US Presidential Election Preview

Authors

Aatu Kokkila

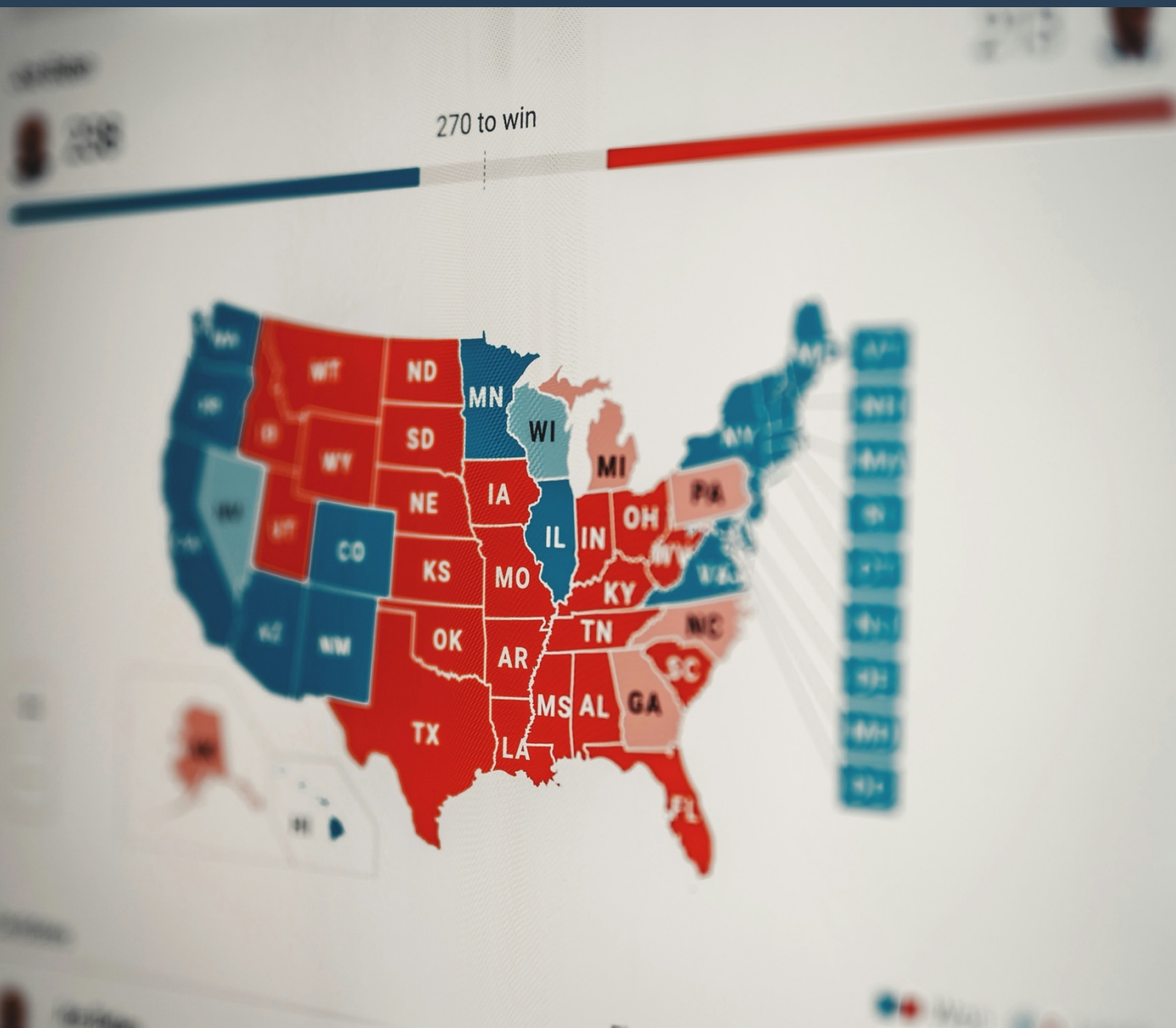**Antti Maimanen**

Date

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FOREWORD

In this research report, we outline everything you need to understand about trading the US presidential election on election day in G10 FX markets.

