# 2020 Election: Navigating the Uncertainty, Vol. II

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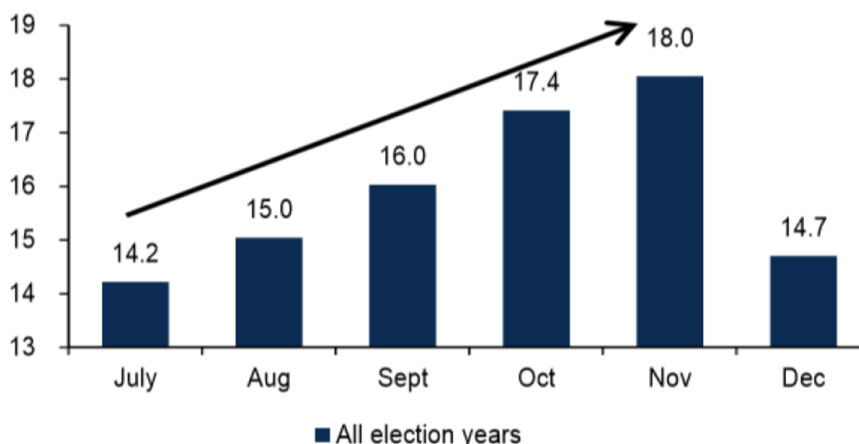
*As we approach the upcoming 2020 Presidential Election, we're beginning to hear some expressions of questions and concerns surrounding investment portfolios. At Mission Financial, our goal is to provide the reassurance that long-term investors have no need to fear this Presidential Election. Let's look at some historical data and economic factors that will demonstrate why we believe the best course of action is to stick to your defined blueprint.*

## SHORT TERM VOLATILITY

Throughout history, markets have shown a steady increase in volatility in the months leading up to an election, and although it's difficult to predict now, volatility is likely to increase surrounding this election. History will also show us that the further we get away from the election, the more diluted the impact of this volatility becomes for long term investors who stick to their blueprints. Let's consider the chart below. We see that since 1928 in all election years, the standard deviation—which is how we ultimately measure volatility of an investment—has seen a steady increase the closer we get to election day. In fact, there's a 30% average increase in volatility in the four months leading up to an election. However, once news has settled and investors know who is in the office, that standard deviation tends to sharply decline back to normal. Considering the fallout from the COVID-19 pandemic, U.S.-China trade negotiations, U.S.-Iran geopolitical tensions and even general social unrest, there are many events influencing the current environment and we are likely to see this volatility continue that rising trend the next couple months.



# S&P RETURNS DURING ELECTION YEARS

Now that we've looked at short term trends leading up to an election, let's examine the history of what has occurred in the year following an election. On the right side of the chart below, you'll see each Presidential winner going back to 1928, with names in red being Republican and blue being Democrat. To the right of their names is the corresponding performance of the S&P 500 for that election year. Going through each name individually, there is absolutely no relationship between which party is elected and the performance of the market for that year. What we do find encouraging, however, is that when you average these performances, the total rate of return is over 11%.

Perhaps the most encouraging fact in this chart is in the bottom-left hand corner under "Observations". Since the S&P 500 began in 1928, we have seen a positive performance in 83% of Presidential election years. When you compare that to the fact that 73% of *all years* have provided positive returns, that statistic is very impressive. (Morningstar, Risk of Stock Market Loss Over Time)

## S&P 500 Index Returns In U.S. Presidential Election Years

Since 1928

There are many factors that impact stock market returns, but one common concern of investors is how the stock market will be impacted by a change in America's President. In past election years, the S&P 500 Index has seen more positive performance than negative. Below we take a look at S&P 500 Index performance during presidential election years, which have historically provided positive gains for stocks.

**S&P 500 Index Total Returns During Presidential Election Years (1928-2016)**

| U.S. Presidential Election Results | Average Return |
|---|---|
| A Republican was elected | 15.3% |
| A Democrat was elected | 7.6% |
| All election years | 11.28% |

**Observations**

There have been 23 elections since the S&P 500 Index began. In these election years:

- 19 of the 23 years (83%) provided positive performance
- When a Republican was in office and a Republican was elected (or reelected), the total return for the year averaged 11.9%
- When a Republican was in office and a Democrat was elected, the total return for the year averaged -2.6%

**Historical U.S. Presidential Election Results**

| Election Year | President Elected | S&P 500 Index Total Return |
|---|---|---|
| 2020 | ? | ? |
| 2016 | Trump | 12.0% |
| 2012 | Obama | 16.0% |
| 2008 | Obama | -37.0% |
| 2004 | Bush W. | 10.9% |
| 2000 | Bush W. | -9.1% |
| 1996 | Clinton | 23.1% |
| 1992 | Clinton | 7.7% |
| 1988 | Bush H.W. | 16.8% |
| 1984 | Reagan | 6.3% |
| 1980 | Reagan | 32.4% |
| 1976 | Carter | 23.8% |
| 1972 | Nixon | 19.0% |
| 1968 | Nixon | 11.1% |
| 1964 | Johnson | 16.5% |
| 1960 | Kennedy | 0.5% |
| 1956 | Eisenhower | 6.6% |
| 1952 | Eisenhower | 18.4% |
| 1948 | Truman | 5.5% |
| 1944 | Roosevelt | 19.8% |
| 1940 | Roosevelt | -9.8% |
| 1936 | Roosevelt | 33.9% |
| 1932 | Roosevelt | -8.2% |
| 1928 | Hoover | 43.6% |

