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Macroeconomic and Geopolitical Risk Summary

SUMMARY

This report builds on our previous assessments of COVID and financial dynamics, assessing their correlation with political risk and market trajectory. We expand on our July analysis which covered market pressures likely to emerge from November election scenarios, highlighting the potential correlation of election outcomes with our forecast evolution of COVID.

In our July 1 report, we highlighted nascent negative market pressures related to November election scenarios, noting that markets face not only the potential for deeper US-China conflict under the Trump administration but also the potential for negative domestic economic policy outcomes under a Democratic administration. This report delves deeper into those scenarios, in particular the **significant market implications of a party securing not only the White House but also both chambers of Congress.**

To better understand the risk of more extreme election outcomes and market pressures, we assess **Republican vulnerability in the Senate** and how COVID dynamics might affect the political and macroeconomic environment in early November. Noting the **potential for November's results to be contested due to allegations of mail-in ballot fraud or improper implementation**, we review market responses to previous periods of election dispute and political unrest.

Presenting our analysis of recent COVID trends and hospital capacity data, we highlight the **importance of seasonal dynamics in recent COVID infection trends**. This evolution implies a high probability of regional spikes in COVID diagnoses in the leadup to November elections as seasonal dynamics shift in the fall.

From a macroeconomic perspective, we focus on how **evolving COVID trends might be leading towards a sustained shift in consumer behavior** with potentially significant negative macroeconomic implications beyond initial "lockdown" shocks. The risk of epidemiological trends and **hospital capacity pressures leading towards localized "shelter-in-place" orders** is assessed.

In terms of geopolitical dynamics, events since our July 1 report have clearly reinforced the potential for US-China relations to deteriorate further under the Trump administration. We have covered China dynamics extensively in previous reports and focus here on likely cyclical aspects of this deterioration. Our perspective regarding how these **cyclical dynamics relate to significant imbalances that have built up due to traditional foreign policy frameworks fundamentally misreading US-China dynamics** is detailed, particularly as relevant to November election outcomes.

This report concludes with an assessment of **recent financial dynamics.** We consider to what extent **recent rallies in multiple asset classes outside of normal correlation patterns** might simply indicate abundant liquidity, or if they represent potential systemic instabilities with negative macroeconomic implications. The potential that these financial dynamics reflect expectations that the economic impact of COVID will prove less than anticipated is also assessed.

THE CURRENT STATE OF COVID

July was filled with disconcerting headlines regarding both COVID infection levels and macroeconomic indicators. In addition to repeated reports of widespread spikes in infections in geographically southern US states and threats of renewed lockdowns, government quarterly data revealed a -32.9% contraction of the US economy year on year from 2Q 2019 to 2Q 2020. Neither of these data points were unexpected per our previous reports. Our assessment is that **other risk indicators which received far less news are of far greater consequence.**

In terms of COVID infections, we highlighted the likelihood of dire headlines emerging in our May 8 analysis. **Recent spikes in infection are best understood as a natural evolution of virus dynamics:** COVID is an opportunistic parasite that follows paths of least resistance, and it has recently moved into areas where penetration was low and the use of masks not universal due to political risk dynamics. A lack of existing immuno-resistance and large percentages of the population failing to take proper preventative measures offers abundant opportunities for the virus to find hosts, hence the spike in infections.

IMPORTANCE OF SEASONAL DYNAMICS

The expansion of COVID in the southern US highlights another critical factor driving our COVID assessments: the impact of seasonal dynamics on infection levels.

As detailed in our previous reports, concentrations of COVID in indoor environments represent the primary contagion vector. Though coverage has focused on how infection spikes might correlate with political leanings that reject mask usage, **the appearance of COVID epidemics in southern US states should be understood in the context of how seasonal dynamics encourage indoor human activity**.

Seasonal dynamics that encourage increased time indoors (i.e. hot weather in the southern US) represent a major factor likely driving recent COVID infections. This has **significant implications both for how infections might expand during the rest of this summer and also in the fall** as colder weather begins to drive populations indoors in larger numbers.

GEOGRAPHIC INFECTION PATTERNS

These dynamics imply **a pattern of correlation between outdoor temperatures and infections**. In the summer, this dynamic differs significantly from hopes that COVID might "disappear in hot weather." That assessment was based on expectations that increased sunshine and humidity might decrease virus survivability and dramatically reduce the R rate of transmission - as is typical with the flu. We warned early against this assessment, with initial patterns of COVID infection in the Middle East and other hot and humid weather environments casting significant doubt on this expectation (see our March 16 report). **Summer seasonal factors undoubtedly affect COVID survivability in outdoor environments, but their impact on driving indoor activity has proven to far outbalance this dynamic.**

Given our assessment of the importance of temperature in driving indoor activity and thus COVID infections where indoor mask usage is not universal, we expect **COVID**

infection patterns to be correlated with geographic latitude as the summer season progresses and temperatures increase in different jurisdictions. This dynamic of hotspots moving north and following paths of least resistance is reflected in current data.

IMPLICATIONS FOR AUTUMN

An inverse of this pattern can be expected in the fall as temperatures begin to drop in northern latitudes. This trend is likely to be punctuated with a temporary respite in R rates of transmission as temperatures shift between extremes during late summer/early fall mild weather. *The correlation of an autumn weather shift with the timing of the 2020 elections is of particular relevance.*

That seasonal shift is typically correlated with the beginning of the flu season in early October. **The coincidence of this shift with the beginning of the flu season and our assessment of COVID dynamics implies an infection spike could be a significant factor in the leadup to November's elections.**

We see this dynamic as a **significant potential political risk factor in terms of impact on the November election environment and news cycle**. As weather shifts and there is an increase in flu-like symptoms, it is highly likely there will be a major increase in people seeking testing and a high probability that increased testing numbers will result in a disproportionate spike of COVID diagnoses. Continued refinement of COVID tests to reduce false negatives is further likely to increase the number of positive diagnoses.

SUPPRESSORS OF RATES OF TRANSMISSION

Though seasonal dynamics are only one factor affecting R rates of transmission, they appear to be a critical one. **We continue to have confidence that R can be significantly reduced through the indoor use of face masks**. We also anticipate that current evolving waves of infection will develop population resistance that further reduces R, i.e. an evolution towards herd immunity along the sliding scale we discussed in our May 8 report.

The **impact of herd immunity on suppressing rates of transmission is indicated by current infection trends in areas that were most heavily hit by COVID previously**. We measure the rate at which virus cases are doubling as a proxy for R. Per this data analysis, rates of transmission in the 4 states hardest hit by COVID infections initially – New York, New Jersey, Massachusetts, and Connecticut – now have the lowest R of all 50 states.

ADAPTIVE HERD IMMUNITY

Policy and behavioral responses certainly are contributing factors to lower R levels, and we highlighted in our May 8 report that any advances towards herd immunity will need to be complemented by significant other R-reducing factors. Cumulatively, this **evolution in areas that have been heavily penetrated by COVID can be seen as an adaptive response in terms both of immune resistance and behavior**. This outcome has significant positive implications for the future trajectory of COVID infections, once the virus's powerful initial wave has spread into areas that previously had low levels of penetration.