The election has been described as pivotal in shaping the direction for markets. While as traders we are naturally contrarians and hence bound to react to such hype with healthy scepticism, this is one of the rare occasions where the event will most likely be very volatile and with opportunities abound.

Given the US presidential election is once just every four years, we decided to reveal some of the contents from our historical databases leveraging data logs of trading the past presidential election events. In particular we will discuss how the 2016 election was initially mispriced.

Nothing in the reports is of course investment advice, you must come up with your own conclusions how the pieces of the election puzzle come together. Although the report is primarily targeting institutions, even a less experienced trader can walk away with ideas how to trade, hedge or manage positions during the election.

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The US Elections in brief

The US will hold a Presidential Election November the 5th. On top of the presidential election, there will be an election for House of Representatives and the United States Senate.

In the unique US presidential election system, 270 electors are required for victory. Most of the electors, e.g. New York for Harris, Texas for Trump, are what we can call 'certain' electors. In total there are 226 certain electors for Harris and 219 for Trump.

There are seven key swing states, Arizona (AZ), Georgia (GA), Michigan (MI), Nevada (NV), North Carolina (NC) and Pennsylvania (PA). These states determine who wins the election.

Out of the swing states, AZ, GA and NC are leaning more towards Trump – 11 + 16 + 16 = 43 more for Trump (total 262).

NV, WI, MI and PA are very close and could go either way – 6 + 10 + 15 + 19 = 50 electors up for grabs.

So, Harris needs to win 44 electors to win, Trump needs 8 (assuming the Trump-leaning swing states vote for Trump).

The most likely path to Harris victory is grabbing all the WI, MI and PA. The most likely path for Trump victory is winning any one of WI, MI or PA which seals the deal.

Therefore, no wonder betting market odds for Trump are looking high!
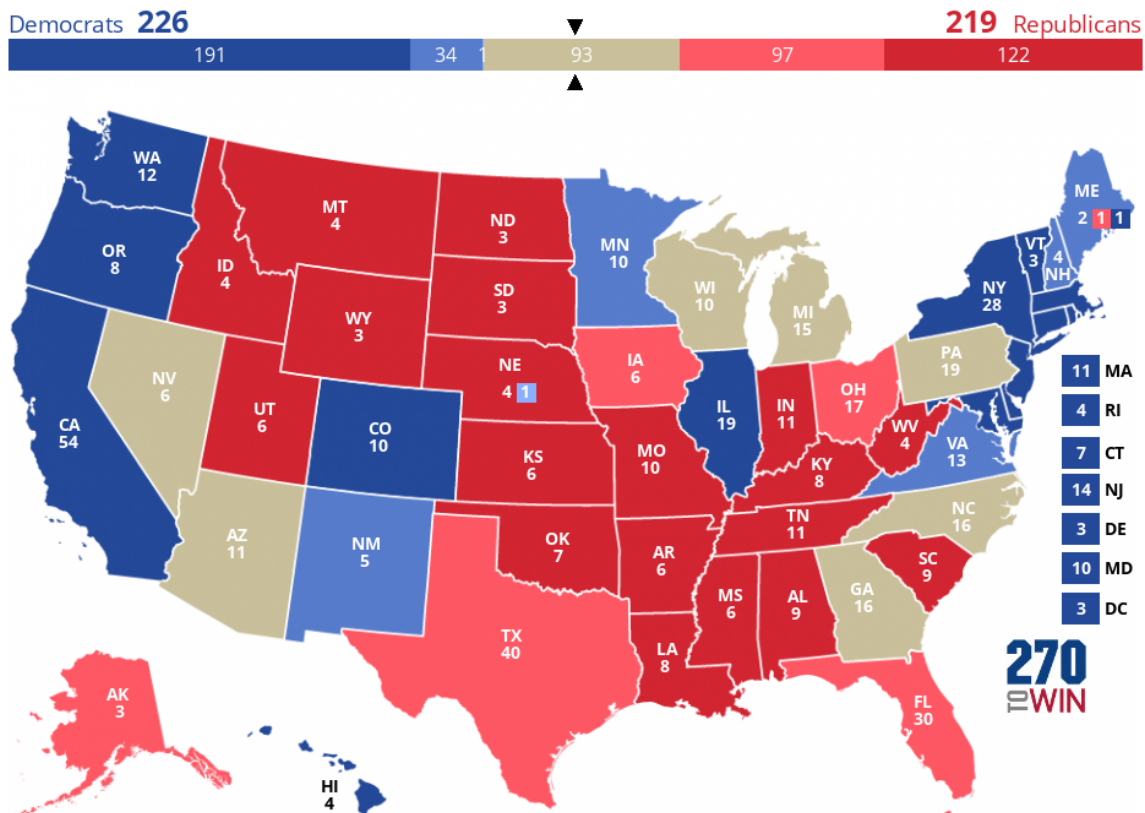
Source: 270towin.com

