above the probability (in a separate contract) that any Democrat became president.

### Tepid asset-market responses so far

*Investors may expect policy stances to moderate after the election*

It may be too early for asset markets to respond to the ups and downs of the nomination process. Moreover, even though candidates have stated positions, investors may be discounting the follow-through once elected. Elected officials often do not implement their positions, and with a split Congress (online markets give about a 70% chance that the House stays Democratic and the Senate Republican), the President may not be able to push through his/her agenda.

*Deeper into election season, electability will matter more*

Our expectation is that these probabilities will change as we get deeper into primary season. By the end, one candidate will have been chosen and electability will be all that matters. In equation (1) terms, p(N) will be one. At present it looks as if the most electable Democrats are also the most market-friendly. Investors may be thinking that either the Democratic nominee will be closer to the historical norm of market-friendliness, or will face an uphill climb to be elected.

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