Market Commentary

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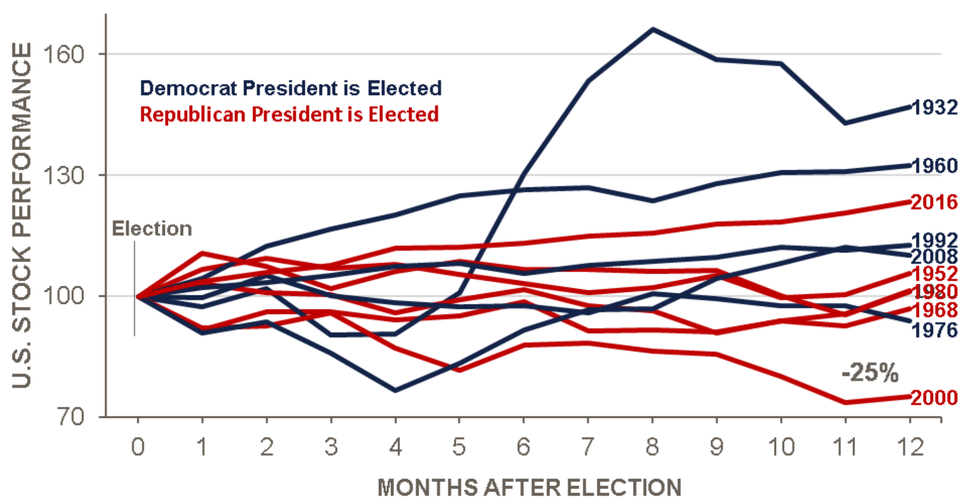
Preparing Your Portfolio for an Election

Election outcomes are inherently difficult to predict; however, it seems that uncertainty has increased in recent years. Looking back four years, no one thought that an outsider like Donald Trump could win the presidency. Now, as we prepare for the 2020 election, the outlook is constantly changing, and there is much at stake.

As of now, Biden appears to have a solid lead, but polls have proven to be unreliable before. Much can happen between now and November, so it's far from certain who will win the election. The congressional elections are also important to consider, as they will be key in either empowering or neutralizing whoever wins the presidency. With the advantage shifting toward the Democrats over the past six months, the potential for a Democratic sweep has become a distinct possibility.

Some investors fear that a Democratic sweep would be negative for markets, as tax and regulatory cutbacks from the Trump era could be reversed. On the other hand, others are critical of Trump's handling of the current health and civil crises and fear the consequences of another four years under his leadership. Either way, it could be tempting to view this election as a good time to sit out of the markets, especially given currently stretched valuations, social unrest, and coronavirus (COVID-19). However, in the last 100 years, there is no historical precedent for a market collapse or even a correction following an election that shifted control of the White House, as illustrated in the accompanying graph. The only apparent exception is the 2000 election and the -25% decline that followed over the next 12 months; however, that bear market resulted from the dot-com bubble bursting, not the 2000 election.

U.S. STOCK RETURNS AFTER CONTROL OF WHITE HOUSE CHANGED
(1920-2020)



Source: FactSet, Shiller, S&P

For those who think this election is different, it's helpful to remember that investors typically worry that the outcome of an upcoming election will be especially troublesome; however, their fears are often unfounded. For instance, there was great uncertainty leading up to the 2008 election. Similar to now, the economy was in a deep recession, and some feared a Democratic sweep would be bad for businesses. However, in the 12 months after Democrats swept the 2008 election, U.S. stocks were up 10%. Then in 2016, some pronounced that stocks would suffer a certain decline if Trump was elected. Instead, stocks rallied 24% in the 12 months following the Republican sweep.

It's not that politics don't matter. Leadership and governance are very relevant to investing. However, the thought of a single election completely derailing the economy seems far-fetched. We have a federal, constitutional government with multiple independent branches that provide checks and balances. In addition, the political environment is just one of many factors that drive the ultimate success of an economy. It's unlikely that policies would change in such a certain and abrupt manner that politics would be a primary driver of near-term financial market prices.

In the U.S., elections and political developments are typically too short-lived to have a pronounced and lasting effect on long-term assets like stocks. Most of the value of publicly traded companies are derived from future cash flows—related to things like population growth, capital investment, and innovation—well beyond a president's four-year term. What's more important are the systems and institutions that outlast elected officials and change only gradually. And, if Americans believe policies need adjusting, they need only wait two years until the 2022 midterms to issue a course correction.

We believe that a decision to divest of stocks now would likely be detrimental to long-term returns because, despite stocks' high valuations and projected low economic growth, globally diversified stocks still have much higher expected long-term returns than cash. Also, trying to time the markets is not advisable. History and academic studies demonstrate that attempts to get out and back into markets to avoid potential adverse events don't work. Because markets are forward-looking, it's unforeseen and unpredictable risks, rather than known risks, that typically cause markets to tank.

Instead, to protect against an uncertain future and unstable economies and markets, we recommend that clients have a financial plan and diversify accordingly. Money that's needed in the near term should be protected from the volatility of the stock market, and when allocating long-term monies, investors should consider valuations and a range of potential economic scenarios.

Ultimately, we rest in God's loving control over all things. Acts 17:26 says, "[God] marked out [nations'] appointed times in history and the boundaries of their lands." Based on this, we believe the next president and the future of our country are under the control of our Savior Jesus Christ.

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