

The Election's Influence: Real or Overstated?



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As we head into a news-packed few weeks, the election feels imminent, yet it's the macro data, not just election buzz, driving markets. This data has done two things: supported the recent surge in rates and created a path of least resistance for equities to move higher. Interestingly, there's a divergence between asset class signals on the election and what media polls predict. For example, long-term bond rates have risen sharply (10-year moving from 3.6% in mid-September to 4.2%), painting a picture largely supportive of a Trump win and reflecting the market's expectation of higher inflation and deficits. Regardless of the election outcome, both candidates' policies indicate potential deficits, with Harris pushing for more stimulus and lower taxes for the middle class, suggesting a weakening fiscal situation and higher rates—for either candidates policy agenda

Contrasting Asset Signals: Divergence from Polling

Outside of rates, the performances in currency, banking, renewables, and DJT (Trump Media & Technology Group) also hint at a Trump victory, while polls project a much tighter race. This divergence signals that upcoming weeks could be dynamic and complex.

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Macro vs. Election: Attributing Market Moves

In all likelihood, the election takes too much credit for what is going on. The September Fed rate cut, supporting the narrative of a soft-landing, might actually be the primary force. Additionally, prediction markets suggest the winner of the presidency may lack a majority in Congress, hinting at stability beyond immediate election results, which is really where the rubber meets the road. Institutional continuous trading volumes have dipped recently, but 2024 has seen remarkable market liquidity and trading conditions. Election headlines may promise significant market shifts, but historically, markets absorb this event cyclically without major long-term impacts. Now, with institutional cash deployed at very high levels and signals of overexposure to the US markets, if there was ever a time to take a breather as institutional asset manager, it is now, especially as extended state polling could delay election results.

Institutional Sentiment and Volume Trends

While never a perfect measure, institutional trading volumes—measured through flows at investment banks—indicate asset manager complacency, likely due to the election and recent shifts in Fed rate expectations. Meanwhile, volatility remains quietly elevated, with the VIX around 20, even as indexes reach new highs. That 20ish reading is likely indicative of asset managers' apprehension but some of the recent equity performance stats jump off the page, with all time index highs coming often. Meanwhile, retail activity remains aloft at roughly 20% of market volume. The slowdown of continuous institutional volumes while retail driven wholesaler exhaust is elevated can exacerbate market choppiness. Earlier this week, the market showed signs of fragility, with tech stocks slumping and big retailers like Starbucks indicating that the general consumer may be losing their appetite for \$8 coffees. While higher TRF-reported volumes over the course of the year have been driven by higher block/risk appetite (both in ATS's and traditional block sourcing), a shift away from sizeable institutional contra will be unique to the setting 2024 has afforded traders and portfolio managers up to this point.

Survey Insights: Cash Levels and Asset Manager Optimism

Some studies show that fund manager cash levels have moved to historic lows, reflecting the aggressive asset deployment throughout 2024. Over-positioning is evident, with sentiment readings being overly bullish to trigger the contrarian signals. Though the election overhang may persist, macroeconomic fundamentals, not election results, are likely the true performance drivers. As we approach important payroll data and corporate earnings, these macroeconomic indicators may have more market-shaping power than electoral shifts.

Rates and Equities: A Potential Pause Ahead

The quick climb in both rates and equities suggests that a pause may be on the horizon. Equity gains in the face of rising rates, mostly with thinning institutional volume, indicate a degree of money manager apathy. It's likely that tangible data supporting a soft landing will continue to steer markets. Historically, presidential elections do not leave long-term impacts on markets, so a similar outcome can be expected here.

Correlation and Risk: Signals of a Potential Pullback

Recently, correlation data shows a sharp uptick, moving off historic lows from earlier this year. Lower correlations have supported strong stock-picking opportunities but signal increased overall risk. This shift suggests that, while inflation seems stable and employment remains strong, the rise in correlations could signal a potential market pullback. Historically, correlation valleys precede market corrections, as we've seen in recent years. And with S&P 500 Q3 earnings expected to be modest at 5%—and 2025 projections higher, at around 15%—market expectations are moving into a challenging environment ripe for re-evaluation.

Conclusion

As we move closer to the election, market activity remains rooted in a complex balance between macroeconomic fundamentals and election-related sentiment. While headlines emphasize the potential impact of political shifts, historical trends suggest that the market is more resilient to election cycles than one might think, with the broader economic landscape playing a decisive role. Rates have risen sharply, equities have defied the odds by climbing alongside, and institutional volumes are strong yet thinning into the election. Meanwhile, the sharp move in correlations off a bottom and signals of asset manager slowing deployments underscore some vulnerability in today's market.

With institutional cash deployed at high levels and retail enthusiasm buoying volumes, a measured approach might be prudent as earnings season and crucial economic data loom on the horizon. Regardless of electoral outcomes, the real drivers—economic fundamentals, liquidity, and institutional behavior—will likely guide markets forward, emphasizing the value of data-driven decisions over presidential headline-driven reactions. As we head into this final stretch of the year, staying attuned to the underlying economic signals may provide the clearest path through the inevitable noise ahead.

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