SHARPER GRANITE LLC

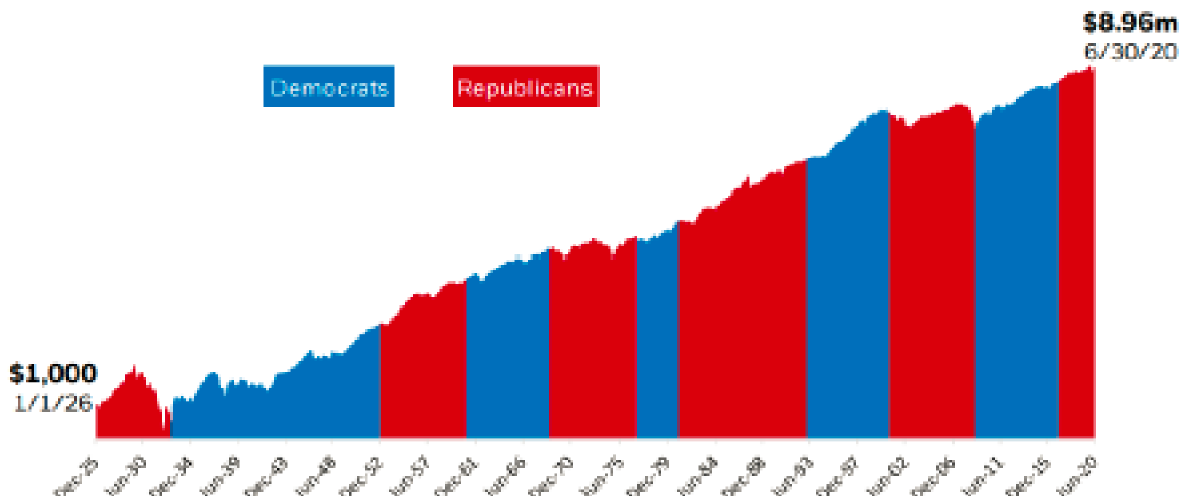
Letter on the Economy

Elections and the Market

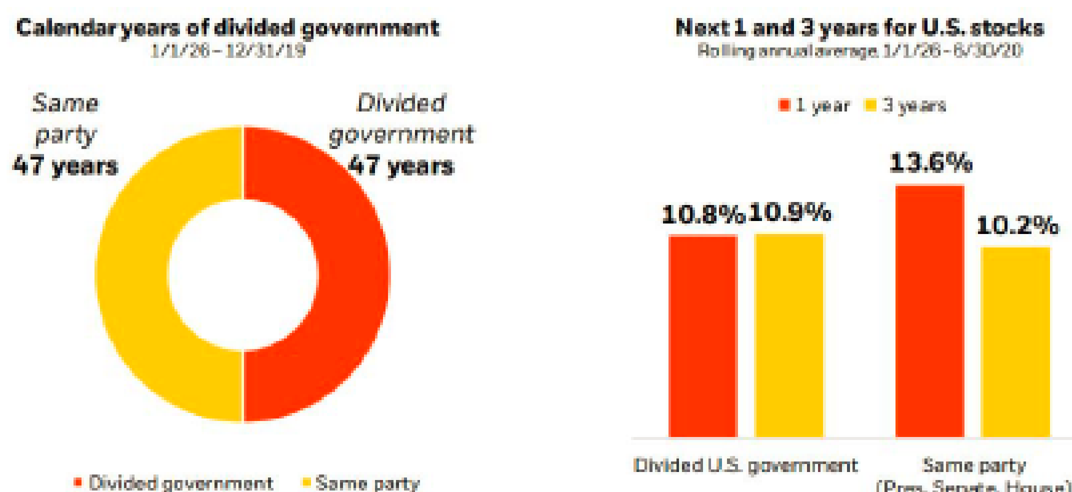
Every four years at this time, investors ponder whether markets will rise, or fall based on who is elected president of the United States. Political pundits make predictions, bets are placed, and each side of the aisle is convinced that electing the "other candidate" spells certain doom for the market. However, historical data demonstrates that the market continues to rise, regardless of which party resides in the White House and whether there is a same-party or divided government.

From 1926 to 2020, we have had ten changes in party leadership representing 15 different presidents. This timeframe also encompasses the five largest market declines, including the Great Depression crash of 1929, Black Monday in 1987, the Tech Bubble of 2000, the Financial Crisis of 2008 and the COVID-19 crash, where the S&P 500 Index dropped more than 10% in a single week. Despite all of this, the market continuously reached new heights as shown below.

Stock Gains through Democrat and Republican Presidents [1]



History indicates that capturing long-term returns of the capital markets does not depend on which party controls the White House. But what happens when our government is divided? Over the last 94 years, the U.S. government has been controlled by a single party or has been divided for 47 years each. When we assess the annual rolling average of stock returns at one year and at three years, remarkably little difference exists between a single party-controlled government or a divided government. [1]



The historical average return after the first year of single-party government control is 13.6%. The rolling average after three years drops to 10.2%. Under a divided government, the historical average returns after one year and three years are 10.8% and 10.9% respectively. Average returns are similar and independent of party control. [1]

This market behavior exists because many factors influence stock prices, which represent expected corporate earnings extending over future decades. These factors include competitive actions of individual companies, macroeconomic forces like interest rates and inflation, commodity prices, technology advances, and much more.