Source: Morningstar/Ibbotson Associates. **Past performance is no guarantee of future results.** For illustrative purposes only and not indicative of any actual investment. The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. These returns were the result of certain market factors and events which may not be repeated in the future.

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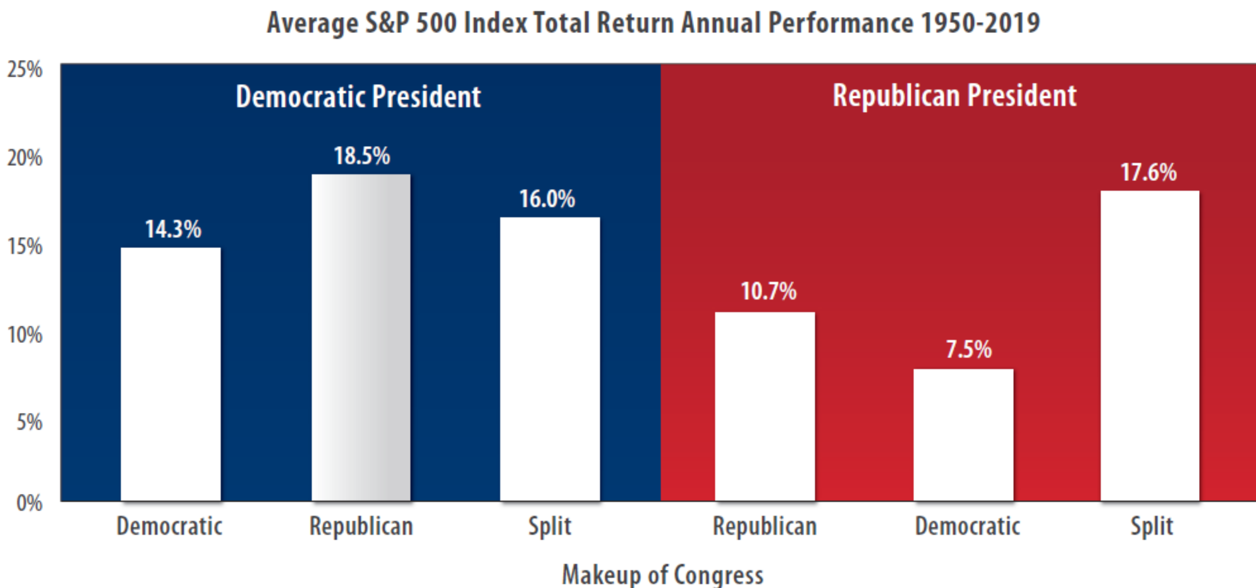
# CONTROVERSY IN THE WHITE HOUSE

One of the most frequent statements we hear is that there's more controversy, arguing, and fighting between the executive and legislative branches than ever. For some, this a cause for concern. However, when we take a look at the historical data, we see that markets have typically preferred gridlock! When you analyze this, it makes sense. The more bickering and arguing you have between the branches, the harder it is to get extreme policies through one way or the other. The system we have was set up for exactly this reason; it's a system of checks and balances. In a divided government, enacting tax and spending legislation becomes more difficult. This gridlock is normal and by design.

In fact, since 1950, market returns have been much better than average in periods where the President and the House can't seem to see eye to eye: 16% in a split congress during a Democratic Presidency and 17.6% during a Republican Presidency with a divided Congress.