It is unlikely that herd immunity will have developed in northern latitudes prior to the fall weather shift to an extent that will reduce R enough to prevent a cold-weather-induced infection spike. Absent a significant preventative shift in political attitudes and

mask implementation - and in combination with what we expect to be a significant increase in testing correlated with the beginning of the flu season - our assessment is that there is a high probability for COVID diagnoses to increase substantially in October and early November. **This is a potentially significant political risk factor.**

CURRENT AND EVOLVING COVID THREAT TO HEALTH SYSTEMS:
The Risk of Shelter-in-Place Orders

The below map details **the percentage of hospital beds in each state that are currently occupied by COVID-diagnosed patients**. This high level of COVID hospitalization should be understood as indicating areas where COVID is building in greatest concentration: exposure to concentrations of the virus is what leads to severe outcomes. **This map clearly demonstrates the geographic south-spreading-north pattern discussed above.**

Hospital Capacity Utilization
COVID Patients
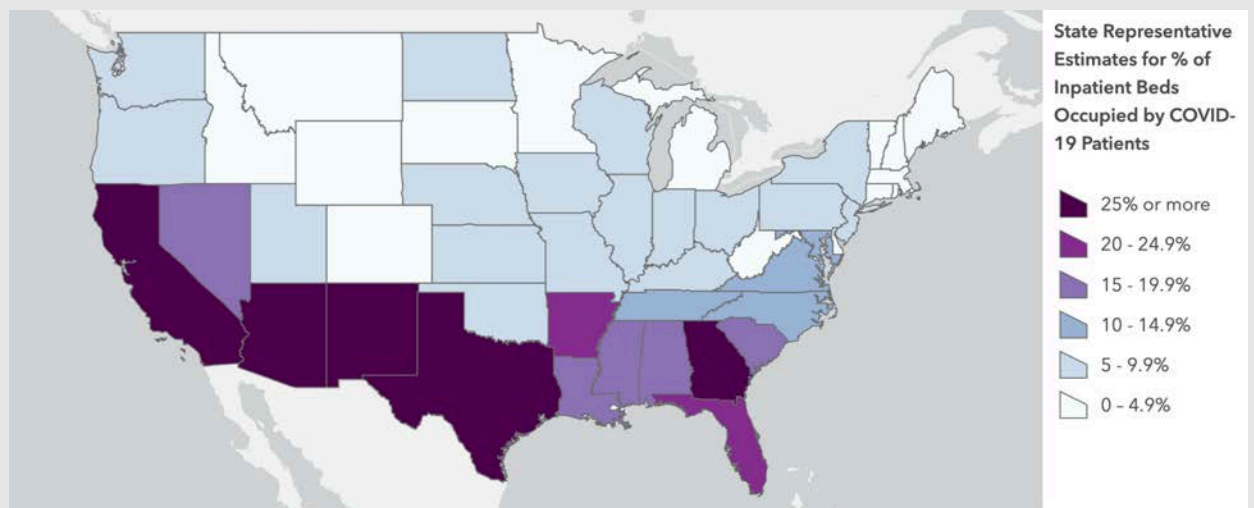
In the states that have the highest COVID patient demand for beds, COVID is currently on average consuming just over 30% of hospital capacity (Arizona: 42%; Georgia: 34%; New Mexico: 30%; Texas: 30%; California: 27%).[*]

R
FOLLOWING
CLEAR PATTERN

Age	0-4 yr	5-17 yr	18-49 yr	50-64 yr	65+ yr	To
2020	238	338	12328	12142	17357	424

[*] Source: HHS Hospital Capacity Data

trendlines appear less hopeful in the next most vulnerable states - Georgia and California; however, the rate of cases doubling in those states indicates they are also on a positive trajectory in terms of the R rate at which COVID infections are spreading. This **positive development related to herd immunity and behavioral shifts is being overwhelmed by the large base of COVID-infected individuals on which the virus's growth is building.**
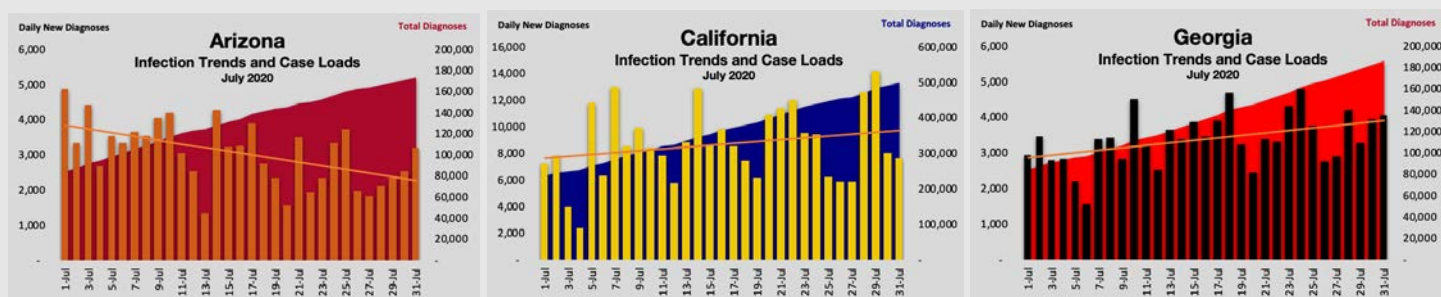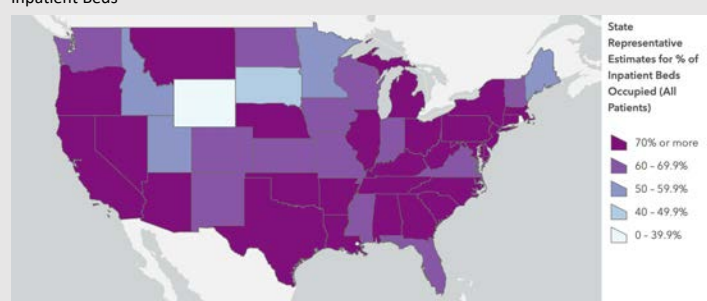

...en of COVID patients is affecting overall ...mulative threat to health systems.

Hospital Capacity Utilization
ICU Beds
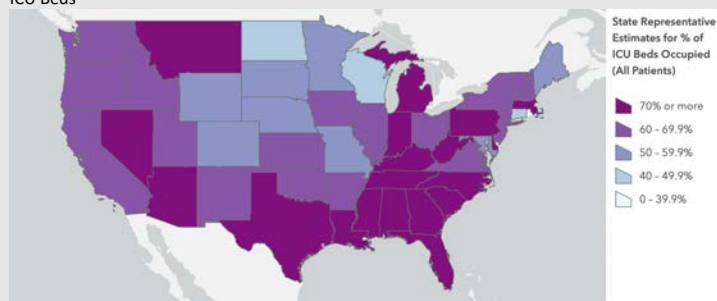
Hospital Capacity Utilization
Inpatient Beds

There is clear crossover between the percentage of bed capacity used by COVID patients (see COVID Patients, Map 1) and health system pressure in the southern US. Yet there are also **multiple states further north that are** ... relatively low number of beds occupied by ... **potential systemic vulnerability should CO** ... **evolution forecast above.**

SYSTEMIC VULNERABILITIES

Arizona is already near existing hospital capacity, with 87% of ICU beds occupied and 95% of all inpatient beds in use - a direct consequence of 42% of Arizona's inpatient beds being used for COVID patients. Yet Michigan also has 70% of its hospital beds full despite having less than 5% of those beds occupied by COVID patients. In multiple states, **there appears to be minimal existing capacity available to absorb an influx of patients should COVID infection waves move north.**

The **severity of seasonally-driven infection waves in states further north is likely to differ** given a different severity of summer seasonal factors: there is a major difference in the amount of time that must be spent indoors without windows open under Arizona's 120-degree desert heat vs. a few 90+ degree August days in Iowa. The potential for R to be suppressed through the use of face coverings also exists, as well as for hospital capacity to be expanded with a rapid roll out of temporary facilities.