Candidate's policies

There are two key elements to assessing each candidates' policies, fiscal policy and trade. Both candidates are seen fiscally "looser" than Biden, reflecting stimulatory proposals (Harris less tax hikes than Biden, Trump outright extension of tax cuts) leading to a larger deficit and more government debt.

Trump is clearly seen as more stimulatory (and inflationary) than Harris. For this reason, expectations are that the Federal Reserve might not be able cut rates as much with Trump in office as with Harris, which is one of the reasons why Trump presidency is seen as a positive for the USD. Moreover, more fiscal stimulus comes with accelerated short-term growth, which is another positive.[1]

Fig. 1: Fiscal Impact of the Harris and Trump Campaign Plans (trillions, 2026-2035)
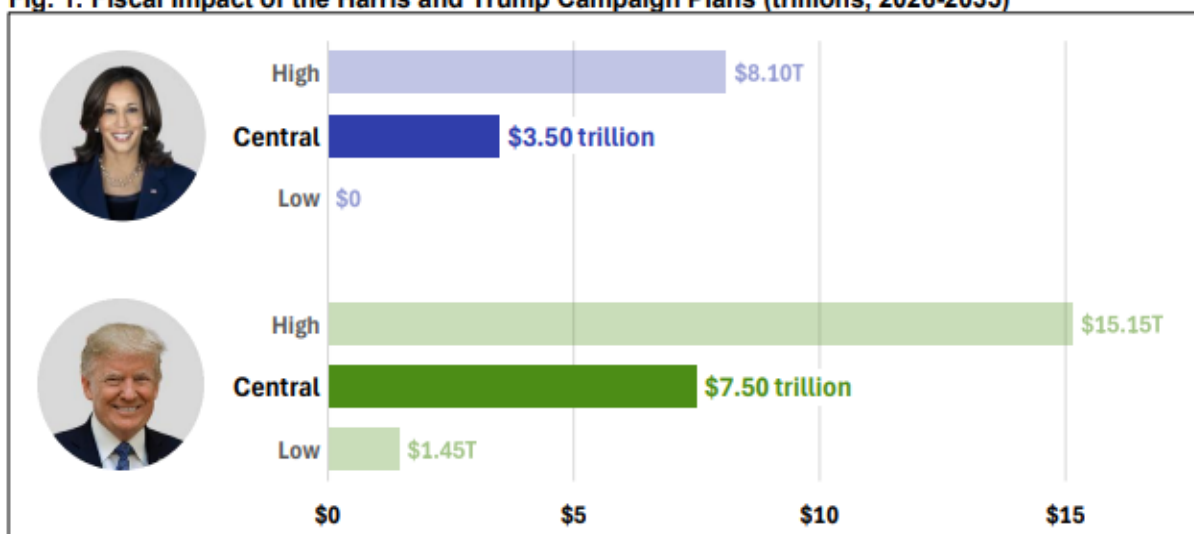
Finally, Trump is likely to implement tariffs on trade, including a 10% tariff on all imports and 60% tariff on Chinese imports. With Harris one can simply expect continuity of Biden's policies, though moderate tariffs for Chinese goods are expected.

In terms of roughly assessing probabilities what policies will get implemented, there's a rule of thumb that

1. A sweep (the President's party controls both houses of Congress) will enable the President to pass any legislation more easily. With a divided Congress the enactment of FIPO (taxation & budget related) is harder and compromises must be made. Hence the house election is also particularly in focus.
2. Tariffs can be implemented via executive orders meaning the balance of power in Congress is less important

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[1] https://www.crfb.org/papers/fiscal-impact-harris-and-trump-campaign-plans

What is priced into the market?