**S&P 500 Index Performance by President and Makeup of Congress**

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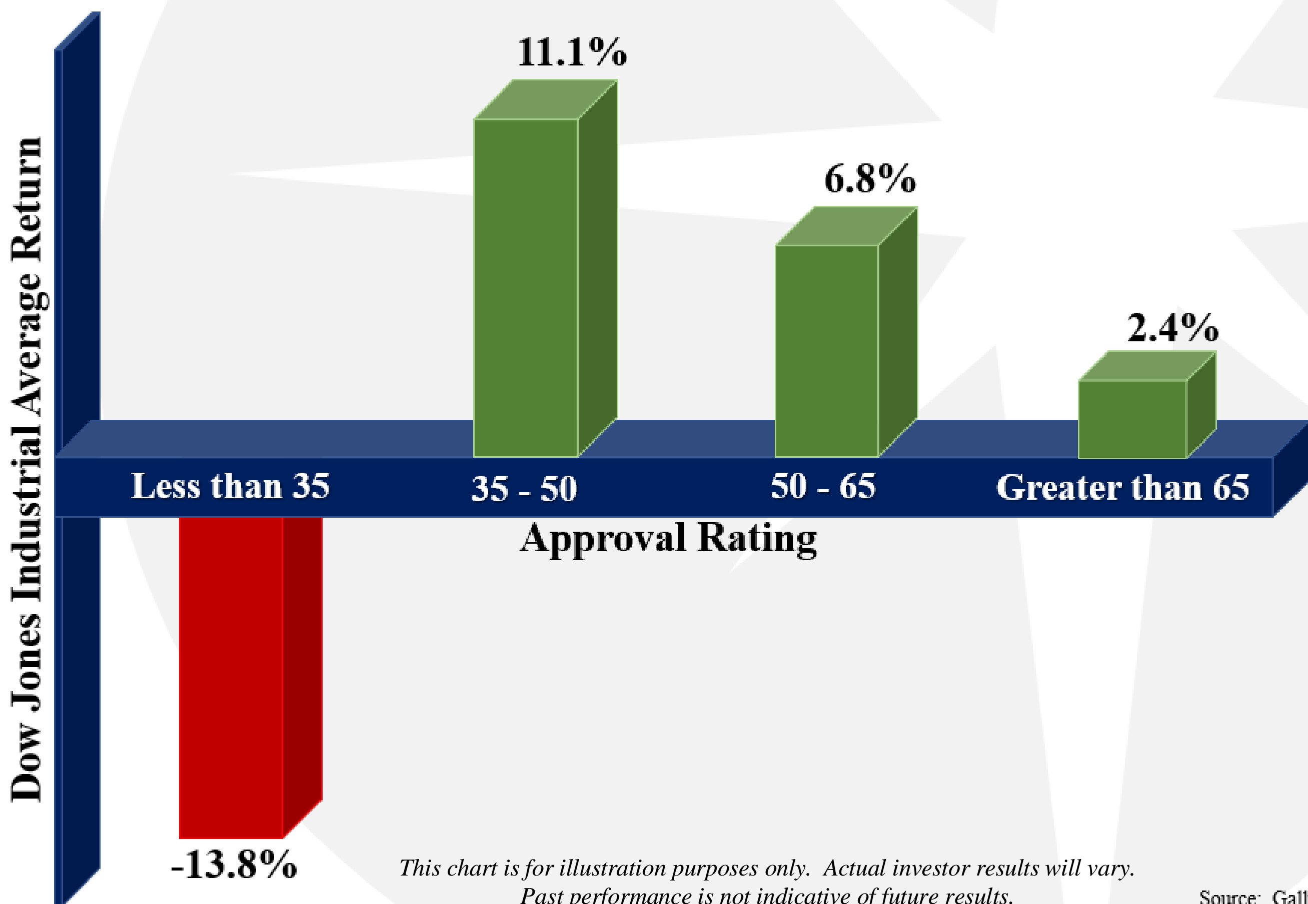
Although presidential candidates loom large and tall during election season, Congress holds the key to big policy shifts. A clean sweep, whether red or blue, actually makes a bigger difference. Regardless of the outcome, the common denominator in all scenarios is long term growth, based on history.

# CONTROVERSY AMONG THE AMERICAN PEOPLE

Another increasingly common statement we hear is, "We as a nation are so divided, half of the country will panic if one president is elected over the other!" To examine this a bit further, let's take a look at what we can learn from historical approval ratings in relation to average market returns. After researching, we found that if approval ratings are too low or too high, it was typically less favorable for markets. Believe it or not, markets seem to do best when there *is* division among the American people! If a majority absolutely love or reject the President, the market has tended to do worse than if we are divided.

What does this mean? It means when you're out to dinner with your friends or peers and there's some conflict over political views, or when you scroll through Facebook and there's an alarming amount of arguments centered around the upcoming election and policies, it's not a bad thing from solely a market performance outlook. When you see political conflict, know that there's no determined negative correlation to your portfolio over a longer period of time. Historically, markets have shown they are agnostic towards feelings about the President. Further, this research shows that it is uncommon to see politics move markets. Rather, it is far more common to see markets move politics! Think back to the stimulus the government pumped into the economy to stabilize markets, and we can see an example of this.



