McCARTHY GRITTINGER
FINANCIAL GROUP LLC

Stock Markets and Elections

August 2020

Election 2020

We are less than three months away from another US Presidential and Congressional election. Much ink will be spilled (or data sent throughout the internet) regarding what the future will look like after Tuesday, November 3rd. This, along with a pandemic, will make the Fall more tense than other years. Data will be squeezed, twisted, and turned into a story that is favorable to the party telling it. This should not be surprising. When the issues turn to economics, much of what is said is speculation at best. Most policies discussed will need input and agreement from others. That means policy being discussed will look different in practice. Economics, like the virus, has no one path to conclusion.

Voting for the US President is a binary decision. There is no in-between choice. You cannot fill in one oval 75% and the other 25% to make your one vote (fun facts about ranked-choice voting[i]). Even though we are voting on many issues, the one vote promotes a winner and loser mentality for voters (either "my" person won, or “my” person lost). It is an us against them adversarial mentality. The thought of “losing” is difficult to stomach which can cause your mind to wonder. And, sometimes, this mentality shifts to investor views on the stock market direction.

[i] Ranked-choice voting is an electoral system in which voters rank candidates by preference on their ballots and is used in several state Jurisdictions, one state (Maine) at the state level, and a few countries around the world (article). For example, suppose there were five candidates running for mayor of your city. The ballot would enable you to rank them, one through five, in the order in which you would prefer each of them to be mayor.

Markets

Elected officials certainly help shape many policies across many different industries. Maybe the biggest decisions are related to fiscal (spending and collecting of tax dollars) policy. Given their role, it becomes easy to assume that the elected officials have a large effect on the future direction of the stock market. Many news outlets will promote this idea as well. Expect to see charts of Presidential years and associated stock market returns and maybe a story of why those are correlated. Those stories and headlines bring in viewers, so they will be repeated. The stock market went up or down today, this week or this year and the President was the reason. However, I would argue there are too many variables to make that direct comparison. We are not saying that the President cannot affect stock market returns. It is the degree of how much it is affected that is in question.

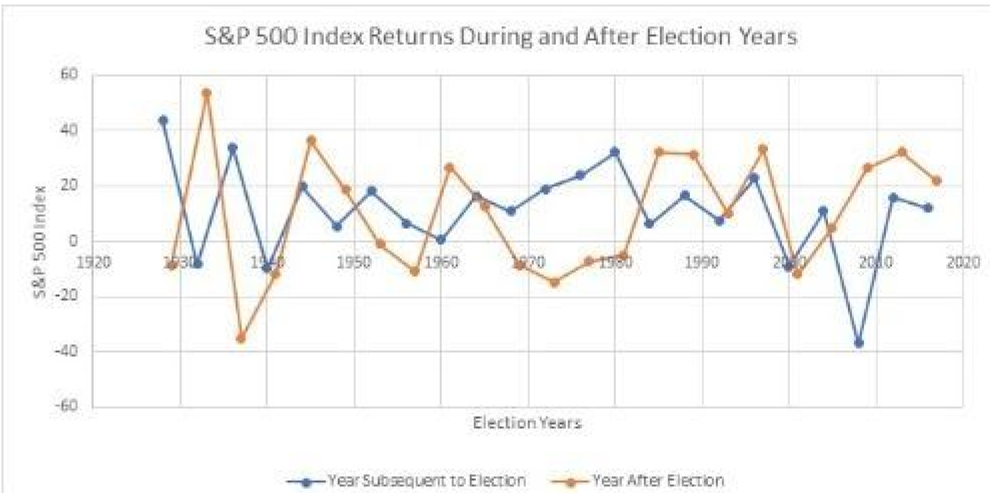
Personally, it would be fun to see someone try and quantify the effect a President has on the stock market. The analysis would go something like this:

- Assuming no Presidential interference, the baseline return should be X.
- Observe returns which we would call Y.
- The difference between X and Y would be the value added in the stock market by the President

This is obviously a fictitious illustration. There are just too many moving parts to the stock market to be able to reliably determine how much of the stock market movement was attributable to the President's actions. This example also illustrates the ridiculousness of attributing returns to a President’s specific term (good or bad). This is a simple story, but gets fuzzy quickly in practice.