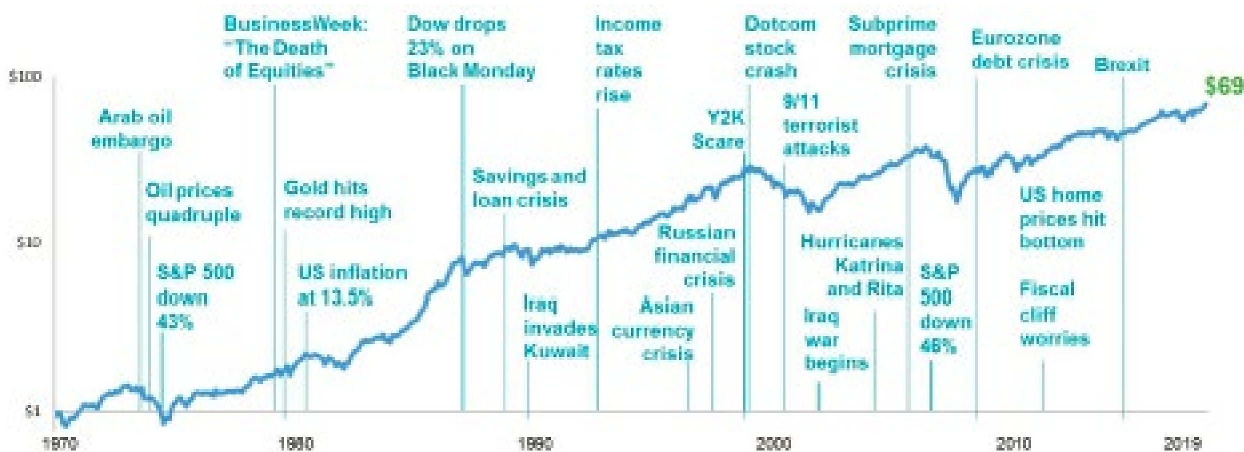
This Time It's Different – Or Is It?

With the current economic crisis and civil unrest as a backdrop for the upcoming election, some believe that "this time it's different." Unfortunately, nearly every decade has had its share of economic headwinds, political division, civil unrest, and other calamities.

In the seventies we saw high inflation, the oil crisis and the Vietnam War. The eighties experienced high unemployment, the savings and loan crisis, and Black Monday. The nineties had income tax rate hikes, Middle East conflicts, and the Asian currency crisis which nearly toppled the financial markets. The 2000's saw the Dotcom crash, natural disasters including hurricanes, terrorist attacks and more. Each time investors thought, "this time it's different."

They were partly correct. Each new crisis was caused by something different. The market, however, continued to march along a familiar path. In the long run, the market rose. The chart below shows the growth of $1 from 1970 to the end of 2019. Some of the crises from this era are labeled for context. Through this time frame, every $1 invested in 1970 grew to nearly $70 over the next 50 years.

Stock Gains through Crises 1970 - 2019 [2]



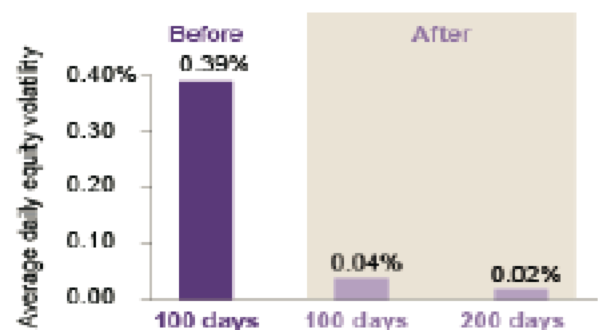
Even though the past does not predict the future, we can expect the market to move upward in the long run, despite new crises that arrive.

Expectations for the Coming Months

Markets are historically less concerned with which party is in charge and more concerned with the closeness of the race. [3,4] Market volatility often surges leading up to the election. The closer the race, the greater the volatility. In the months following the election, volatility fades as the figure below shows. Economists attribute this effect to the resolution of election uncertainty. [3]

When separation in the polls is greater leading into elections, not only is volatility lower, but stocks also perform better. [5] Stocks often rally during the second half of presidential election years as the anticipated outcome becomes clearer. In 14 of the 16 elections since 1950, the S&P 500 Index produced gains over the final seven months of the year. [6] The two exceptions were the contested election of 2000 where the winner was not determined until 36 days after the election, and in 2008 when the financial crisis was an overriding event. [6]

Volatility Tends to Wane After Elections



The bottom line: Elections are critical to the future of our country and the world. The contentious nature of this current election is likely to cause some volatility throughout this remainder of this year. But as far as corporate earnings and the markets are concerned, history suggests it will have a minor impact in the long run. Other economic factors such as interest rates and money supply are also important.

In order to capture a premium on returns, long-term investors must bear some uncertainty. And part of successful investing is understanding what can be controlled and the importance of keeping emotions separate from financial planning. By maintaining perspective, discipline, and a long-term outlook, you can sustain progress toward your financial goals, despite the short-run uncertainty caused by events such as elections.

Notes and Acknowledgements:
1. BlackRock, "Student of the Market, Election Year Special," August 2020
2. MSCI data 2020, S&P 500 Index, 1970 – 2019
3. Vanguard, Thomson Reuters Datastream, September 2016
4. Stocks for the Long Run , Fifth Edition, Professor Jeremy J. Siegel, Wharton School of Business at Penn University
5. Liz Ann Sonders, Chief Investment Strategist, Charles Schwab & Co., September 2020
6. "Markets Get Nervous", Investment News, Stock Trader's Almanac, September 12, 2016

All forms of securities investing involve risk of loss for which clients should be prepared. There are no guarantees or insurances of principal preservation and market fluctuations of any level may occur and impact portfolio value. Past performance is not a good predictor of future performance. [Winter 2020]