MARKET INSIGHTS

Market Bulletin

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Five Keys to Investing in an Election Year

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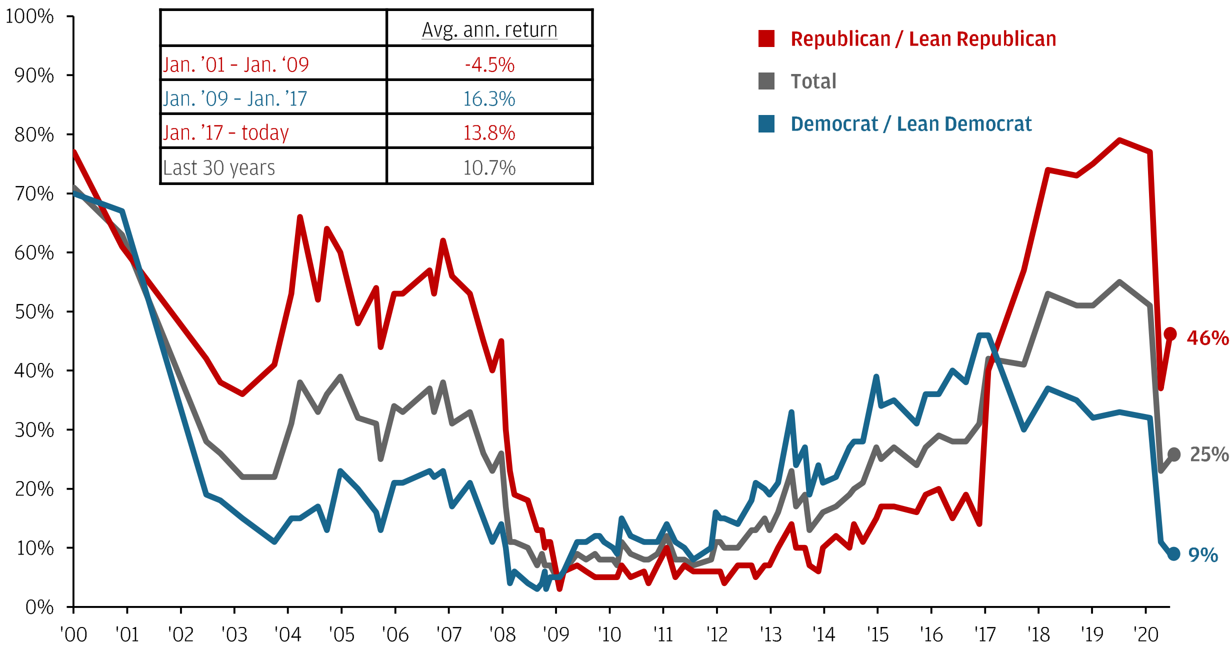
Presidential elections always add an extra element of uncertainty to investing and this is certainly the case in this most challenging of years. However, while uncertainty can create opportunity, investors often make their worst mistakes during uncertain times, mistakes which can take years for a portfolio to recover from. That is why it is particularly important to invest with discipline during election years. While the environment may be shifting rapidly, investors' long-term portfolio objectives usually aren't, making it important to stick to a plan. In focusing on the importance of a disciplined approach in the midst of political volatility, we have compiled 5 principles for investing in the run-up to an election.

1. Don't let how you feel about politics overrule how you think about investing.

Political opinions are best expressed on Election Day, not in a portfolio. To illustrate this point, **Exhibit 1** shows a survey from the Pew Research Center, asking Americans how they feel about economic conditions. The results show that Republicans often feel better about the economy under a Republican president, while Democrats often feel better about the economy under a Democratic president. Other research suggests that investors tend to invest in stocks when they feel good about the economy. However, the reality is that equity returns in recent decades have generally been positive regardless of who has been in the White House. During the Obama administration, average returns were 16.3%. Under the Trump administration, thus far, returns have been 13.8% on average. Republicans who balked at buying stocks during the presidency of Barack Obama and Democrats who refused to invest in stocks during the Trump presidency have both lost out.

Exhibit 1: Percentage of Republicans and Democrats who rate national economic conditions as excellent or good



Source: Pew Research Center, J.P. Morgan Asset Management. Pew Research Center, June 2020, "Republicans, Democrats Move Even Further Apart in Coronavirus Concerns" Question: Thinking about the nation's economy, How would you rate economic conditions in this country today… as excellent, good, only fair, or poor? Guide to the Markets - U.S. Data are as of October 5, 2020.

