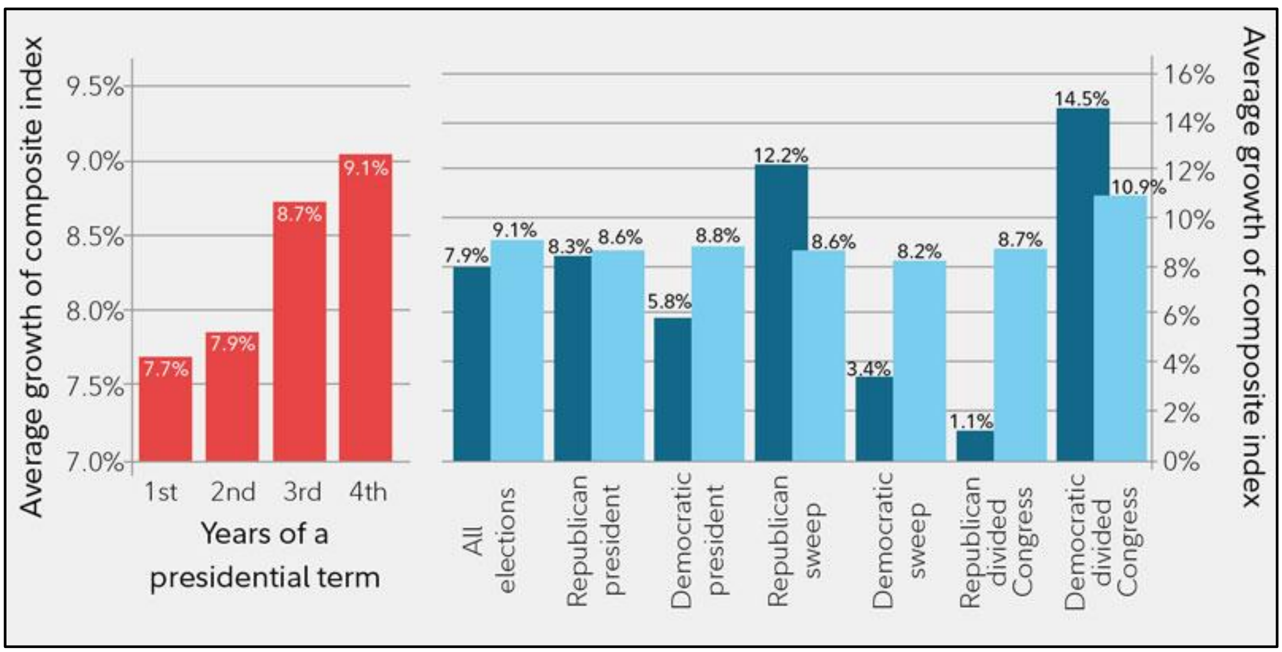
POLITICS & PORTFOLIOS

The upcoming U.S. Presidential Election will undoubtedly have a significant impact on our country; however, investors should exercise caution when mixing their politics and portfolios. While the short-term market anxiety is reflected in higher volatility as November approaches, statistical research has shown that elections are not correlated with the long-term performance of the market. In terms of the market impact, the elections of Barack Obama and Donald Trump drew dire warnings from both sides of the aisle. Most of these alarmist positions, two of which are highlighted below, proved to be incorrect. This is because corporate earnings, interest rates and economic growth are the long-term drivers of the market, and not which party occupies the White House.