# MARKETS PERFORM OUTSIDE OF POLITICS

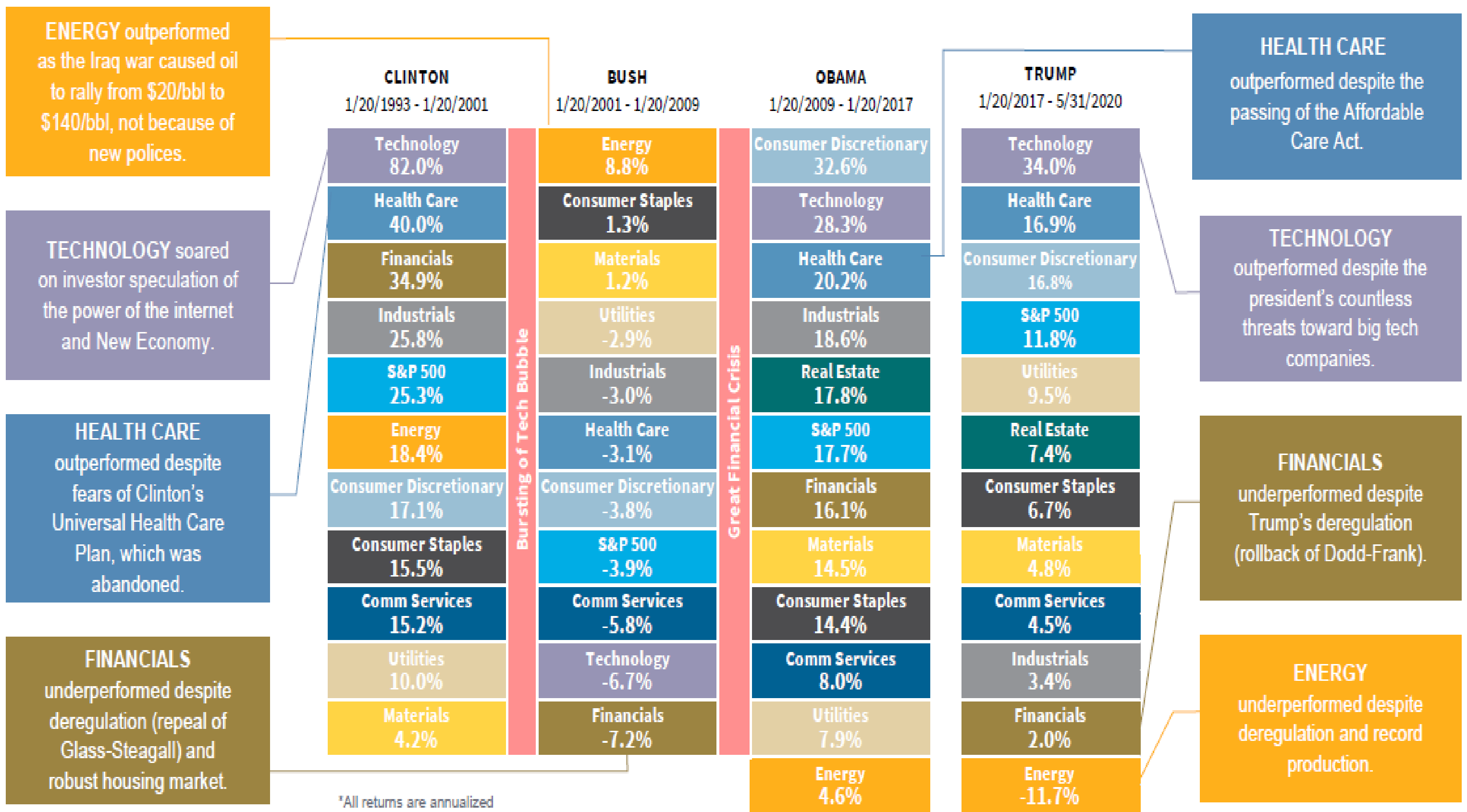
To this point, we have clearly seen that markets commonly perform outside of politics. In order to reiterate this concept, let's take a look at some specific examples of this in the past few presidencies. The chart below reiterates this concept on a more tangible level and highlights a few examples of sectors performing outside of political influences—or a lack thereof.

During the Clinton era, the technology sector far outperformed expectations.  This wasn't because of anything President Clinton did, but rather because of investor speculation of the power of the Internet and the New Economy.

In the Bush era, energy outperformed other sectors due to the price of oil rallying from $20/barrel to $140/barrel. This was a result of the Iraq war, not a result of any policies he implemented. The financial sector severely underperformed, even though Bush implemented deregulation and policies intended to help financial performance.

More recently, during Trump's reign, the technology sector again outperformed despite threats towards big tech companies, while the energy sector has underperformed despite hefty deregulation of the industry and record fracking production. President Trump may be one of the most pro-oil presidents in recent memory, and despite this, the sector has underperformed.  This is yet further proof that markets are usually not affected by how we, or the President, think they should perform.