2. Markets don't like uncertainty. Elections almost always reduce it

The defining characteristic of the market environment in an election year is uncertainty. However, as that uncertainty dissipates, stocks often rise. This could account for the fact that, since 1940, the average fourth quarter return of an election year (2.8%) has exceeded average returns of the prior three quarters (2.0%)[1]. **Exhibit 2** shows the market 100 days before and after an election. Only in 2000 and 2008 did the market decline sharply in the weeks following the election. The fourth quarter of 2008 was, of course, the height of the financial crisis, which was likely more important than the election in driving the market lower.

However, it must be acknowledged that on one occasion an election seemed to increase, rather than reduce, uncertainty.

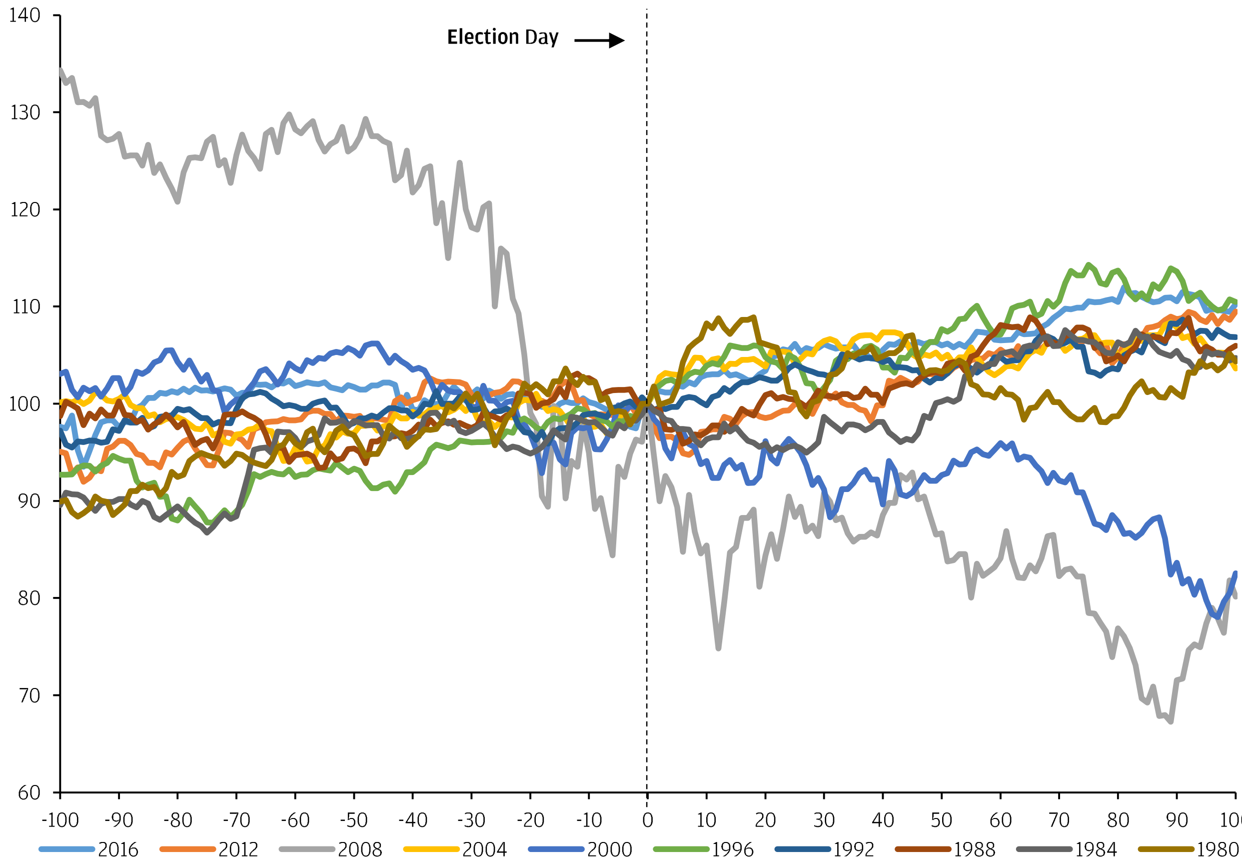
In the extraordinary presidential election of 2000, we did not get official election results until a Supreme Court ruling on December 12, 2000 and the S&P500 fell by 4.2% between the election and that ruling. Some worry that we could see a similar situation in 2020, given the increase in slow-to-count mail-in ballots. However, it should be recognized that the vast majority of even these ballots should be counted within a few days and the odds still favor the recognition of a clear winner in days rather than weeks following the election.