INCREASED THREAT OF PUBLIC HEALTH ORDERS

Despite the potential for R to be suppressed, the above dynamic highlights **a growing threat of mandatory public health orders being issued (such as "shelter-in-place") in areas nearing hospital capacity**.

Such orders are highly contentious politically and entail significant economic damage, but fundamentally are issued **to protect health systems at risk of resource demands exceeding capacity**. This threshold is already near in Arizona: 95% overall bed utilization, 42% of beds to COVID patients; in California: 97% overall bed utilization, 27% of beds to COVID; and in Georgia: 90% ICU bed utilization, 34% of beds to COVID. Per the above utilization data, **as summer advances it appears possible health system crises will emerge in further areas.**

POTENTIAL OUTCOMES

We have highlighted previously that "shelter-in-place" orders as implemented in the US in response to COVID's initial wave are an exceptionally inefficient means of limiting COVID infections. In terms of their relative economic impact vs. epidemiological benefit, they are nowhere near as efficient as universal usage of face coverings indoors.

POLITICAL RISK FACTORS

Unfortunately, **July demonstrated a continued failure of multiple jurisdictions to engender widespread usage of face masks indoors**. This reinforces our assessment that political risk continues to be the primary factor driving negative COVID outcomes, with the **downside potential of outcomes increasing rapidly due to a failure to suppress R rates of transmission**.

MACROECONOMIC IMPLICATIONS

Despite the immense negative impact of earlier shelter-in-place orders, from a macroeconomic perspective the resulting **drop in GDP during the second quarter has proven to be less than initial worst-case scenarios.** In mid-June, a greater than 50% drop in GDP was forecast,[†] and final data demonstrating a -33% YoY contraction was slightly better than the -35% estimates at the time of our July 1st report.

SHUTDOWN RISK

Current **health system capacity utilization numbers and continued failure to suppress R rates of transmission through mask usage indicate a strong potential for a return to shutdown orders in at least some areas**. The associated macroeconomic impact of such

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[†] Source: Atlanta Fed GDPNow estimates

measures on affected jurisdictions is, however, not what we see as the primary current COVID macroeconomic threat in the US.

CONSUMER BEHAVIOR SHIFTS

Of far greater concern is the potential that "stay at home, stay safe" consumer habits are solidifying. Current GDP forecasts expect a robust rebound in economic activity in Q3 2020. Should high frequency data indicate a plateauing of activity and a sustained shift in consumer behavior, this would suggest a persistent sustained drag on consumption and a scenario of previous market expectations being disappointed.

UNCERTAINTY DRIVING MACRO RISK

Sustained uncertainty regarding the direction of COVID and correct preventive action at the individual level appears to have impacted consumer behavior in July.

We see this uncertainty as **indicative of a fundamental failure to communicate the realities of COVID dynamics**, exacerbated by distrust of public officials who have repeatedly proven irresponsible in their messaging and management of the crisis.

Should COVID patterns as outlined above emerge in force, we see the macroeconomic **threat of a shift in consumer behavior likely to grow in importance and exceed the direct macroeconomic impact of localized "shelter-in-place" orders.**

COVID RISK REALITIES

"Stay at home, stay safe" may make sense from the perspective of officials seeking to defend health care systems facing acute resource pressures. From an individual perspective, however, this makes sense only for specific at-risk populations. **The risk of COVID to individuals that do not have pre-existing risk conditions continues to prove very low**, as highlighted in the below chart.

Underlying Conditions of COVID Hospitalizations
% of patients admitted with COVID who show following pre-existing conditions
● = Pediatric   ● = Adults
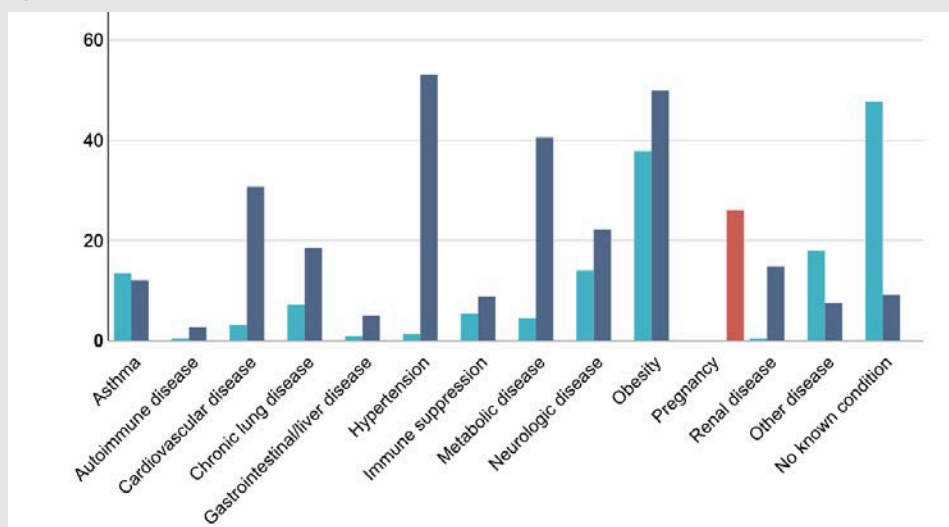
Pediatric hospitalizations account for a very small amount of total COVID hospitalizations, and **only 8% of adult COVID-diagnosed hospitalizations were individuals without other pre-exist**

existing conditions, implying optimal policy to protect health systems is isolation of these individuals from exposure to the virus rather than mass population lockdowns.

ISOLATING AT-RISK POPULATIONS

Mask-utilization continues to be the most efficient measure to minimize exposure of at-risk individuals to COVID, offering the potential for normal economic activity to continue by low-risk individuals while high-risk individuals remain isolated at home. This is a dynamic we've highlighted repeatedly since our March 16 report, but **July developments have demonstrated that political risk continues to thwart this optimal outcome**.

OPTIMAL POLICY DIRECTION

Our assessment is that optimal public health policy will:
- clearly identify and reach out to individuals with risk factors;
- clearly state risk dynamics to the public-at-large;
- encourage isolation of at-risk individuals while emphasizing to their close contacts and household members the importance of face mask usage.

Minimizing the potential for virus concentration to build in environments where at-risk individuals are located is the most important public health strategy to overcome COVID and reduce COVID hospitalizations. It makes general "shelter in place" orders unnecessary.

Furthermore, given the many holes in lockdown orders as implemented in the US – for example, individuals in "essential" jobs still congregating in indoor environments and then potentially transmitting COVID back to their households – **the above strategy is far more likely to reduce hospitalizations yet also encourage herd immunity**.

These actions do not appear to be taking place at the national level. This might be due to their significant political and logistical challenges, compounded by the fact that **a very large percentage of the American population carries the risk factors of obesity and hypertension**.

In this context, the COVID crisis in the US might be understood as fundamentally one of pre-existing poor public health and health system preparation.