Sectors Trade Outside of Political Perspective

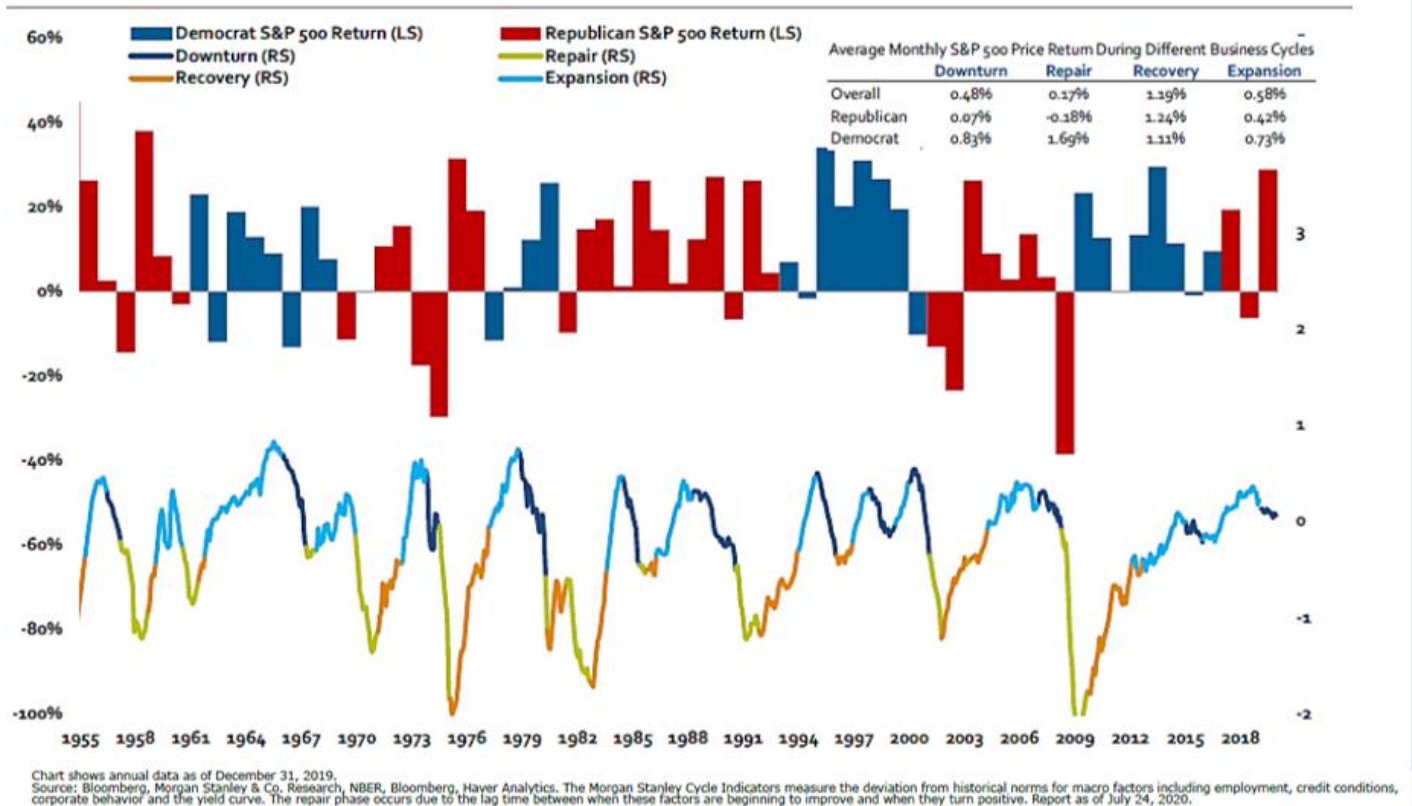



Source: FactSet, Raymond James Investment Strategy

*This case study is for illustrative purposes only. Individual cases will vary. Any information is not a complete summary or statement of all available data necessary for making an investment decision and does not constitute a recommendation.*

# BUSINESS CYCLES MATTER MORE THAN POLITICS

Now that we have looked at market performance relative to politics, let's look at some indications of current and historic economic conditions that may give us a better idea of where we are headed long term. While news is focusing on who will be in the White House, our job is to focus on where we are in the economic cycle, because the economy is cyclical. While we don't see correlation of stock prices to politics, we clearly see it related to this business and economic cycle.

