

Investment Perspectives

Presidential Election Year to Impact Markets

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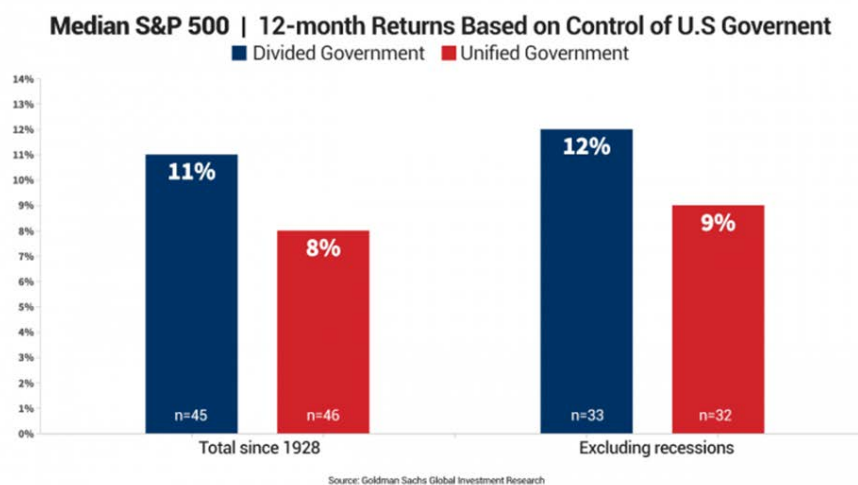
Key Takeaways

- The upcoming election cycle will have an impact on markets in 2020 and beyond
- History shows that returns are higher following elections that result in divided government
- It appears unlikely today that control of Congress will change regardless of the Presidential election outcome
- GDP growth is a bigger driver of market returns than which party has control of the White House

As the U.S. Presidential cycle enters an election year in 2020, it can be a worthwhile exercise to review the impacts that elections tend to have on market behavior. A lot can happen between now and next November, but polling data, predictive markets, and historical data can help to provide context for how markets may react to different outcomes.

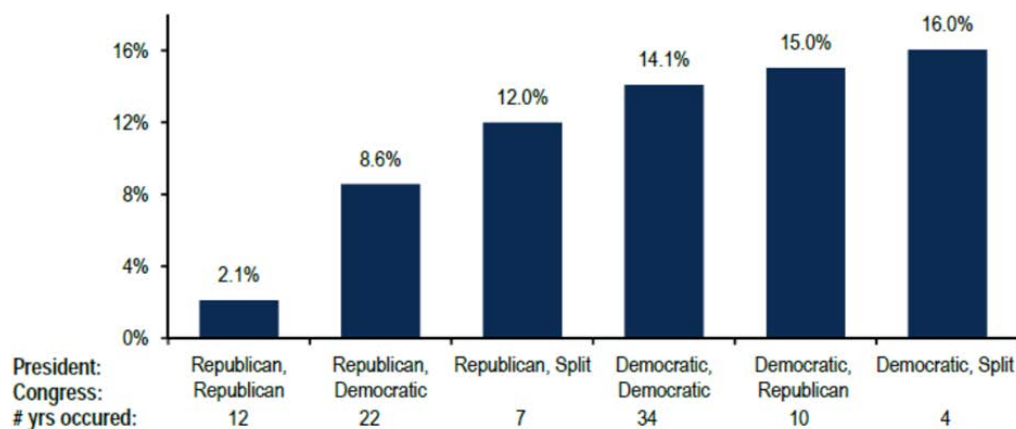
At the time of this writing there are 312 days until the 2020 Presidential and Congressional elections, a virtual lifetime when it comes to politics and the fate of politicians. Things are bound to change, perhaps a lot between now and then. But when November 3rd arrives, Americans will head to the polls to cast their votes and in the process determine the fate of the markets. This isn't a judgement of any candidates' policies, although those will have some bearing on future returns. It's merely an observation of how markets have historically performed under different political circumstances. Philosopher George Santayana famously said, "Those who do not learn history are doomed to repeat it." Of course, this time may be different, but let's see what we can learn.

The political climate in the U.S. has gotten more and more contentious. Both Democrats and Republicans have become more polarized. As a result, it may not come as a surprise that markets favor a divided government. While voters are frustrated by gridlock, the stock market tends to prefer it. As the chart below illustrates, the average annual return under a divided government is 3% higher than a unified government.



