Don’t Let Your Politics Interfere with Your Portfolio

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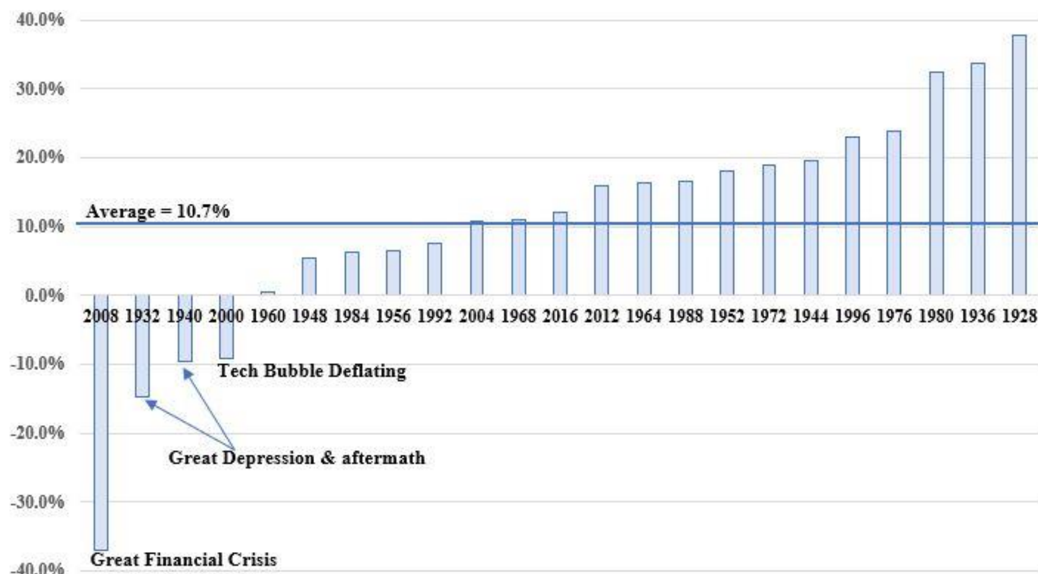
Despite all the concerns surrounding COVID-19 (see RGT’s thoughts here) and yesterday’s surprise 50bps reduction in the Fed Funds rate, it’s hard to forget that this year is an election year. We all know what that means: incessant media coverage of candidate personalities and their policy proposals – caricatures and unrealistic talking points, mainly. Many policy proposals, regardless of which side of the aisle they come from, would likely have a direct impact on your investment portfolios: higher capital gains taxes, financial transaction taxes, taxation on unrealized gains, or various regulatory changes. Other policy proposals may have a more indirect, though no less impactful, effect as they consider broader issues that could spur or hinder both domestic and global economic growth.

However, all the above is a quadrennial version of the movie Groundhog Day. 2020 is hardly new in terms of political “uncertainty” overhanging markets, though perhaps the rancor this time around is exceptionally impressive. The recently concluded impeachment proceedings only add to this year’s novelty and political polarization – no president has previously sought reelection following impeachment as no president had been impeached during his first term in office.

As Super Tuesday results continue rolling in, there are precious few things we can be confident in. What we do know is that the Democratic nominee set to challenge Donald Trump will emerge between now and November. It will be tempting for investors to react to political headlines by making significant portfolio changes. **History is decidedly on the side of simply staying the course.** What we continually remind ourselves, even when tempted to believe otherwise, is that not only is the future unknowable, so is the response of the market to unexpected news.

The 2016 election is a recent and appropriate example. As election results were rolling in throughout the evening of November 8, 2016 and it became clear Donald Trump would win the presidency, U.S. stock market futures were down as much as 5.5% from where they closed earlier that day. The common narrative was that the markets fear “uncertainty.” Hillary Clinton was a known political quantity while Trump was a wildcard. Trump winning was a shock to market expectations and the selloff was apparently the result of uncertainty being priced in. However, by the time the market opened on Wednesday, the U.S. markets had recovered 4% from the overnight lows and even closed Wednesday higher than they’d closed on Tuesday, before election results started rolling in. The S&P 500 ended up rising almost 6% from the time of the election through the end of the year. **All that to say, it’s hard enough to handicap the outcome, but even harder to handicap the market’s reaction to the outcome.**

S&P 500 Total Return During U.S. Presidential Election Years



As can be seen above, U.S. presidential election years have historically been quite normal relative to non-election years for equity markets. Since the 1928 presidential election, U.S. large cap stocks have averaged a return of +10.7% per year during election years and +11.6% during non-election years. There have been four negative years over that time, each of which were likely unrelated to the political machinations of the time and a result of economic imbalances or speculative excesses. This is not to say that elections cannot or will not weigh on markets, but the historical precedent suggests otherwise.

Now, what does an investor do with this information?

- Remember that consensus expectations and experts are often wrong and "sure things" are only certain in hindsight.
- Think strategically: do not let political noise undermine your investment strategy. We believe you should continue to allocate your portfolio based on your long-term income and growth needs given your tolerance for risk and volatility. Diversification can be helpful for uncertain times and historically has shown to help limit volatility when the unexpected occurs.
- Recognize that underlying fundamentals likely matter more to portfolio results over the long-term than who wins an election.
- Even when the election results are known, understand that there will still be significant uncertainty regarding which tax and spending policies will become law.

Please let your RGT advisor know if you would like to discuss these ideas or others at your earliest convenience.

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