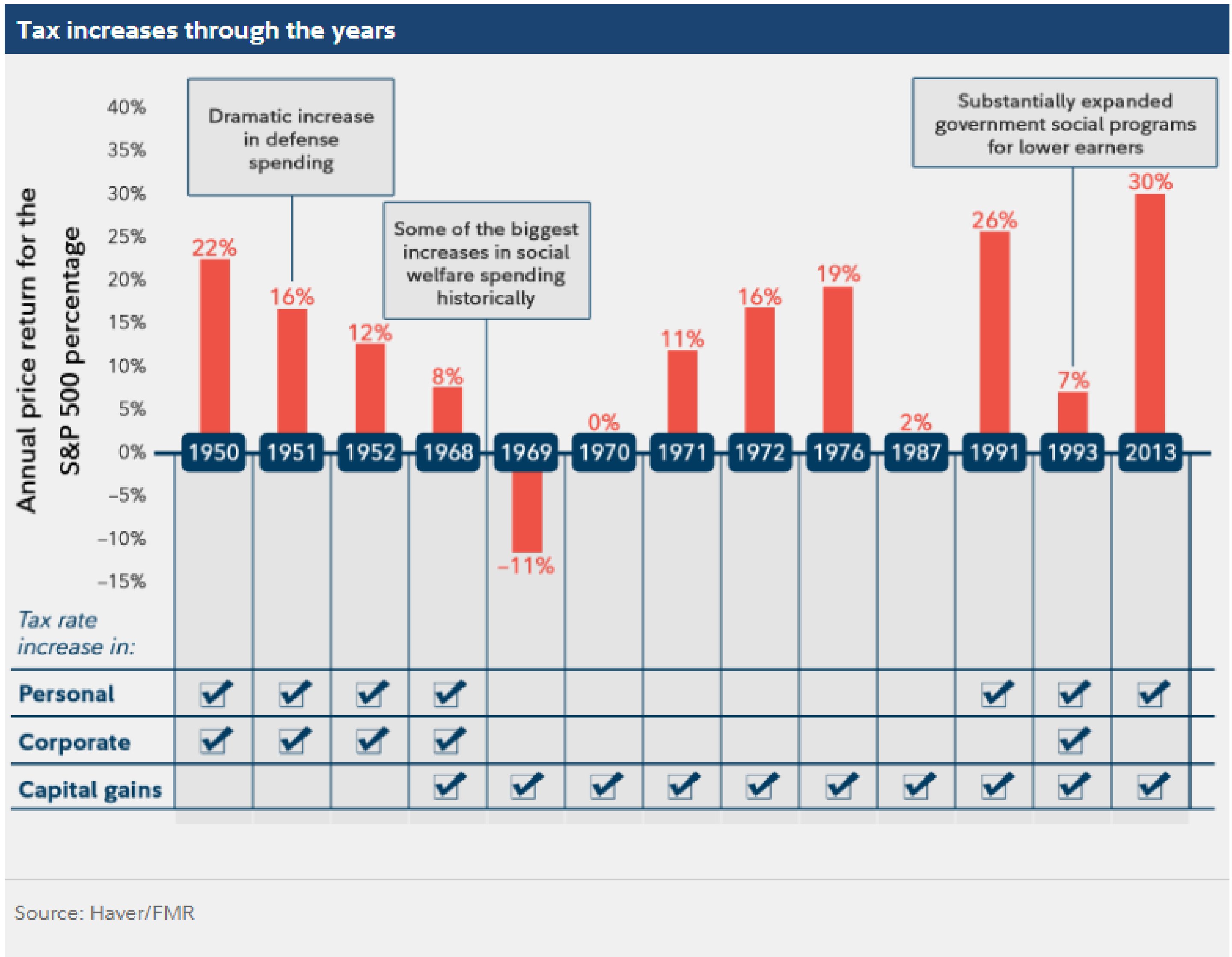



In the chart above, the red boxes represent the S&P 500 return during a republican presidency, and the blue represents a democratic presidency, showing back to 1955. In summary, this chart shows no correlation between market return and political party. Where we do see correlation is on the bottom half of the chart, where you'll see four different colors representing different stages of the business cycle. At Mission Financial, we believe indicators point towards the economy being in a recovery stage, represented by the orange on this particular graph.

Transitioning to another more tangible economic factor, let's examine money supply in the US by considering current M2. M2 is the measure of all cash, coins, and short-term notes, and includes money markets. More simply put, it's the measure of money American's have available to spend that can be easily and quickly converted to cash. Current M2 is up over 24.8% year over year from where it was in the midst of a booming economy in 2019. This is in large part due to the $6 trillion in stimulus the government pumped in over the last few months. Remember, money in American pockets is good. If Americans are spending, the money goes towards companies' revenue. If they save, that money potentially goes toward stocks and into the market. Either way, higher M2 has the potential to be beneficial for your investment portfolio. (federalreserve.gov/releases/h6/current/default.htm)

# WHAT ABOUT TAX HIKES?

One of the fears we have heard numerous times is that one of the candidates is promising to raise the corporate tax rate from 21% to 28%. Many fear that this tax hike would negatively affect the returns of the companies they are invested in and ultimately the overall performance of their portfolio. While no rise in taxes is ever enjoyable, let's look at the chart below to see why even in the midst of corporate tax spikes, long term investors need not panic.




In this chart, we see three different scenarios for tax rate increases—personal, corporate, and capital gains—going back to 1950. Above the check marks is the corresponding return of the S&P 500 that same year. When looking at some examples, we find there to be no truth behind the idea that markets decline when taxes rise. In fact, in 1968 and 1993, Americans saw an increase in all three tax rates accompanied by approximately 8% growth and 7% growth in the market, respectively.

Historically, analysts and research studies alike have found there to be zero solid trend of market declines in the midst of tax increases. This is in large part because high quality corporations know how to adapt and prepare for these changes long in advance.