PROBABILITIES OF A COLLAPSE IN DEMAND

We emphasized in our July 1 report that beyond a shift in consumer behavior the primary traditional macroeconomic threat related to COVID was expiration of Pandemic Unemployment Insurance payments. This **PUI source of income for affected individuals has been a key pillar offsetting what would otherwise be significant consumption pressures from tens of millions of unemployed Americans**.

Since July 1, each of these macroeconomic risk factors has increased:
- increased probability of lockdowns;
- indications of a potential sustained shift in consumer behavior due to uncertainty;
- and the at-least-temporary expiration of Pandemic Unemployment Insurance payments.

ASSET PRICES SUSTAINING BALANCE SHEETS

Offsetting these negative macroeconomic factors, **financial systemic dynamics have appeared to remain relatively strong, with robust equity and real estate asset price dynamics**. There have, however, been some financial system developments in July that potentially hint at deeper issues, as detailed later in this report.

Should consumer demand show further deterioration this can be expected to flow through into financial markets and have political repercussions for the November election.

2020 ELECTION RISK

COVID DYNAMICS

Whether voters will attribute responsibility for COVID-related deterioration to federal health officials who mismanaged the initial COVID response, to President Trump as the executive in charge of those federal agencies, or to inefficient state-level policies and political dynamics remains a challenge to predict. **Seasonal and other dynamics highlighted above do indicate that this is likely to be an issue fresh on voters' minds as election ballots are submitted in November.**

Rather than speculate about a major psychological shift that might cause extensive voter movement for or against President Trump or the Republican or Democratic Party, **our analysis focuses on election outcomes and the calculus behind probabilities of different scenarios.**

Of particular focus is any scenario of a Republican or Democratic sweep of elections to garner simultaneously control of both the Executive and Legislative branches of the US government (i.e. victory in the White House and a majority in both the House of Representatives and Senate).

2020 Election Outcome Scenarios				
President	**Congress**	**Overall Market**	**Regulatory-Sensitive Sectors**	**China-Related Sectors**
Trump	Republicans control both houses	Highly Positive	Positive	Highly Negative
Trump	Republicans don't control both houses	Positive	Positive	Negative
Biden	Democrats control both houses	Highly Negative	Highly Negative	Positive
Biden	Democrats don't control both houses	Neutral / Negative	Negative	Positive

The above table summarizes our short-term assessments of likely market trajectory one month post-election. It does not incorporate longer-term trajectories, for example as might derive from fiscal shifts or trends in economic inequality correlating with party policies. Nor is it based on any perspective of the political merit of different election results.

Our assessment of the above scenarios considers the market impact of party ideological policy direction and stated platforms, combined with a party's ability to implement its agenda. **The impact of outlier scenarios of either a Democratic or a Republican sweep is of particular note** given its implication of a lack of legislative or executive checks (other than a filibuster by the Senate minority party) under a sweep scenario.

IMPACT OF A DEMOCRATIC PARTY SWEEP

The most concerning scenario we see for markets is a Democratic sweep. This might be expected to lead towards significantly increased fiscal stimulus, but a marked recent shift in Democratic Party politics towards more radical ideas and priorities is likely to be of far greater market consequence. **This outcome can be expected to result in major changes to the tax code**, and we anticipate a significantly negative market trajectory under such a scenario.

A scenario of Biden securing Democratic control of the Executive Branch but Republicans having control of at least one chamber of Congress has fewer negative implications short-term. We forecast market direction as neutral/negative under this scenario in part because of the potential for markets to respond positively to **a return to international economic orthodoxy** following the Trump administration's aggressive engagement of China and other trading partners.

This potential sigh of relief will likely be outweighed not only by regulatory shifts that can be expected under a Biden administration. **Should Biden become President but Republicans control at least one chamber of Congress, we expect prospects for fiscal stimulus to be significantly reduced.** In support of a Trump presidency, Republicans have stepped away from fiscal conservatism. This can be expected to reverse strongly under a Biden administration, representing a net negative for markets in addition to regulatory and executive order concerns.

SECTORAL IMPACTS

The above table highlights how different sectors are impacted unevenly under election scenarios. **Of particular vulnerability are regulatory-sensitive sectors and China-related sectors.**

CHINA RELATED

Under a continuation of the Trump administration, we anticipate a significant further deterioration of US-China relations regardless of Congressional results. This negative trajectory is **likely to be accelerated if Republican members of Congress are able to push through anti-China legislation via control of both the House and Senate.**

REGULATORY SENSITIVE

Similarly, **a shift in the regulatory environment can be expected under a Biden administration regardless of whether Democrats secure a dual majority in Congress**. Should the Democratic Party secure control of both chambers of Congress, this shift can be expected to accelerate dramatically with legislative initiatives such as the Green New Deal, Medicare for All, etc.

IMPORTANCE OF SENATE CONTROL

Under a scenario of a Democratic sweep, the only Republican check on majority Democrat initiatives would be the Senate filibuster. This might help to explain why the filibuster has recently been repeatedly cited by multiple Democratic Party leaders as a
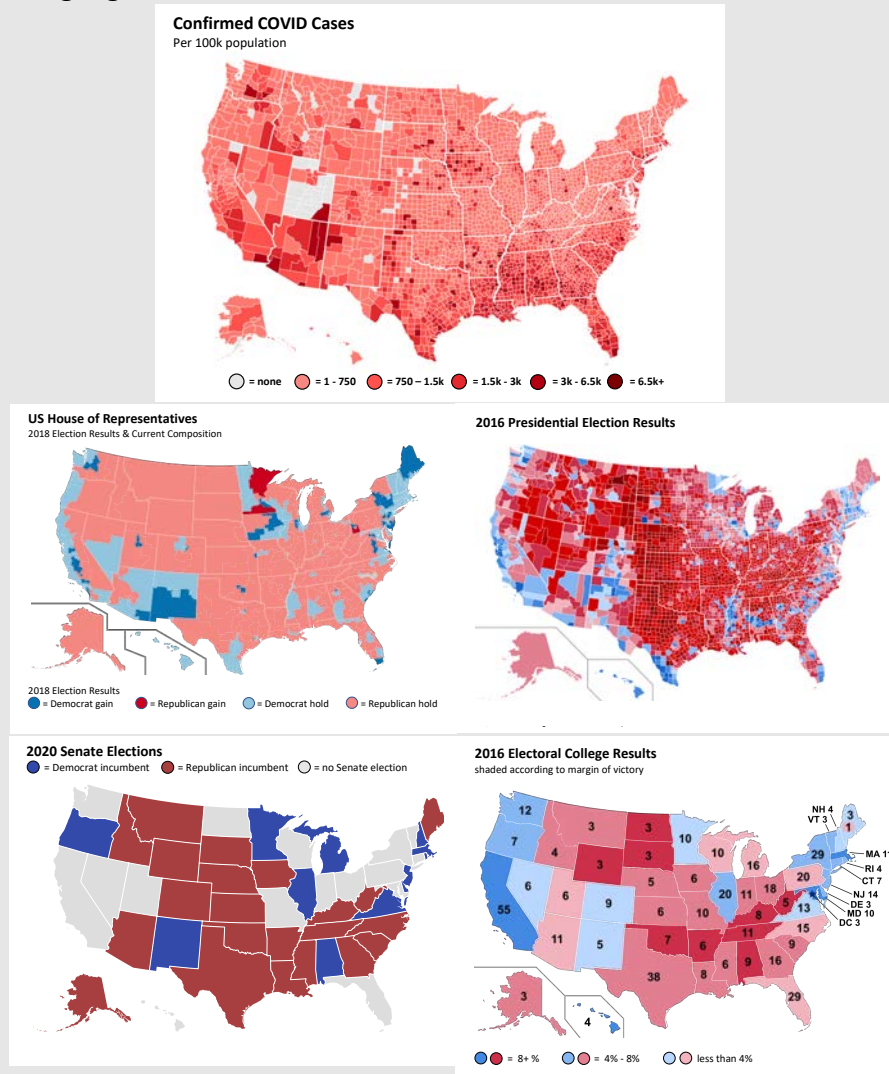
barrier to democracy. **Neutralizing the filibuster would require Democrats winning enough seats in the upcoming election to seat 60 Senators, or to use a simple majority to push for a change in Senate rules.**

Senate election dynamics are covered in detail below given the importance of Senate majority control.