It is also important to highlight that during this period of uncertainty, defensive sectors, like health care, utilities and consumer staples, still had positive returns. As always, balance and diversification protect portfolios during uncertain times.

[1]S&P 500 total return back to 1940

Exhibit 2: S&P 500 Price index 100 days prior to and following a presidential election

Election Day equals 100, 1980-2016



Source: Standard and Poor's, J.P. Morgan Asset Management. Data are as of October 5, 2020.

3. Volatility may be heightened, but transitory

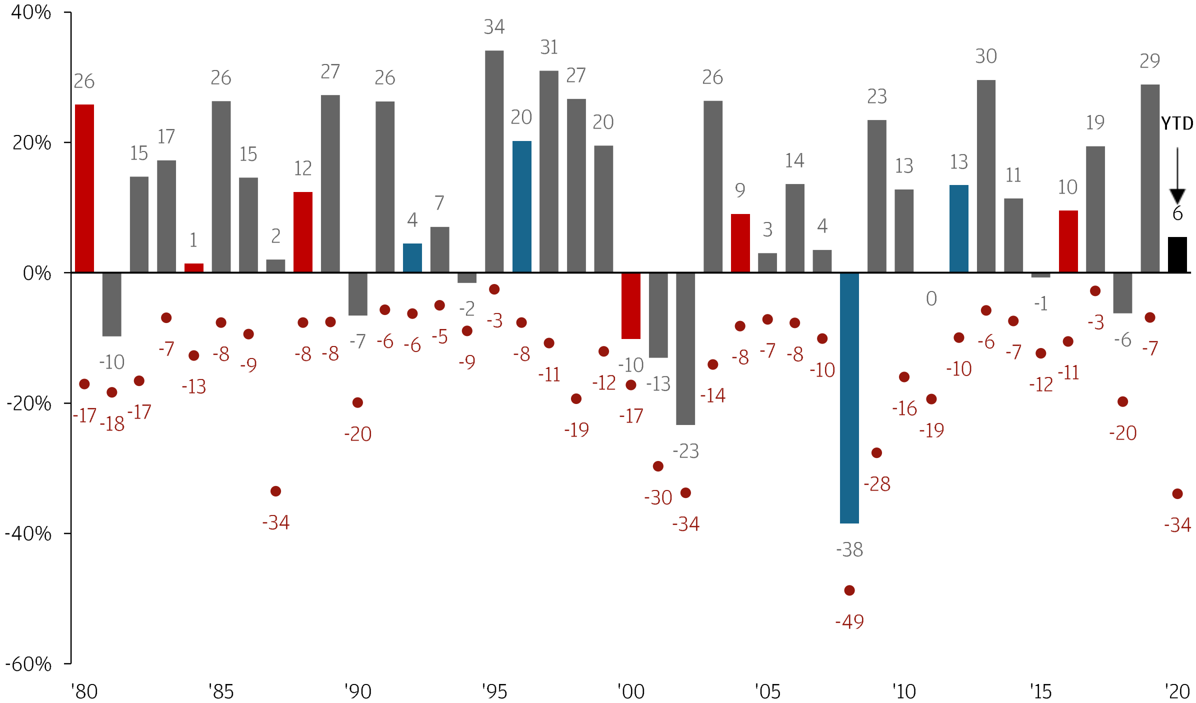
While election uncertainty can lead to higher volatility and could, in some circumstances, trigger a market pullback, it is important to consider any volatility from a long-term perspective. **Exhibit 3** shows calendar year market returns and the maximum market decline that year, with election years in red or blue depending on which party won the presidency. This spring's 34% decline resulted from the first pandemic in 100 years, 22 million people losing their jobs in two months (for scale, it took 10 *years* to create 22 million jobs), financial markets freezing up and 42 states and territories going into lockdown. It was completely unexpected; we had no playbook.

On the other hand, we have a presidential election every four years, and we are already discussing some of the complications that may arise. While we will likely see a period of volatility, the events of this spring do set a high bar. Additionally, once the uncertainty ends and we have official results, markets are likely to revert to focusing on fundamentals. After all, the market has enjoyed one of the fastest rebounds in history, thanks in part to substantial fiscal and monetary policy easing.

While we see volatility each year, we also often see rebounds.

Exhibit 3: S&P 500 intra-year declines vs. calendar year returns

Despite average intra-year drops of 13.8%, annual returns positive in 30 of 40 years



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2019, over which time period the average annual return was 8.9%. *Guide to the Markets – U.S.* Data are as of October 5, 2020.

In fact, despite intra-year declines, the market has had positive calendar year returns in 30 out of the past 40 years. Because some degree of market volatility is expected, portfolios are built to withstand some volatility. Understanding this, it is critical to be disciplined in adhering to one's investment plan.