One variable that I think may have more weight than the President is where we are at in the business cycle. Ups and downs for various reasons have been constants throughout time.

To illustrate the business cycle theory, see the following chart. The ups and downs look more like normal business cycle patterns than anything else.



Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Index returns are not representative of actual portfolios and do reflect costs and fees associated with an actual investment. Actual returns may be lower. Source: The S&P 500 data is provided by Dimensional Fund Advisors.

What to Do

The biggest issue we have with predicting stock market returns in election years is the short-term nature of the prediction. Investors can get into trouble when the predictions being made and acted upon differ from the time horizon for their portfolio. Typically, client portfolios are built for a more long-term time horizon. Making predictions about Presidential elections are short-term. For instance, a four-year term looks inconsequential within a 30-year time horizon.

Making large portfolio changes based on short-term events is not ideal. Just as the prior chart highlights (very sharp turns) the markets will fluctuate in the short-term. However, when you show the same figures compounded over time, the long-term chart looks very different. The jagged lines are replaced by a more consistent upward-sloping line. This seems simple but, given the news-noise, it is not always easy to keep your long-term goals aligned with your long-term investment strategy. Timely reminders are needed to be able to see over longer horizons and we love these conversations with our clients.

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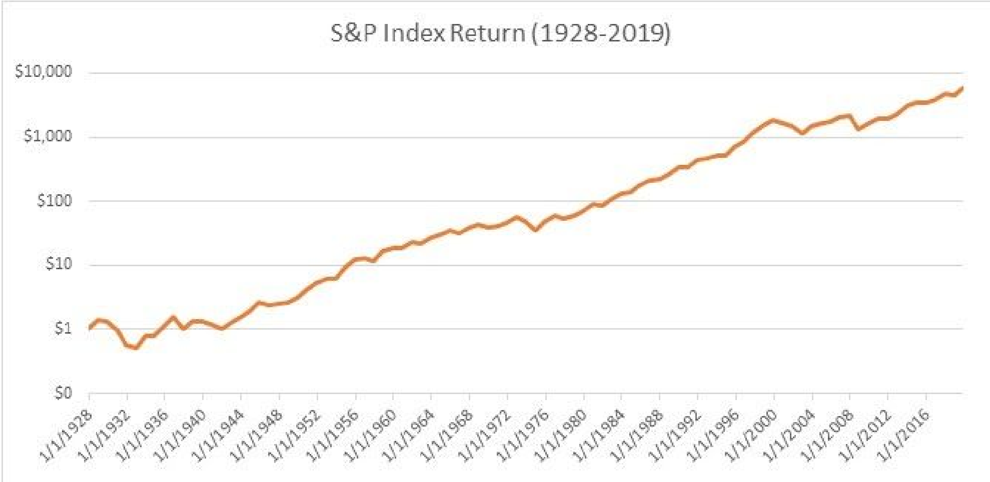

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Are there reasons to have short-term concerns regarding the Presidential election? Yes. Will we ever know how the actual path would have been different if the other nominee won? No. However, we do know that no one event happens in isolation. The results of current events will change future responses to the next event and the business cycle should continue to live on.

New Blog – Wealth for Good

In attempt to increase communication on current events, we have created a new blog on our website: https://mgfin.com/wealth-for-good/

The goal of this blog is to publish short weekly commentary regarding a relevant topic in the news. As we have discussed previously, data and stories are not in short supply these days. This is not our attempt to clutter the internet with more noise. This is our way of translating world events through our investment and planning lenses. Hopefully, these will give helpful perspectives on current news. Maybe it triggers additional questions for you and your advisor. Maybe it helps bring clarity to a confusing situation. Maybe it relates to a recent issue a friend or family member was recently talking about. In the end, the goal is to help individuals and families better use their wealth for good. “Good” meaning how each individual defines it.

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