CORBETT ROAD

MACRO MUSINGS

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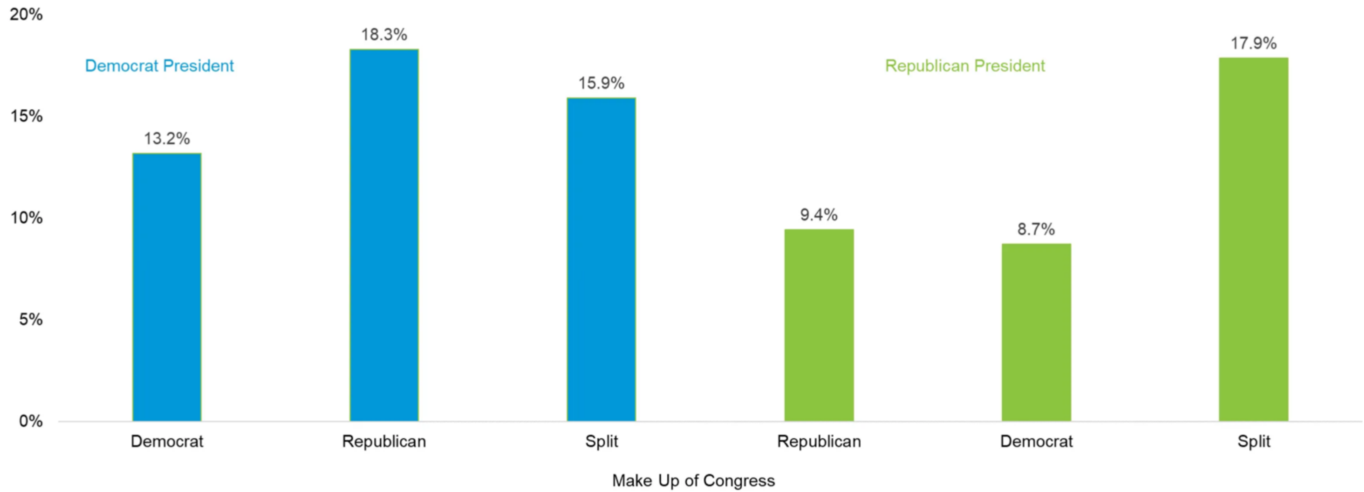
ELECTIONS AND THE MARKET

SUMMARY

- **Whenever a major election nears, concerns grow among investors about what the results could mean for the economy and stock market. History shows that there are no meaningful differences in market performance. Average returns tend to be positive regardless of which party occupies the White House and controls Congress.**
- **The Federal Reserve took historic action in adjusting its policy prescription, introducing "average inflation targeting", which suggests interest rates will remain low for the next few years.**
- **Volatility has picked up. It is not unusual or unexpected for the market to pullback after its strong rally since March. We expect the market to remain unsettled through the election, but we don't think this is the beginning of a bear market.**

THE MARKET HAS PERFORMED WELL REGARDLESS OF WHO IS IN CHARGE OF THE FEDERAL GOVERMENT

The following chart summarizes the average performance of stocks under various governing scenarios (from LPL):



Over the years, we have seen every type of scenario. Here are our conclusions:

1. ***The sample size is small.*** The chart shows performance since 1950. Sixty-nine years isn't a long time when you're trying to assess whether something is statistically significant. We would not use this information to make any broad sweeping conclusions about which election outcome is best for stocks.
2. ***The most important takeaway: in each scenario, average stock returns have been positive.*** There hasn't been a situation where the makeup of Congress and the presidency have led to negative average returns. Stocks have risen over time, despite multiple changes in the power structure. **Based on history, repositioning a portfolio's asset allocation in response to changes in party control hasn't paid off.**

BE HIGHLY SKEPTICAL OF NARRATIVES AROUND WHAT WILL HAPPEN IF BIDEN WINS OR TRUMP GETS REELECTED.

Despite the above evidence, it seems that every time there is an election, a narrative emerges among partisans that one outcome or the other will be either disastrous or advantageous for the economy and markets. Below are just a few examples of these hot takes and the folly of making personal financial decisions based on them:

- George W. Bush was our first "MBA president" who would cut taxes and deregulate, which the market would love. Bush took office in January 2001, two months before an official recession began and almost a year into the bear market that occurred when the Dotcom bubble burst. The S&P 500 didn't hit its final low until October 2002. While the market was falling, multiple tax cuts were passed, and Democrats complained about how it would blow up the deficit and hurt the economy. Deficits rose, but the economy rebounded, and stocks doubled over the next five years!
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- Barack Obama was elected during the Global Financial Crisis, and there were concerns among Republicans that his administration would overregulate and implement anti-growth policies. The market sold off through the first six weeks of his presidency, bottomed in March, and ended the year up 26%.
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- There were similar calls for economic turmoil when Obama was re-elected due to the expiration of the Bush tax cuts at the end of 2012 and the implementation of government spending cuts agreed upon during the 2011 debt ceiling crisis. After taxes went up and cuts were made to the federal budget, the S&P 500 had its best year since 1997, rising 32%. In the end, the S&P 500 rose in all eight years of Obama's presidency.
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- On the night of Trump's election, the S&P futures were down as much as 5% before rallying during regular market hours the next day. From the day after Election Day until the end of 2017, the market rallied 26%!

When it comes to elections and markets, the prevailing narrative rarely materializes.

But what about policy and regulation? While specific sectors can and do benefit from policy changes passed by Congress and signed into law by the president, it is not always clear how the stocks in these industries will react. After Trump was elected there was a belief that cyclical stocks like energy, infrastructure, and banks would do well, and they did…for a couple of months. Fundamentals eventually took over, and the market's gains were driven by the secular growth in large tech companies.

THE FED INTRODUCES AVERAGE INFLATION TARGETING

The Federal Reserve has two goals mandated by Congress: 1) support maximum employment; and 2) maintain stable prices (inflation). Fed Chair Jerome Powell outlined a significant adjustment to the second of these mandates last month during a speech at Jackson Hole, Wyoming, which he further elaborated on after last week's scheduled meeting.

In the past, the Fed started raising rates any time inflation came anywhere close to their target, in this case 2%. The problem is, we haven't seen inflation near its target level in years. Still, in anticipation of rising prices, the Fed hiked rates several times from 2015-2018 despite the lack of clear inflationary pressure.

Now, the Fed has suggested they won't raise rates until:

- Unemployment reaches levels consistent with the Committee's assessment of maximum employment.
- Inflation is on track to moderately exceed 2% for some time.

The language suggests we won't see higher short-term rates until at least the end of 2023, and possibly not until 2025, depending on how quickly the labor market rebounds to pre-pandemic levels. This means that borrowing rates should remain low and savings accounts should pay next to nothing for the foreseeable future.

VOLATILTY WILL LIKELY REMAIN THROUGH NOVEMBER

Periods around election season can be volatile, and we expect it to be no different this year. The market has pulled back from its September 2nd all-time high, but a correction after a 60% rally is hardly surprising, and in fact, may be necessary for the market to continue to rally once some of the uncertainty dissipates after November.

MACROCAST™ remains positive, with economic data improving thanks to a robust housing sector and improved manufacturing activity, but with uncertainties related to the pandemic, election, social unrest, economic clashes with China, and continued high unemployment top of mind for many investors, we think it could be a while before stocks reach all-time highs again.

Between the pandemic and widespread social upheaval, 2020 has been a volatile year. Heading into the final three months, we're prepared to handle the political uncertainty as well as any other surprises the year might have in store.

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