SYMMETRY PERSPECTIVE:
THE IMPACT OF ELECTIONS ON YOUR PORTFOLIO

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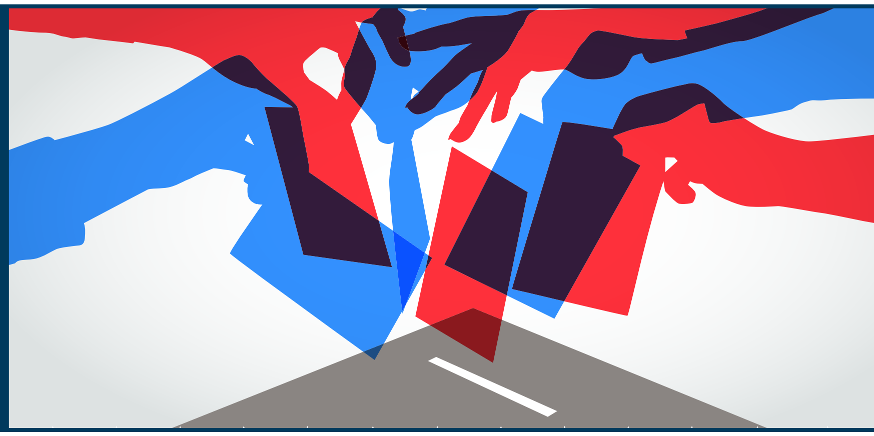
If the 2016 election taught us anything, it's that election outcomes can be unpredictable. No major network or poll predicted that Hillary Clinton would lose. If we learned anything, it is that polls provide unreliable guidance (for a variety of reasons), and pundits are fallible. After a few down days, once the markets had time to process the unexpected result, they quickly recovered.



Now with the 2020 Presidential election just around the corner, investors are once again beginning to ask, "How should I position my portfolio during election season to protect my investments and take advantage of the election's effect on the economy?"

We firmly believe that the most beneficial way to invest during this time period is the same as during any other time period: with Evidence-Based, research-backed strategies that are broadly diversified across markets, industries, nations, and the factors—identified by academia—that help drive returns.

One thing that makes the economic impact of elections difficult to predict is the implementation lag associated with the transfer of power from one president to the next. Once a candidate wins a presidential election, there is a two month window of time before he or she is inaugurated and able to implement policies that can influence the economy. This process often takes a considerable period of time. And presidents have imperfect ability to shape the economy.

Take the process of bill writing, for example. A president is not permitted to write a bill, but rather, must propose the bill to a member of Congress, who must then write and submit it to Congress. On average, a mere 4% of bills introduced to Congress are passed and signed into legislation.[1]

Even if the House, Senate and Presidency are all controlled by one party...getting major legislation enacted can be challenging. This means that change tends to be incremental. And the long-term effect of any legislation on the market or economy is hard to determine in advance.

Even if you knew with certainty which candidate would win the Presidency—and/or Congress—you would have no way of knowing how particular stocks or markets would be impacted. When Donald Trump was elected, one company favored by many stock "gurus" was Boeing. They reasoned that Trump would accelerate defense spending, and Boeing would be a major beneficiary. Then of course, Boeing ran into severe problems with the 737 Max. Then the COVID 19 pandemic drastically curtailed air travel. And Boeing's stock has declined substantially—worth about half of what it was four years ago.

With this in mind, consider that by rearranging your portfolio prior to an election, you are essentially betting on a potential candidate to win. Similarly, you are also betting that the policy platform that the candidate is running on will ultimately be enacted into law, and that this will be immediately, or at least in the near term, reflected in stock prices. Investing your money on such uncertainties may result in you exposing yourself to significantly higher levels of risk with little to no evidence to support such an investment decision.

1 http://www.huffingtonpost.com/wires/2009/08/25/thevastmajorityofbill_ws_268630.html

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The annual returns surrounding past presidential elections further back this claim, suggesting that this is not just theory, but rather a historical trend. If we examine the change in annual returns for the S&P 500 between the year of the election (the incumbent's final year) and the year directly after the election (the first year the new president is in office)[2] the change in returns is often large, sometimes for the better and other times for the worse. What is interesting about these numbers is that although from election to election they may be very large, the average change between the pre and post year election returns has been under 1%[3]. This low average highlights that if you are investing for the long run, the best way to handle an election and avoid sustaining a potentially large loss, may be to hold your course through the election just as we believe you should in any situation. By utilizing broadly diversified, factor based portfolios, you may significantly hedge your risk associated with the U.S. election by being exposed to a variety of other nations, markets and investments that will not be nearly as volatile during our election season.

A great real world example of the implementation, lag, and investor psychology in action was the Brexit vote in 2016. When the news broke that the United Kingdom had voted to exit the European Union (EU), investors across the globe immediately sought shelter from possible exposure to risks created by the U.K.'s exit. As safety was sought and money was pulled from risky investments, the markets initially dropped significantly. The S&P 500 dropped from a pre-brexit level of 2113.32 to 2000.54[4], and the FTSE 100 fell from 6338.1 to 5982.2[5] over the two trading days following the vote. Just one week later, the markets had fully recovered4 and were on their way to new all time highs.

This initial overreaction by investors who failed to realize the implementation lag associated with policy change further backs the claim that investors should not let elections influence their investment decisions. This situation is no different than a current investor seeking shelter from a possible change in presidential power.

Some are worried that this year, with many voting by mail, we will have a period of uncertainty when we don't know who the new president is. This could lead to markets over-reacting in the short term. But again, this is all speculation, and the long-term or even medium-term impact should be negligible. Nothing that warrants any changes in your portfolio.

In summary, elections often come with periods of increased economic volatility, and as such, investors become more susceptible to making emotional decisions. As the data shows, on average, the change in presidential power will likely have a null effect on returns. As a result, we believe it is more important to focus on having a well diversified portfolio that will mitigate your investment risk, not just from elections, but any event that may influence the economy and portfolio returns.

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2 http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

3 http://www.forecast-chart.com/historical-dow-industrial.html

4 https://finance.yahoo.com/quote/%5EGSPC/history?p=%5EGSPC

5 https://www.google.com/finance/historical?q=INDEXFTSE%3AUKX&start=60&num=30&ei=N2D-V_DgGdaFeK-siig