At the time of writing, the market is pricing in roughly 65% chance of Trump victory depending on source and roughly 40-50% chance of Republican Sweep[2]. The market reaction on Election Day is <u>initially</u> based on how these probabilities swing, until potentially secondary logics step in.

The probabilities are contingent on

1) Initial "certain states" showing any surprises in terms of victory margins
2) Any of the Trump leaning states providing "surprises" for Harris
3) The outcome of the ever-important swing states i.e. WI, NI and PA. In base case, these electors decide the election and Pennsylvania is the most likely Kingmaker.

Note on prediction markets: A Bloomberg analysis of Polymarket data has shown that a significant portion of the rise in Trump's odds can be attributed to a few "whales.", i.e. big orders placed on Trump. This has sparked speculation of manipulation in order create a sense for momentum for the Trump campaign and has made some question the credibility of betting odds as an indicator of the real election sentiment. [3]

However, we have seen Trump's odds simultaneously rising in other betting markets as well, not just Polymarket, and this has also coincided with a strong USD across the board.

Therefore, our view is this: whether the betting odds were manipulated or not, and whether the intentions of the "whales" were benign or malign, doesn't really matter for us as traders. The bottom line is this: a Trump presidency is more in the price than a Harris presidency.

Market reaction scenarios

Combining the market pricing and our knowledge of the candidates' policies we can come up with rough scenarios on how the markets will price the election. Since this report is published on Friday, we highly recommend everyone to check the implied volatility data on Monday to determine the likelihood of exact market movements!

US Presidential Elections		
Scenario	Probability	Expected FX market reaction
Trump Victory - No Sweep	20%	USDX stronger in a choppy price action by 100-150 points. Trump without a sweep could be a mean reverting scenario vs. the EUR and JPY, though still very negative for currencies suffering from protectionism, especially CAD and MXN.
Hawkish: Trump Sweep	45%	USDX stronger by 100 – 150 points and once the sweep is confirmed, USD stays strong. Trump with a sweep is particularly negative for the JPY.
Dovish: Harris Victory	30%	USDX will sell of 200-300 points initially. Harris without a sweep is the most USD negative scenario. MXN and CAD could emerge as the largest winners, though JPY migh also benefit, if stocks sell of initially.
Harris Sweep	5%	Similar FX market rection as in Harris victory.

Source: Thales Research

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[2] Based on aggregate of betting odds from Polymarket, Predictit, Fivethirtyeight and *Betfair*.
[3] https://www.bloomberg.com/news/features/2024-10-25/polymarket-whale-traders-how-1-of-bettors-are-boosting-trump-s-odds

Buy rumour, sell fact?

Could there be a "buy rumour, sell fact" market reaction? That is the market reverting the initial euphoria/panic completely. In one of the most famous such market reactions in history, in the 2016 election, stocks went initially limit down and dollar sold off 3% (below is a chart of USDJPY). However subsequently the markets retraced and both stocks and USD trended significantly higher.

Why did the market revert? Well, it sure wasn't because Trump's presidential speech was "presidential" or "conciliatory", although that was the news outlets first opinion![4] Most likely explanation was that despite all the scaremongering pre-election, Trump came with a lot fiscal stimulus which was a great thing for economic growth regardless of his brash demeanor.

Could there be a similar trade here? We highly doubt so, while we think the mechanism could still exist in certain circumstances, the massive Trump trade in 2016 was based on the market having not priced in the fiscal stimulus at all.

On smaller scale "buy rumour, sell the fact" trades, we think the Trump victory is so well in the price, that unless republicans sweep the house, the market might revert a lot of it on the same day, especially if there's signs of no republican sweep.

Equally we are not sure a Harris victory will have much long term impact on FX markets, as that is a status quo and the dollar direction will depend on the data moving forward. On intraday basis though, we believe the USD will sell off.