4. Market timing is just as difficult around an election as it is at any other time.

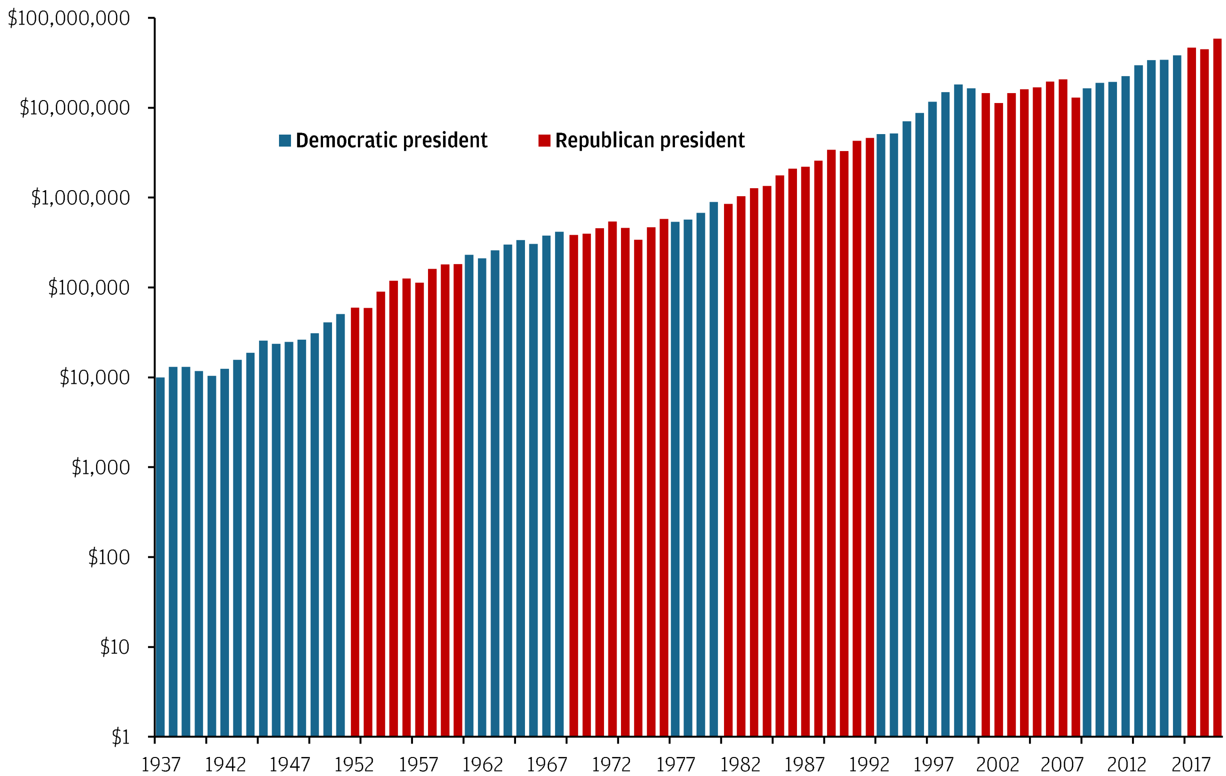
Investors may still be tempted to make dramatic portfolio changes in advance of the election, or exit the market altogether. However, not only do we not know the outcome of the election, but even if we did, we don't know how the market would react to a given outcome. For example, in the early hours of November 9, 2016, as election results were coming in and signaling a Trump victory, futures markets sold off. However, at the end of that day's regular trading hours, the market closed up 1.1%. Markets react swiftly and unpredictably and market timing around election results is just as difficult as at any other time.

5. Time in the market should dampen the impacts of election volatility over time.

Rather than trying to get in and out of markets around an election date, history points to the advantages of a long-term approach. The vast majority of people have investment horizons that extend far beyond election cycles and presidential administrations **(Exhibit 4).** Investors should remember why they are invested—whether its retirement, or other specific goals—and that portfolios are built to withstand periods of volatility in pursuit of those investment objectives.

Exhibit 4: Growth of $10,000

S&P 500 total return, annual returns, log scale, 1937-2019



Source: Standard & Poor's, J.P. Morgan Asset Management. Returns are total return, shown on a log scale. Data are as of October 5, 2020.

The Market Insights program provides comprehensive data and commentary on global markets without reference to products. Designed as a tool to help clients understand the markets and support investment decision-making, the program explores the implications of current economic data and changing market conditions.

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