# CORPORATIONS ADAPT

Ron Graziano, Head of Global Accounting and Tax Research at Credit Suisse, says firms with strong balance sheets that generate steady cash and profits "have a proven ability to manage, absorb and sidestep potential negative tax issues." While many investors project negative consequences to corporate tax hikes, huge companies are sophisticated and have long known how to skirt tax barriers and navigate capital to where it is most profitable. Tax shifts are typically known well before they're implemented, and many of the companies you may be invested in have been through tax hikes before. High quality companies learn to thrive and adapt to their environment. That's the beauty of capitalism, and that will continue to happen as long as we are in a country that practices capitalism.

To drive this point home, let's look at some real-life examples of companies that found a way to adapt in our most recent major circumstance, the COVID pandemic. Again, tax shifts are known *in advance*, and this pandemic was an *unforeseen* circumstance, and these companies were still savvy enough to not only survive but, in some cases, thrive.

## *Corporations Adapt*

### AMAZON

***Adding additional 200,000+ jobs in 2020 in the midst of record high revenues***

www.cbsnews.com/news/amazon-jobs-hiring-33000-corporate-tech/

### APPLE

***Revenue for quarter ending June 30 outperformed estimates by more than 14%***

marketwatch.com/story/apple-beats-on-earnings-and-announces-stock-split-sending-shares-toward-record-high-2020-07-30?mod=article_inline

### ETSY

***Reported YOY revenue growth of 137%***

investors.etsy.com/press-releases/press-release-details/2020/Etsy-Inc.-Reports-Second-Quarter-2020-Financial-Results/default.aspx

### FACEBOOK

***Revenue increase of 11% YOY for Q2 2020***

marketwatch.com/story/facebook-shares-rally-as-quarterly-result-easily-top-street-view-2020-07-30?mod=article_inline

### FORD

***Reported $1.1B in net earnings despite decreased Q2 sales***

Ford Motor Company 2020 2Q Earnings Press Release

### PROCTOR & GAMBLE

***Sales outperformed targets by 4% in quarter ending June 30th, despite expectations of missing targets***

https://www.usatoday.com/story/money/2020/05/15/40-solid-stocks-of-companies-thriving-through-the-covid-19-recession/111701046/#

### TRACTOR SUPPLY CO.

***Added 5,000 jobs from April-June 2020 and realized an increase in sales of 35% YOY***

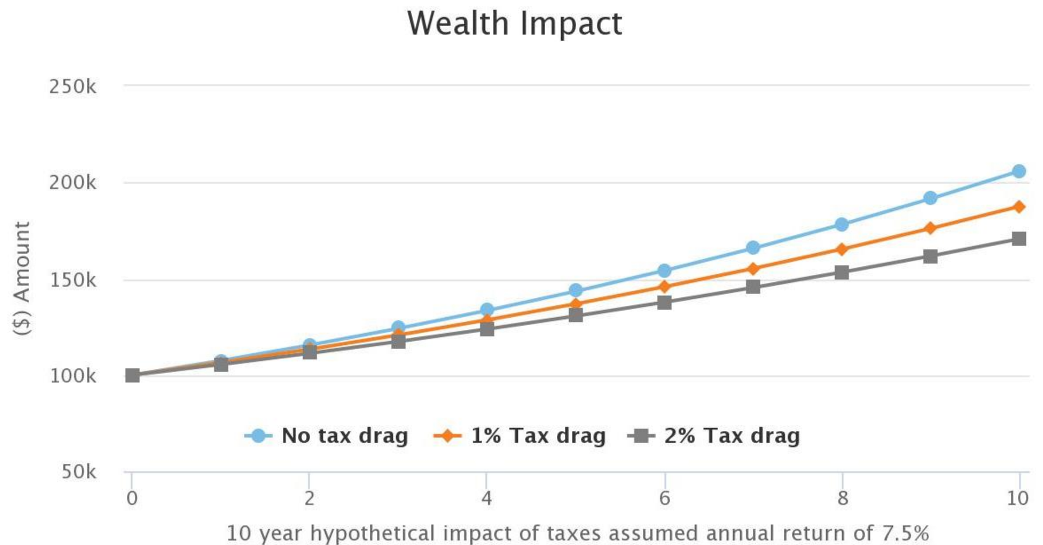
www.washingtonpost.com/business/2020/08/10/recession-coronavirus-pandemic-winners/

One of my favorite write ups on this comes from Josh Silverman, the CEO of Etsy. After the reported year over year revenue growth of 137%, he said, "This is a testament to the agility of our team, the strength of our brand, and the innovation of our sellers." I think agility, strength, and innovation are great way to describe many other companies and their ability to adapt as well. Looking at the historical data combined with tangible examples of America's resilience should give us the confidence we need to stick to our blueprint through the upcoming turbulence.

