Election Outcomes and Market Returns

On election night four years ago, Dow futures dropped nearly 1,000 points as news hit that President Trump was going to win Florida. In the early morning hours following, we crafted an email for client distribution reinforcing our long-term investment principles. With our collective efforts, we finalized a draft and disseminated to clients near the market open. Amazingly, by that time, the Dow had already turned positive, erasing all the overnight losses.

Looking back to 2016, the initial selloff was the result of a surprise in the election outcome, rather than an immediate repudiation of the prospects of a Trump presidency. Markets hate uncertainty, and the odds of a Clinton victory sat at 80% going into Election Day. Once Hillary Clinton conceded and eliminated the possibility of a contested election, markets reversed course as the Trump upset was digested.

The 2020 election odds bear a striking resemblance to 2016, with the obvious exception that President Trump is the incumbent rather than upstart candidate. While the validity of current polling can be debated, Former Vice President Biden enters the final days of his campaign with roughly the same percentage chance to win as Clinton had four years ago, at least according to FiveThirtyEight. Mathematically, Trump's current path to victory is narrow, but doable, as his odds improve to nearly a coin flip if he can retain both Ohio and Florida. Should that occur, Pennsylvania will likely decide the election. A Florida victory by Trump also increases the chances of a contested election, as the Midwestern states collect, and likely recount, their historic number of mail-in ballots.

In the short-term, markets could respond to any number of scenarios. Are election results definitive or contested? What is the composition of Congress? Do markets respond favorably to a second term for the President, even in the event he is paired with a unified Democratic Congress? If the result is a Blue Wave, do stocks rally on the near certainty of an additional round of massive fiscal stimulus? Or, do they fall as earnings expectations get recalibrated on the prospects of higher corporate taxes and increased regulation? Finally, how do the results interplay with the resurgence of the pandemic, which just hit a record number of cases?

All elections bring a heightened sense of uncertainty, and market performance tends to be weak in the month following an election. In the long-run, evidence suggests the importance of election outcomes are often overstated when it comes to stock market returns. Consider the data below:

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Presidential Terms and Market Returns Since World War II

Administration	Party	Months in Office	Annualized Return US Stocks	Initial P/E Normalized (Valuation)	Max Drawdown
Truman	Democrat	91	13.8%	13.0	-29%
Eisenhower	Republican	96	15.1%	10.7	-21%
Kennedy	Democrat	36	14.3%	18.3	-28%
Johnson	Democrat	60	10.6%	23.2	-22%
Nixon	Republican	69	-1.4%	19.3	-32%
Ford	Republican	27	16.6%	20.6	-24%
Carter	Democrat	48	11.7%	12.5	-17%
Reagen	Republican	96	14.6%	10.5	-34%
Bush I	Republican	48	14.1%	16.5	-20%
Clinton	Democrat	96	18.7%	19.6	-19%
Bush II	Republican	96	-2.8%	27.6	-52%
Obama	Democrat	96	11.4%	11.4	-23%
Trump	Republican	48	14.0%	22.5	-34%
Republican		480	8.6%	18.2	
Democrat		427	13.7%	16.3	
Overall			11.0%	17.4	

Source: Jeremy Siegel, Ben Carlson, Leuthold Group, Morningstar

» Since World War II, it is most important to note that stocks have generated significant positive returns under both Republican and Democratic Presidents. Although not shown in the chart, positive return results are also exhibited when examining periods under different Congressional compositions.

» At the Presidential level, since World War II the market has produced higher returns under a Democratic President. Are these results statistically significant? Probably not. Instead, the results are likely driven by starting valuations, which have been cheaper on average at the onset of a Democratic presidency. In the long-run, valuations matter.

» The worst return for any President was during George W. Bush's 8-year run. The primary culprit of the market's struggles during Bush II's administration was quite likely that his tenure coincided with the highest initial market valuation faced by any President.

» The Dow fell 5% one day after President Obama's Blue Wave election, which is the largest election-related change in Dow history. Despite this, the Dow posted an average annual return of 11.4% during Obama's tenure. Again, the low valuations entering Obama's term likely played a factor.

» Importantly, stocks also experience drawdowns regardless of the President. Stocks have fallen at least 17% at some point during every Presidential tenure. Surprisingly, the smallest drawdown for any President belonged to Jimmy Carter, who presided during a secular bear market and failed to secure a second term in office.

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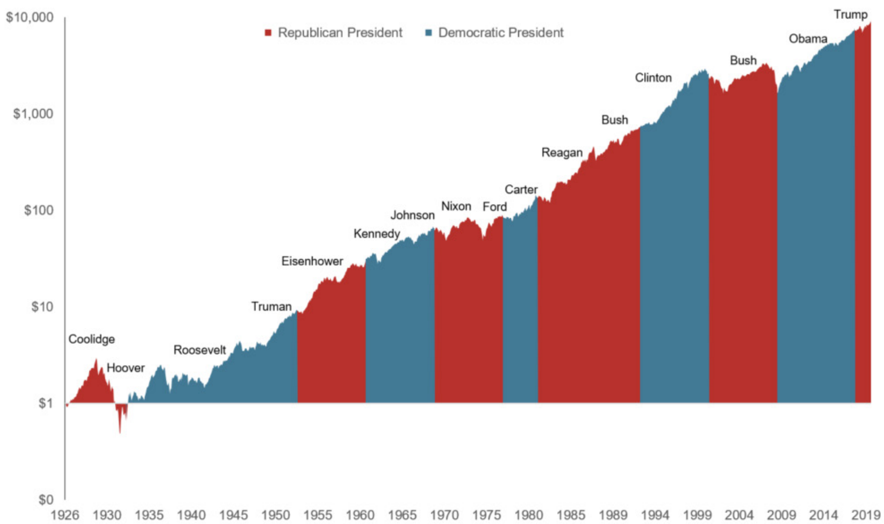

Source: DFA

Markets will continue to go up and down regardless of who is President but have rewarded long-term investors under a variety of both Republican and Democratic administrations. Our primary point in our email four years ago was that **if your investment goals had not changed, then your investment plan should not change in response to the election**. We believe this sentiment still rings true in 2020.

Please feel free to contact us if you would like to discuss further. We hope everyone stays safe and healthy as we get to the other side of the pandemic.

Your Opus Capital Management Team