But not all divided governments are the same. As can be seen in the next chart, there is a clear distinction between a divided government with a Republican as President and one with a Democrat. The average annual return for a Republican President was 7.6% versus 15% for a Democrat. The difference has had very little to do with policy and more to do with the state of the economy. Gross Domestic Product (GDP) growth has averaged 3.6% for Democrats and 2.6% for Republicans over this period, which says a lot more than politics. The important thing to note is that regardless of who wins the presidency, the markets do better when Congress is controlled by the other party or split between them.

Avg. annual S&P 500 total returns based on control of White House & Congress, 1928-present



Note: Excluding 2008, average for Republican President, Democratic Congress is 10.2% (still the second-weakest period). Total returns 1936-present and price returns prior to that.

Source: S&P, FactSet, BofA Merrill Lynch US Equity & US Quant Strategy



Since a unified government is far more capable of passing legislation that may be considered extreme by both moderates and members of the other party, it can create a heightened level of anxiety amongst investors. This anxiety feeds into the market by reducing the overall valuations of stocks and ultimately leads to lower returns.

With the Democratic nomination still up for grabs, its still too early to tell who might become the next President or what their policies might be, but we can get some insights by looking at the predictive markets and recent polling data. Real Clear Politics has Joe Biden leading the field of Democratic candidates.

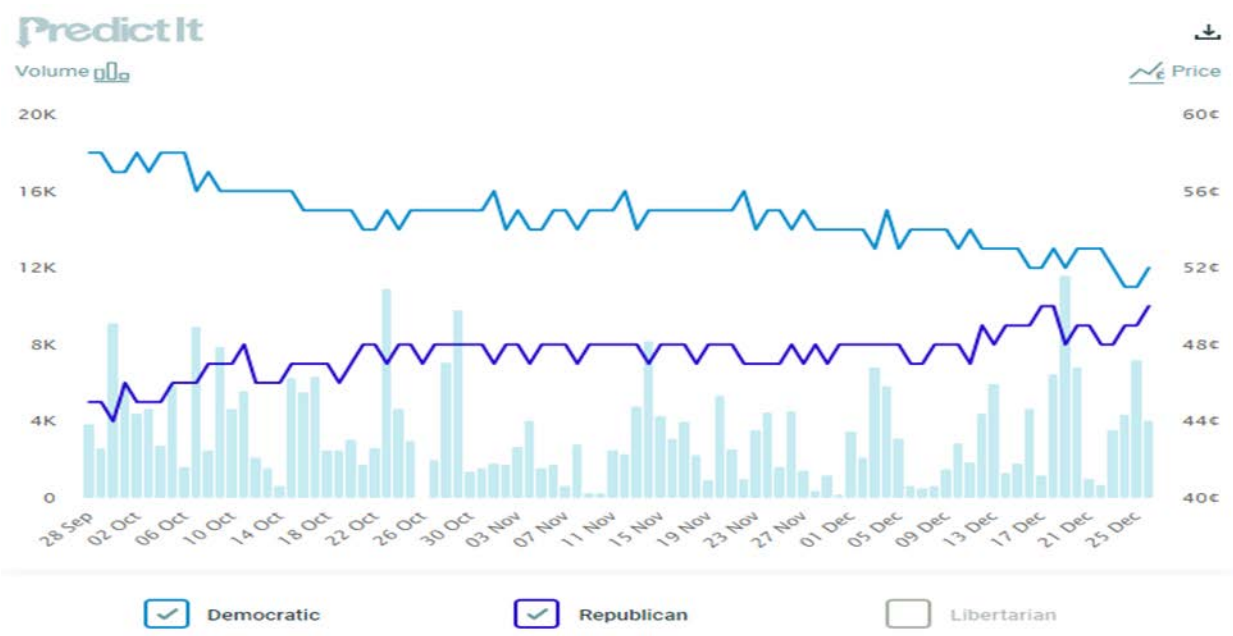
Polling Data															
Poll	Date	Biden	Sanders	Warren	Buttigieg	Bloomberg	Klobuchar	Yang	Booker	Gabbard	Steyer	Castro	Delaney	Bennet	Spread
RCP Average	12/5 - 12/24	28.1	18.8	15.2	8.4	4.9	3.5	3.5	2.5	1.7	1.5	1.2	0.5	0.5	Biden +9.3
Economist/YouGov	12/22 - 12/24	30	17	19	7	4	5	3	2	2	1	1	1	0	Biden +11
Morning Consult	12/20 - 12/22	31	21	15	9	6	3	5	3	2	3	1	1	1	Biden +10
Emerson	12/15 - 12/17	32	25	12	8	3	2	6	2	4	2	0	1	0	Biden +7
NBC News/Wall St. Jnl	12/14 - 12/17	28	21	18	9	4	5	3	2	2	1	1	0	0	Biden +7
CNN	12/12 - 12/15	26	20	16	8	5	3	3	3	1	1	2	1	0	Biden +6
The Hill/HarrisX	12/13 - 12/14	29	13	13	5	5	3	3	2	1	3	4	2	1	Biden +16
Quinnipiac	12/11 - 12/15	30	16	17	9	7	3	3	2	1	1	1	0	0	Biden +13
USA Today/Suffolk	12/10 - 12/14	23	14	13	8	6	3	2	3	1	1	0	0	0	Biden +9
NPR/PBS/Marist	12/9 - 12/11	24	22	17	13	4	4	5	4	1	0	1	0	1	Biden +2
IBD/TIPP	12/5 - 12/14	26	18	14	9	5	2	2	3	1	2	1	0	1	Biden +8
FOX News	12/8 - 12/11	30	20	13	7	5	5	3	2	3	1	1	0	1	Biden +10