ASSESSING ELECTION OUTCOME PROBABILITIES

Given uncertain COVID and macroeconomic dynamics, assessing the probability of the above scenarios is exceptionally difficult this election cycle. For detailed analysis, contact us: we work with election experts focused on granular election forecasting and probability assessment and can offer insight into your specific area or topic of concern.

For a general overview of election dynamics, **the below maps highlight how COVID dynamics might correlate with voting patterns**. Senate seats that are up for vote in 2020 are also highlighted.

Confirmed COVID Cases
Per 100k population

◯ = none   ◯ = 1 - 750   ◯ = 750 – 1.5k   ● = 1.5k - 3k   ● = 3k - 6.5k   ● = 6.5k+

US House of Representatives
2018 Election Results & Current Composition

2018 Election Results
● = Democrat gain   ● = Republican gain   ◯ = Democrat hold   ◯ = Republican hold

2016 Presidential Election Results

2020 Senate Elections
● = Democrat incumbent   ● = Republican incumbent   ◯ = no Senate election

2016 Electoral College Results
shaded according to margin of victory

◯◯ = 8+ %   ◯◯ = 4% - 8%   ◯◯ = less than 4%

HOUSE ELECTION DYNAMICS

Democrats currently hold a majority in the House of Representatives with 232 out of 435 seats; Republicans hold 198 seats. 4 seats are vacant, and 1 seat is held by a former Republican who shifted his affiliation to Libertarian. **All House seats will be up for re-election in 2020, and 218 seats are required for a majority.**

The current Democrat majority was secured in 2018 when the party gained 41 seats overall. Prior to 2018, the Republican party had controlled the House since the 2010 elections. **Of particular concern for 2020 is the potential that the 2018 Democratic victory reflected a rejection of President Trump.**

2018 House election results and its current composition by geography are detailed on the previous page. Adjacent to that map is a map of COVID infection levels, offering an opportunity to compare COVID dynamics with political trends. It is worth noting that **districts reporting the highest levels of COVID infections (as measured by cases per 100k residents) appear to tend to be Democratic districts.** This is likely related to minority voting patterns and urban dynamics: data indicates densely populated cities and minority groups have been disproportionately impacted by COVID infections.

PRESIDENTIAL ELECTION DYNAMICS

Analysis of the 2016 Presidential election map adjacent to the House map indicates **a significant correlation between Presidential and House election results**. Whether voters will cast their ballots in 2020 based on a repudiation of Trump and federal COVID policies, repudiation of Democratic policy direction and recent political unrest, or an overall sense of economic wellbeing and the direction of the country, is a critical unknown. *Contact us for access to detailed assessments and analysis per renowned election forecasters.*

Given the potential for multiple negative COVID and economic dynamics to coalesce leading up to the 2020 elections - and the significant negative market outcome that can be expected should the Democratic party control the White House and both houses of Congress - **analysis of 2020 Senate election dynamics is of particular importance.**

SENATE ELECTION DYNAMICS

On the surface, **the Republican party would appear to be at a distinct disadvantage in terms of maintaining control of the Senate in 2020**.

Republicans currently control a majority in the Senate with 53 seats, with the minority composed of 45 Democrats and 2 Independents. **The Democratic Party needs to gain 4 seats in order to form a majority, and only 3 for control if Biden wins the White House.** Vice Presidents cast tie-breaker votes in the case of a Senate tie, making **the Presidential race a potentially critical factor in determining Senate dynamics.**

In order to have a "filibuster-proof" supermajority of 60 votes in the Senate, Democrats would have to gain 13 seats. They can, however, also change Senate rules via a simple majority vote. Republicans would need to gain 7 seats for a supermajority.

Unlike the House, only 35 of the 100 Senate seats will be up for election in 2020 (33 per normal turnover, plus 2 special elections). **Of the 35 seats up for election, 23 are currently held by Republicans and 12 by Democrats.**

In order to maintain its majority, the Republican Party must win 21 of the 35 Senate seats up for election this cycle – i.e. it can only afford to lose 2. If Republicans win only 20, the Senate would be divided 50/50, in which case the tie-breaking vote goes to whoever is Vice President. If Republicans win only 19 of the 35 races, the Democratic Party will form a majority in the Senate without any Vice President tie-breaker. **The Democrats must win only 16 of the 35 Senate races, or 15 under a tie-breaker scenario.**

SENATE SEAT VULNERABILITY

To better assess the potential for such a shift in majority control and the vulnerability of Senate seats beyond any national-level trends, **the table below highlights available Senate districts that have seen excess death rates above the national average of 34 deaths per 100k.[‡]** Districts where the margin of election in the last victory was less than 10% are also listed.

Other Senate seats might be expected to be reasonably secure, short of some sort of major electoral shift or extraordinary candidate dynamics.

Senate Seat Vulnerability

	Excess Deaths per 100k	Incumbent Previous Margin of Victory
New Jersey	183.0	13.5
Massachusetts	103.8	22.8
Arizona	70.6	13.7
Illinois	66.7	10.8
Michigan	63.0	13.3
Louisiana	53.8	11.8
Mississippi	52.9	7.2
South Carolina	47.3	15.7
Delaware	42.5	13.6
Colorado	40.7	1.9
Rhode Island	34.7	41.4
Virginia	31.9	0.8
New Hampshire	31.6	3.3
Alabama	16.1	1.7
Iowa	4.8	8.3
Alaska	(23.3)	2.2
North Carolina	(86.5)	1.5

Per this analysis, a Democrat supermajority seems unlikely, short of a massive national electoral shift. **The number of vulnerable Senate seats also appears more balanced by party than might be implied by the relative imbalance of total Republican vs. Democrat Senate seats up for election.**

DEMOCRATIC STRONGHOLDS

More refined analysis shifts this dynamic somewhat: it seems unlikely that Democratic stalwarts Rhode Island, Massachusetts, New Jersey, or Delaware will elect a Republican senator in the current environment, despite COVID death tolls in those states.

[‡] Note that negative excess death numbers indicate that per CDC data there have been less deaths in the state than normal. This of course does not mean there have been no COVID-related deaths.