- March 2009: Michael Boskin, professor of economics at Stanford University and a senior fellow at the Hoover Institution, wrote "Obama's Radicalism is Killing the Dow", explaining "the continued sell-off on Wall Street and the growing fear on Main Street is a product, at least in part, of the realization that our new president's policies are designed to radically re-engineer the market-based U.S. economy". [i]
- October 2016: Simon Johnson, a former chief economist at the International Monetary Fund and a professor at MIT's Sloan School of Management, wrote "The Consequences of a Trump Shock", explaining that in a Trump presidency "we should expect a big markdown in expected future earnings for a wide range of stocks – and a likely crash in the broader market". [ii]

The charts below are from research by Jurrien Timmer, Director of Global Macro for Fidelity Management & Research Company, outlining trends of the Presidential Cycle since 1789. The left panel shows how the first two years of a presidential term produce below average returns, and the last two years produce above average returns. The right panel shows market returns based on various election outcomes, with the dark blue bars representing the first 2-year return and the light blue representing the 4-year return. What is evident by this data is that any differences in return have narrowed by the time a full 4-year term has taken place (for example, after two years: Republican sweep (12.2%) and Democratic sweep (3.4%), after four years: Republican sweep (8.6%) and Democratic sweep (8.2%)).



Timmer explains the only notable gap in returns over a 4-year period, which is when there is a gridlock scenario of a divided Congress:

"Part of this difference could just be the result of small sample size...there were only 6 instances of a Democrat winning the White House without taking control of both houses of Congress, including President Obama's second term in 2012 as well as President Clinton's second term in 1996. These were very strong periods for the market, producing annualized gains of +22% and +27%, respectively. There were only 9 gridlock cycles on the Republican side, including George W. Bush's first term in 2000, right at the top of the tech bubble. That produced a 2-year annualized return of −25%. Ronald Reagan's first term in 1980 produced a 2-year return of −2% as the double-dip recession of 1980 and 1982 was still finding its bottom." [iii]

Regardless of which political party holds office, the market impacts have been unpredictable over time when considering the mix of fiscal and monetary policy in the face of recessions, war or health pandemics. While the party in control can certainly dictate legislation, such as tax reform, the impact on the market is not always what is assumed. With fiscal policy, for example, "in the 13 previous instances of tax increases since 1950, the S&P 500…has shown higher average returns in the calendar year of the tax changes…the market either discounts it in advance or the economy has received stimulus to offset it." [iv] Regarding monetary policy, Presidents Reagan, Clinton and Obama benefited from the Fed continuously lowering rates during their terms (besides a few brief increases), as all inherited recessions of various severity and spurred by different causes. All statistically receive credit for outsized market returns driven by easy money, and generally improving economic fundamentals, which was completely independent of them. Conversely, while President Bush had no association with the tech bubble, his first term is still statistically defined by outsized market losses during that time. The combination of market forces with unprecedented events like September 11, the Global Financial Crisis or the COVID-19 Pandemic profoundly override any impact the Oval Office may have.

Planning around a U.S. Presidential Election that will have a short-term impact on market prices is advisable, however, this is inherently part of building your investment guidelines. If there have been any changes to your financial picture, or if your risk tolerance has changed, RMC is here to discuss. Making investment decisions solely by your political preference involves timing the market based on unpredictable events, which regardless of politics, is not a sustainable investment approach. Maintaining a historical perspective and a long-term focus is important during volatile periods in the market. Goals-based investing is rooted in your needs and objectives with an intent to protect against volatility, keeping you prepared for short-term goals but remaining invested for the long-term. Like many people today, your portfolio will be happy it was left out of political discourse.

---

[i] Boskin, Michael. "Obama's Radicalism Is Killing the Dow." *The Wall Street Journal*, 9 March 2009, https://www.wsj.com/articles/SB123655157422765325. Accessed 2020.

[ii] Johnson, Simon. "The Consequences of a Trump Shock." *Project Syndicate*, 29 October 2016, www.project-syndicate.org/commentary/economic-consequences-of-trump-victory-by-simon-johnson-2016-10. Accessed 2020.

[iii] Timmer, Jurrien. "Presidential Elections and Stock Returns." *Fidelity Viewpoints*, 29 January 2020, www.fidelity.com/learning-center/trading-investing/markets-sectors/stock-returns-and-elections. Accessed 2020.

[iv] "History lessons from past tax hikes." *Fidelity Viewpoints.* 9 September 2020. www.fidelity.com/learning-center/trading-investing/tax-hikes-history. Accessed 2020.