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[4] https://www.bloomberg.com/news/articles/2016-11-09/dollar-erases-loss-as-clinton-leads-in-florida-north-carolina

Understand how the vote counting affects the markets

The votes trickle in a way that can be confusing to understand because voting via mail is more popular among Democrat voters than Republican. For the first time in American history, the most common way of voting in 2020 was to receive a ballot by mail.[5] However, law changes enacted since 2020 should speed up the counting of mail-in ballots, which have tended to favour Democrats but have been embraced more widely this year by Republicans.[6]

Regardless, if history is any guide these <u>factors imply that initial results are skewed</u> towards Trump in states where counting mail-in votes in advance is not allowed and vice versa.[7]

Market will draw its conclusions much earlier than the election is called, therefore if one wants to bet probabilistically, <u>you have to come up with conclusion way earlier than the vote is called.</u>[8]

Certain states; Many of the "certain electors" are called in earlier than the swing states. For example, if Harris does well in "red ruby" states of South Carolina and West Virginia the probabilities could go up for her victory. Depending on victory margins for each candidate this could have an impact on probabilities, though we would not draw conclusions yet.

Arizona – Initial results favor Harris (pre-counting of mail-in votes is allowed, and mail-in voting is very popular). Trump win odds at the time of writing (1.11.) stand at 66% based on probabilities from FiveThirtyEight.

Georgia – No clear favourite for initial results (pre-counting votes is allowed, can vote in advance both in person and via mail). Trump odds at 63%. GA is one of the earlier swing states and **Harris lead here could flip the odds.**

Michigan – Initial results probably favor Harris (large jurisdictions are allowed to count mail-in votes in advance). Harris odds 58%. **If initial results favour Trump this is meaningful, and election could be priced in quickly.**

Nevada – Initial results slightly Favor Trump (the state accepts mail-in votes up to 4 days after the election as long as they are postmarked by Nov. 5.). Odds are tied.

North-Carolina – Initial results slightly favor Harris (both mail-in and in person votes are counted in advance). Trump odds 60%.

Pennsylvania – Initial results favor Trump (the counting of mail-in votes isn't allowed until election day). Trump odds 54%.

Wisconsin – Initial results favor Trump (similar rules to Pennsylvania). Harris odds 56%. **If Harris leads Pennsylvania and Wisconsin, this is meaningful.**

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[5] https://elections-blog.mit.edu/articles/how-policy-influenced-partisan-divide-over-voting-mail
[6] https://www.thetimes.com/world/us-world/article/when-us-election-results-announced-time-dgcqm52jw

[8] For potential timelines, see https://www.livenowfox.com/news/election-results-vote-count-timeline-swing-states-2024

When do we know the winner?

It depends on how down to the wire the vote and counting is. Many news providers focus on the fact the election will not be "called" until a couple of days. This does not mean the market will not price the winner fully much earlier.

During the last election, for example Pennsylvania and the National vote was only called on Saturday, but the market had priced in a Biden victory 90% ten hours after the polling stations closed. Trump victory in 2016 was priced in even sooner, roughly five hours after the polls closed.

Overall reviewing our sources and internal material from last two elections, we think the election will be priced in roughly six-eight hours after the closing of polls in a base case scenario. However, in case of Trump win, especially in any of the contested swing states (PA, MI, WI), the election might be priced in a couple of hours after the polls close.

How will the probabilities shift in practice? A historical look

To showcase in practice how market moves based on probabilities, below is an excerpt of the headlines from Trump Victory in 2016 (from our internal library) and five-minute screenshots from EURUSD. Time zone is Eastern European Time (EET), i.e. six hours ahead ET.

As a background Trump odds were roughly 15% right before the polls closed, having stood at 20% a week earlier. At the time the consensus market reaction expectation was that Trump would be terrible for dollar and stocks, and the view that his policies might actually be great for the economy was a fringe opinion.

Notice how at 3.45 EET (9.45 pm ET) Trump was leading Florida by 1.1 percentage points with 91% of votes reported. (red). At the time Florida was the key swing state to watch.