MAJORITY CALCULUS

Of the remaining 13 seats, Democrats would need to win 9 in order to secure a simple majority in the Senate, or 8 to achieve an evenly divided Senate that might be tie-broken by a Biden Vice President. **Republicans need 6 of the below 13 to maintain majority control.**

	Excess Deaths per 100k	Incumbent Previous Margin of Victory
Arizona	70.6	13.7
Illinois	66.7	10.8
Michigan	63.0	13.3
Louisiana	53.8	11.8
Mississippi	52.9	7.2
South Carolina	47.3	15.7
Colorado	40.7	1.9
Virginia	31.9	0.8
New Hampshire	31.6	3.3
Alabama	16.1	1.7
Iowa	4.8	8.3
Alaska	(23.3)	2.2
North Carolina	(86.5)	1.5

The impact of COVID can of course be expected to evolve between now and the election, with different states facing infection and death tolls above the national average. *GCR will continue to monitor these dynamics closely to aid clients in assessing election outcome risks.*

POTENTIAL FOR DISPUTED ELECTION RESULTS

Another threat of a very unique nature related to COVID relates to the potential mass processing of elections by mail-in ballots. **A scenario of allegations of mail-in fraud or poor implementation leading to disputed election results is in our assessment a significant probability**.

In addition to issues posed by the logistical challenges of organizing and processing mail-in voting, **the likelihood that results disputes and legal challenges will contribute to a prolonged period of political uncertainty post-Election Day appears substantial.**

In a scenario where either the Presidency or a sweep of both houses of Congresses is disputed, we assess significant potential for mass protest and even civil unrest.

MARKET RESPONSE TO 2000 ELECTION DISPUTE

It is worth noting that **in the disputed Presidential election of 2000, markets dropped as much as 6% between the election night close and the dispute being legally settled** in early December. By contrast, markets did not drop but actually rallied during the late May-early June height of recent protests and civil unrest in the US.

Given the stakes of the upcoming election, the personalities and political dynamics involved, and the general polarization and tendency towards civil unrest in the US currently, **we believe the impact of any disputed 2020 election is likely to exceed 2000 dynamics.** This risk does not appear to have been incorporated into markets currently.

CHINA AND GEOPOLITICAL ELECTION RISKS

The following three pages cover our perspective regarding deeper drivers of US-China tension that are likely to not only affect markets long-term but also limit the sustainable success of any Biden administration attempts at rapprochement.

The trajectory for China and other geopolitical dynamics will be heavily impacted by this year's elections, with significant market implications for China-exposed sectors. No candidate is going to overtly state an intention to be "soft on China" during the campaign, but our assessment is that **under a Biden administration foreign policy towards China can be expected to see a major shift early in the administration.**

IMPACT OF BIDEN PRESIDENCY

For this reason, we assess the outcome of a Biden election to be positive for China-exposed sectors, whereas under a Trump administration strong negative pressures are likely to increase. These dynamics will likely evolve in a cyclical pattern, as has occurred with China trade negotiations. Our **expectation is that under a Biden administration something can be expected with China similar to the "reset" of Russian policy the Obama-Biden administration attempted in 2009.**

Not only are **domestic initiatives likely to consume any Biden administration** - particularly if the Democratic Party also controls both chambers of Congress - and leave little interest in being distracted by deeper conflict with China. A **Biden administration would likely be consumed with reversing Trump administration geopolitical developments** and "regaining the US's role in the global order" by returning the US on the path of pre-Trump standards of international economic integration.

DEMOCRAT TRADITIONAL FOREIGN POLICY FRAMEWORKS

In this context, it is important to note that **traditional foreign policy frameworks that dominate – especially within the Democratic Party - tend to see China not as an adversary that must be undermined but an inevitable partner that must be engaged and constrained.** From this perspective, the Trump administration's aggressive policy towards China has been an extraordinary mistake that must be reversed so that China and the Chinese Communist Party can be constructively managed.

This traditional foreign policy perspective embodies multiple critical errors. Not least of these is the fact that – as is widely recognized – "the genie is already out of the bottle." Chinese nationalism and a path of strategic conflict with the US have been confirmed in Chinese policy circles as inevitable due to Trump's aggressive engagement and the tone of US debate, with **the Chinese Communist Party accelerating its preparations for a conflict that its Marxist-Leninist ideology has long forecast.**

REVERSING THE CHINA TRAJECTORY

Our expectation is that initial Biden administration policy towards China would attempt to reverse this trajectory. Unfortunately, our assessment is that this is likely a futile and even naïve endeavor as long as the Chinese Communist Party dominates China. **The scale of current conflict - and the scale of China as an adversary - are fundamentally a result of a**

policy direction and suppositions which traditional foreign policymakers would like to return to but are inherently flawed.

In this context, it is important to recognize that **there is in reality no "China;" there is a government and military under the firm control of the Communist Party that it uses to project power, and there is the other 94% of the Chinese nation** taught to see the world from a historic core-periphery perspective that emphasizes how China should naturally be the core but was abused by imperialists in the past.

DEFINING THE "CHINA" THREAT

The threat from China derives from the attempt to set up a world where the Party is the core of global leadership. Chinese citizens know that leadership is far from benign if you resist in any form.

Traditional foreign policy frameworks have focused on constraining the Party's worst impulses. These same frameworks long assessed that by approaching China writ-large with generous foreign and economic policies this would encourage development, and increased wealth would result in the Chinese people eventually feeling comfortable to move beyond Party control and demand political reform.

ERRORS IN PREVIOUS FRAMEWORKS

This framework has not only proven completely inaccurate, it has empowered the Party by giving it a significantly stronger economic and military base to project power.

It also failed to understand just how effectively the Party has embedded its dominance within Chinese nationalism and a sense that the Party is needed to defend China from external nefarious forces.

A Chinese defensive mindset as a legacy of history is understood by many China experts, with generous policies towards China in the past to a great extent crafted to try and overcome this tendency. In addition to the resilience of the Party's authoritarian systems of control, however, **traditional foreign policy frameworks have failed to understand how this defensive perspective is embedded in a Chinese foreign policy trajectory that fundamentally puts the US and China on a path of conflict as long as China remains under the control of the Chinese Communist Party.**

Developments in the South China Sea and China's militarization of that area offer an excellent example of this dynamic.

CHINESE "DEFENSIVE" POLICIES

It is rarely noted in the West - but acutely remembered in China - that sea approaches via the South China Sea were the avenue by which China was conquered and attacked by Western imperial powers during the 19th century. This is how **exercising control of those waters is justified within Chinese foreign policy circles as a critical national security priority**. From this perspective, accusations that Chinese moves are "expansionist" are resoundly rejected and instead framed as a response to "continued imperialist Western tendencies." That is both the propaganda and the logical defensive pretext.

Understanding Chinese moves and strategy in terms of setting up a defensive perimeter offers insight into why conflict with the United States is an inevitable trajectory, beyond

already irreconcilable political dynamics related to CCP plans to globally extend its systems of authoritarian dominance.