All 2020 Democratic Presidential Nomination Polling Data

Source: Real Clear Politics

The polls currently have Biden and Sanders beating Trump head-to-head, but Trump beating Warren and Buttigieg. PredictIt, a market that offers prediction exchanges on political and financial events, shows the Democrats having a slight advantage over Republicans for the White House although the lead has been shrinking the past few months.

Presidential Race

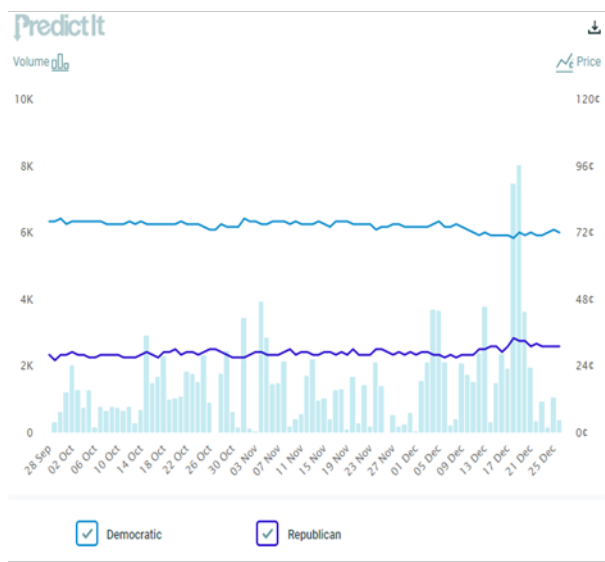




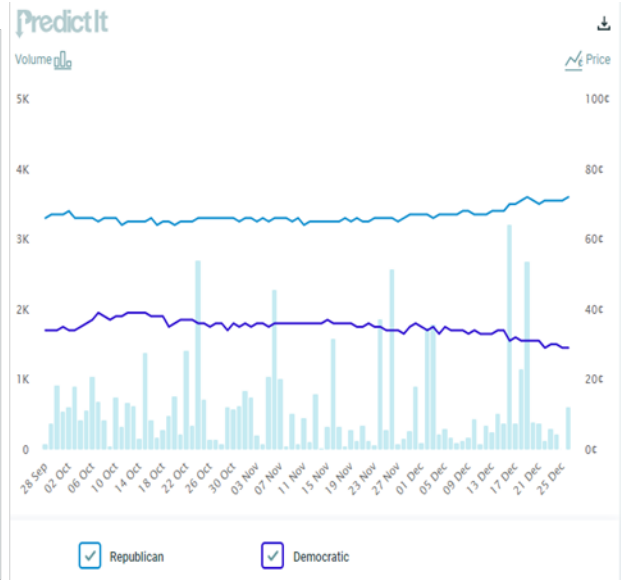
In Congress, Democrats currently have a majority in the House and Republicans control the Senate. Republicans would need a net gain of 19 seats to gain control of the House and Democrats would need a net gain of 3 seats in the Senate. Unfortunately for Republicans, the last time the House changed hands during a Presidential election cycle was in 1952. Of the 92 competitive seats in the House, only 24 are considered “toss-ups”, and of those only 6 lean Republican.

In the Senate there are 14 competitive seats up for grabs, with 3 considered “toss-ups”, so the Republican margin for error is small. However, bettors believe the Democrats will retain control of the House (72% implied probability) and Republicans keep the Senate (72%).

Control of House of Representatives



Control of Senate



While the polls are of little solace given their recent track record in predicting these outcomes, the best case scenario for investors remains a divided government. While we salute each individual’s freedom to vote for the candidate they believe is the right choice, our hope is for the checks and balances our forefathers envisioned, and better returns in 2020 and beyond.