Time	Description
3:45	Swing states in play: **Florida: Trump 49.0% vs. Clinton 47.9% (91% reported)** Ohio: Trump 46.9% vs. Clinton 49.9% (61% reported) Virginia: Trump 50.2% vs. Clinton 45.0% (53% reported)
3:55	Swing State: Michigan (10% having reported): Clinton 49.3% vs. Trump 45.6%
3:59	Swing State: Ohio: Trump 48.1% vs. Clinton 48.0% (37% reported)
4:02	Official result: Trump wins Nebraska
4:02	Official result: Trump wins Kansas
4:04	Risk assets seeing downside as Trump consolidates lead in Florida, edges ahead in Ohio, North Carolina now neck and neck and Trump holding onto gains in Virginia
4:04	Official result: Clinton wins New York
4:05	Official result: Trump wins Wyoming
4:06	Official result: Trump wins Texas
4:06	Official result: Trump wins North Dakota
4:07	Official result: Trump wins South Dakota
4:13	Official result: Clinton wins Connecticut
4:15	Broward County, Florida has only reported 16% of its vote, its very large and Democrat

4:25	Swing State update:
4:27	Rolling Electoral Map: Trump (128) vs. Clinton (97)
4:35	Official result: Trump wins Louisiana
4:35	**NY Times model now predicts Trump win (52% chance)**
4:43	Bookies now have Trump and Clinton neck and neck and NY Times model puts Trump as more likely winner as he leads in several key swing states and is now likely to win Florida
4:49	Rolling Electoral Map: Trump (136) vs. Clinton (104)
4:53	NY Times model now predicts Trump win with 59% chance (20% before any votes were counted)
4:58	Fox New now predicts Clinton to win Virginia
5:01	Official result: Trump wins Montana

Table 1: Headlines from Trump victory in 2016

Source: Ransquawk, Thales Research

Notice how Trump probabilities had arisen at 4.35 to 50%, from initial 15%. Even though at 3.45 based on Florida you could just Trump odds must be much higher than 15%, market had barely budged! Our theory is that many participants *hadn't studied the election system, leading to inefficiencies*!

Now by 5.41 the odds had shifted to 90% for Trump. By that time the election had been in the price. On the above chart market EURUSD topped 1 hr after.

Time	Description
5:02	New York Times model now predicts Trump win with 64% chance (20% before any votes were counted)
5:07	25% of the votes now counted in Michigan (Trump 49.7% vs. Clinton 45.1%)
5:09	Rolling Electoral Map: Trump (151) vs. Clinton (122)
5:15	Three of the four states Trump needed to win (Florida, Ohio, North Carolina and Iowa) look likely to be won – with Clinton in the lead in Iowa, although only 11% of votes have been counted)
5:42	**NY Times model now predicts Trump win with 91% chance (20% before any votes were counted)**
5:49	NY Times model now predicts Trump with 94% chance (20% before any votes were counted)

Table 2: Additional headlines from Trump victory in 2016

Source: Ransquawk, Thales Research

Concluding remark

Given markets understand the importance of betting odds much better than in previous election (we have been slightly disappointed as mainstream media has begun to pay attention!), most likely similar mispricings won't exist this time as in 2016 election.

Most likely the trades will be *very different*, than in 2016 and 2020 election, but there are important mechanisms one can learn from this report

1) That the market moves initially probabilistically to the simple logic whatever is concerned by the consensus

2) Afterward there's a possibility of "buy rumor, sell the fact", depending on the extent of participant being priced in and their policies.

We hope this report has been of good use!

Good luck,

ThalesResearch team

ps. Stay tuned for more insights on our trading and proprietary research.

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THALES

ABOUT THALES

Thales is an event-driven hedge fund strategy deployed on data releases and monetary policy decisions in G10 currencies post-event. The strategy manages circa 30 mn at Darwinex and has have won the Hedge Fund Journal award for Best Performance in FX for the past 5 years (incl. 2023 and 2022).

ABOUT AARNIKOTKA

Aarnikotka Tutkimus (EN: Gryffon Research) is a trading signal provider and a research company based in Jyväskylä Finland. We provide trading signals directly to Thales (THA) strategy managed by Darwinex, an FCA and CNMV regulated investment platform in Spain and UK.

IMPORTANT NOTICE

Aatu Kokkila
Founder & Trader
Thales Research

Antti Maimanen
Analyst
Thales Research

Further inquiries:
info@aarnikotka.com