SOUTH CHINA SEA MOVES IN CONTEXT

The first step in developing such a defensive perimeter is control of all coastal seas that offer access to China's critical coast - regardless of what international law as written by Western imperialists dictates. This is the fundamental driver of Chinese actions in the South China Sea. **The next step, however, is control of the first island chain that abuts those seas: currently controlled by US allies (Philippines, Taiwan, Japan).**

This logical progression of objectives is seen from a Chinese military perspective as a "defensive strategy" of access denial. With PLA doctrine deeply rooted in Party ideology that has always viewed the US as a "capitalist imperialist power" with which conflict is inevitable, military development clearly reflects this "defensive" strategy. Traditional US foreign policy analysts have often found allies within Chinese foreign policy circles that appreciate the risks of this progression. But **PLA priorities dominate Party concerns due to the Party's dependence on military forces as both its original source of power and its continued defender of last resort.**

This defensive mindset of the need to develop a defense perimeter to protect against outside threats is not only diligently cultivated in the Chinese population by Party propaganda. It is **fundamental to the Party's strategy in terms of both military posture and also authoritarian control against threats beyond its borders.**

UNDERSTANDING THE PARTY'S UNIQUE IMPERIALISM

In order to "defend" its power, **the Party's modus operandi is to develop its power base and identify threats using incredible intel capabilities and tracking tools, then crush those threats with the prospect of overwhelming power**. It is less focused on imperial maritime or land expansion in the traditional sense, merely ensuring that no individuals or regime might challenge Party authority. **This is a type of empire that dominant foreign policy frameworks have fundamentally failed to grasp, both in operational terms and as a threat driving inevitable conflict under the CCP.**

The Party has demonstrated this long-term strategy clearly in its growing efforts to monitor and suppress anti-Party individuals and groups overseas, targeting both Chinese and non-Chinese citizens. There is growing appreciation of both the strength of the Party's systems of monitoring and control as well as its intentions to expand these systems to identify and neutralize threats across the globe. Nonetheless, **traditional foreign policy networks continue to be consumed with the details of short-term inter-state dynamics, i.e. negotiations over trade, the terms of Hong Kong's handover and Taiwan's status, etc.**

PROSPECTS FOR ILLUSORY STABILIZATION

Our expectation is that under a Biden administration dominant foreign policy networks will largely return to this approach. **This may give a cyclical sense of stabilization of the "China" relationship, but it will also give time for the Party to continue to develop the resources necessary to implement its "defensive" plan.**

CYCLICALITY OF CHINESE RELATIONS

As a result, **China dynamics should be understood as fundamentally cyclical**. Following any initial Biden foreign policy détente, a further press of the Party's agenda both in terms of authoritarian monitoring and control as well as geographic establishment of its defensive perimeter can be expected. [...] a "reset" scenario our expectation is th[...] expected to press its agenda aggressive[...]

As a result, **any positive short-term ma[...] understood as a cyclical rebound with[...] trajectory.**

China SCI 300
Last 12 Months

CHINESE MARKET DYNAMICS

Of significant note given the **profound [...] during the month of July** is the **major stock market rally China enjoyed over the same time period**. This has been attributed to expectations that China has effectively contained the COVID threat and is poised for a return to strong economic growth, and also to clear Party policy efforts to encourage higher market valuations.

China SCI 300
Last 12 Months

BloombergMarkets

China SCI 300 vs. S&P 500
Last 12 Months

BloombergMarkets

The above charts detail this impressive July rally and compare it with US market performance. **Much focus has been on how this indicates relative performance in handling the COVID threat.** We emphasized the likely value of aggressive COVID containment as seen in China early in our COVID reports, but we see this rally as also [...] to US China policy.

China SCI 300 vs. S&P 500
Last 12 Months

EXCEPTIONAL CONTROL

[...]nomic integration could allow the US to shape [...]ntinues to be very much a command and control [...]inate. This level of dominance far exceeds [...]nomic levers to either engender a loosening of the [...] collapse of China."

[...]**this level of control has been deepened by efforts** [...] has not only increased state importance in economic growth but also increased isolation of Chinese from direct interaction with foreigners due to strict international travel controls.

BloombergMarkets

22.00k

20.00k

18.00k

BloombergMarkets

07/31 | 1,066,153,60
2.000B
1.500B
1.000B
500.0M

Sep   Nov   Jan   Mar   May   Jul

FINANCIAL M

In addition _____ _er **significant market anomaly in July: an exceptional rally in gold.**

Spot Gold
Last 12 Months

07/31 | 1,985.90

1900.00

1800.00

1700.00

1600.00

1500.00

BloombergMarkets

07/31 | 275,960
600.0k
400.0k
200.0k

Sep   Nov   Jan   Mar   May   Jul

|	
SIGNALS OF LATENT INFLATIONARY PRESSURES?	**It is worth considering whether these two dynamics might be related**: i.e. whether the rally in gold is indicative of its role as an inflation hedge, with **anticipation of a "post-COVID" return to growth in the Chinese market driving expectations of a looming global dynamic that has inflationary implications.** Reinforcing this perspective, **copper also rallied strongly in July** – a critical commodity that traditionally rallies or drops based on Chinese and global manufacturing expectations. **However, oil did not rally**. This may indicate an expectation of continued low global demand levels, but it also may be based primarily on supply dynamics.
A SPECULATIVE BUBBLE?	It is worth considering whether July's substantial precious metal rally indicates growth expectations or **may simply be the most recent speculative bubble in an asset class that is prone to volatility**. *As can be seen in the above chart from its trajectory during the initial COVID crisis, gold is not inherently a safe-haven asset in times of turmoil.*
OR A SHIFT TO HARD ASSETS?	Any **concerns that gold's rally is somehow indicative of financial market instabilities related to a looming COVID-related macroeconomic demand collapse in the US seems dubious**. Gold's rally would only make sense in this context if it somehow reflected an expectation that stimulus measures to respond to such a collapse of demand in the US would lead to some type of inflationary pressures and drive **a preference out of the US currency and into hard assets.**
DOLLAR DYNAMICS	In the context of such a tail-end scenario, it is worth noting that a **significant drop in the US dollar relative to other major global currencies also took place in July.**

Dollar Drop vs. Other Major Currencies

Japanese Yen	Euro	Swiss Franc

USD - JPY
Last 12 Months
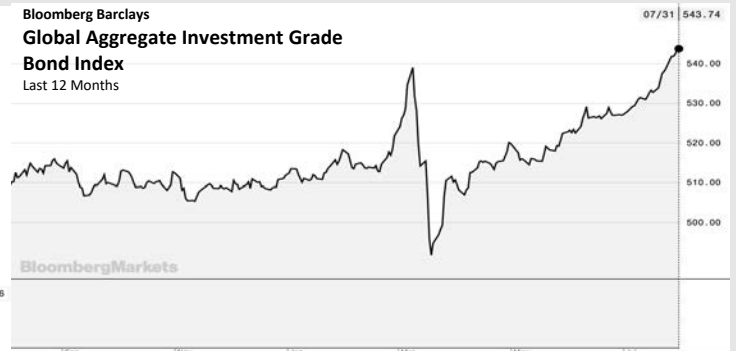

Euro-USD
Last 12 Months
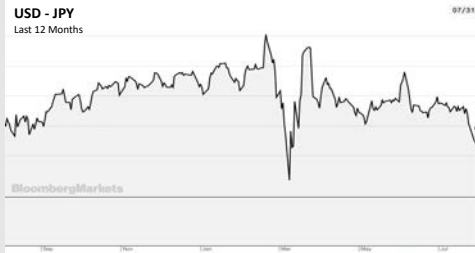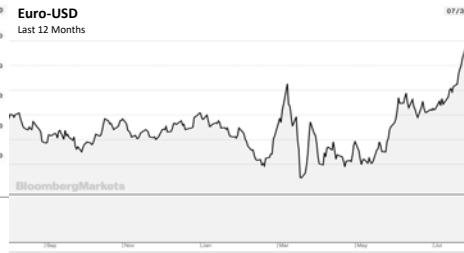
USD – Swiss Franc
Last 12 Months

SAFE HAVEN ASSET TRENDS

The shift out of the dollar into other currencies was not disproportionately large in terms of movement into ~~the~~ [one] currency: the Japanese Yen.

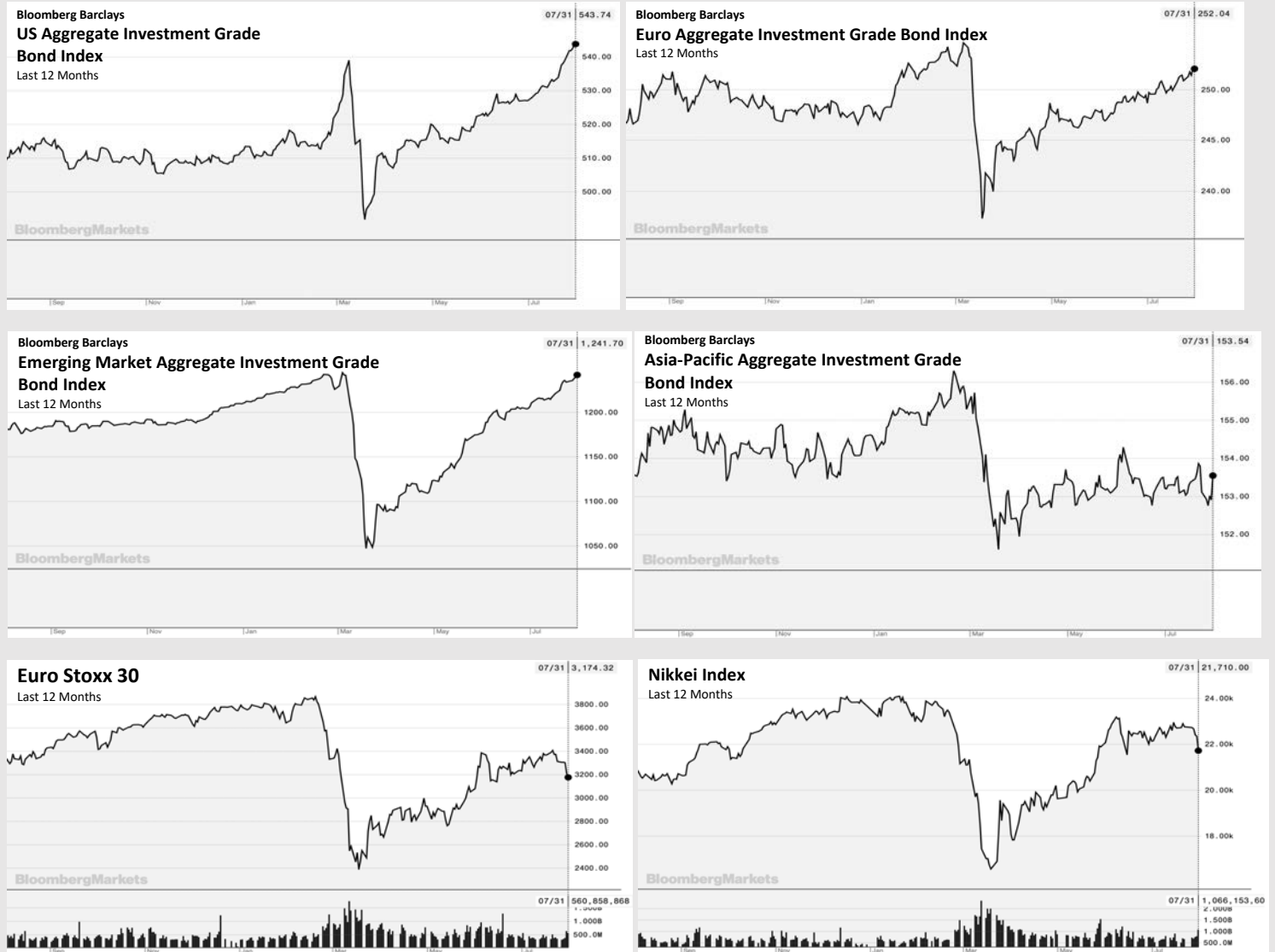Further compound[ing] [the] [tren]d flows into what has long been the principal safe-[haven] [asset] [as] traditional "risk-off" indicator, the US stock mark[et] [outperformed] bond indices across the globe.

US Treasuries 10YR Yield
Last 12 Months

US Treasuries 10YR Yield
Last 12 Months

S&P 500
Last 12 Months

Bloomberg Barclays
Global Aggregate Investment Grade Bond Index
Last 12 Months

US ASSETS REMAIN ROBUST

Any interp[retation] [of] [these] [trends] [as] [a] [sign] [of] systemic instabilities related to poor US management of COVID and the potential for a looming collapse in US demand is not only undermined by US equity market trends. **US bond markets significantly outperformed other global bond markets in July**, too.

Euro Stoxx 30
Last 12 Months

Global Bond and Stock Indices

Bloomberg Barclays
US Aggregate Investment Grade Bond Index
Last 12 Months
07/31 543.74

S&P 500
Last 12 Months
07/31 3,271.12

Euro Stoxx 30
Last 12 Months
07/31 3,174.32

Bloomberg Barclays
US Aggregate Investment Grade Bond Index
Last 12 Months
07/31 543.74

Bloomberg Barclays
Asia-Pacific Aggregate Investment Grade Bond Index
Last 12 Months
07/31 153.54

Nikkei Index
Last 12 Months
07/31 21,710.00

Spot Gold
Last 12 Months
07/31 1,985.90

LIQUIDITY DYNAMICS LIKELY DRIVER

liquidity – especially in the US, which ha[s] ... policy in response to COVID than other ... probable driver of these market trends. ... *move out of the US dollar, however, are* ...

Abundant liquidity tends to drive up th[e ... **in limited supply**. In this context, the rec[ent] ... likely reflects liquidity dynamics.

Whether these financial dynamics are indicative of excessive liquidity as might be associated with a rapid return to economic growth and even inflationary pressures, or preemptive expectations that there will be a need for further liquidity measures to

respond to further deterioration in US COVID dynamics and related macroeconomic pressures, is not definitive given current data points.

GCR continues to monitor this evolution and data signals closely to best advise clients on outlook relevant to their investment sectors.

For delivery of our periodic reports directly to your inbox, sign up [here](#) or at our website. To discuss bespoke research of interest to you or offer feedback, contact us [here](#).

ABOUT OUR BACKGROUND IN PREPARING THIS REPORT

GCR Director of Research Mark Reedy was a team leader in pandemic responses for the United Nations and is an experienced economist, financial analyst, and diplomat who served in China. He helped lead the development of infectious-disease prevention and treatment programs on behalf of the Global Fund to Fight AIDS, Tuberculosis, and Malaria on the ground in Equatorial Guinea, Central Africa. Subsequent work focused on advanced data analysis for the assessment of epidemiological trajectory, clinical operations, and best practices with a Gates Foundation / Clinton HIV-AIDS Initiative co-project called the Consortium for Strategic HIV Operations Research.