# WHAT DO WE DO NOW?

## TAX EFFICIENCY

Over the last 6 months, the US government has pumped almost $6 trillion into the economy. We believe it's likely that tax rates will rise in order for the government to pay off this debt. While it's difficult to predict when a rise will occur, we can help you take steps to ensure your portfolio is as tax efficient as possible. Let's look at this chart to the right. There are three lines that represent a $100,000 investment over 10 years, assuming 7.5% growth each year. The light blue line shows what the investment could grow to with no tax drag – meaning there are no taxes coming out of your portfolio while the investment is growing. The gray line shows a 2% tax drag, meaning the portfolio was not invested as tax efficiently as possible, and yearly capital gains, dividends, and other income taxes decreased the overall value. At Mission Financial, we want to help you develop a tax efficient blueprint that is tailored to your needs.



**NOTE**: The actual value of your investment will fluctuate based on market conditions. This is a hypothetical illustration and not meant to represent an actual investment strategy. Taxes may be due at some point in the future and tax rates may be different when they are. Investing involves risk and you may incur a profit or loss regardless of strategy selected.

## DIVERSIFICATION

Market volatility will be something we continue to experience, whether it stems from an election, a global pandemic, or any other factor, and diversification is an important tool we use at Mission Financial in mitigating risk to your portfolio. To the right is a visual representation of how diversifying your portfolio can help position against volatility. On the left side of graph, we see a portfolio with one stock, and on the right, we see a portfolio made up of fifty stocks. In purple we see the expected returns. The left side shows much more volatility, with highs being higher and lows being much lower. On the right, while still seeing volatility, we see a much more stable return due to mitigating risk with diversification.

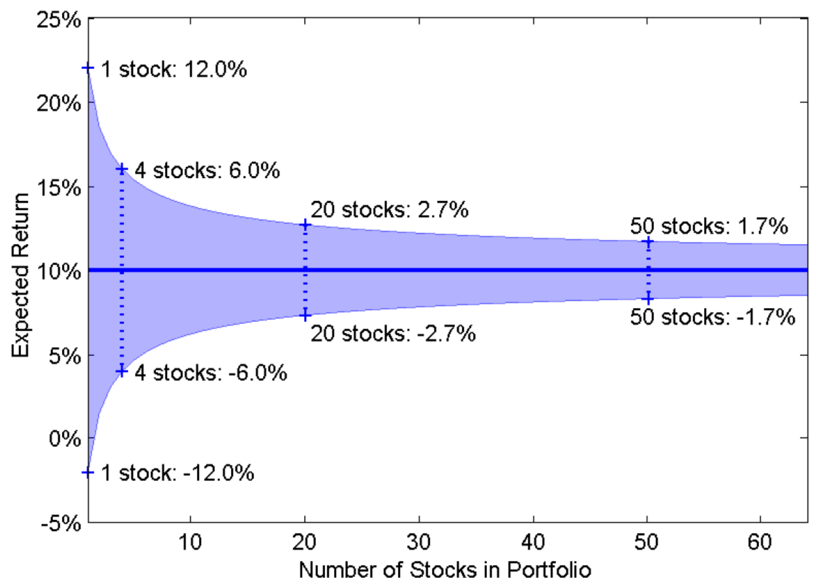


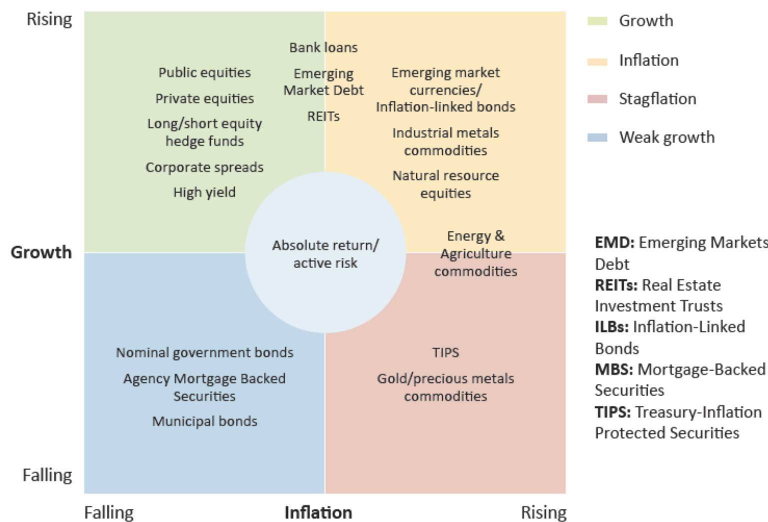

Figure 1: The Volatility Trumpet

jvbruni.com/sites/default/files/inline-images/Diversification%20Chart%201.PNG

*This is a hypothetical example for illustration purpose only and does not represent an actual investment. Actual investor results will vary.*

## INFLATION

As previously mentioned, current money supply has grown 24% over the last year. When we experience an abundance of greenback in the economy that's being spent, this can help create healthy inflation. We want to make sure your investments help preserve you from inflation. The chart to the right has four quadrants. At the top and bottom, we see rising and falling economy, and left to right we see rising and falling inflation. At Mission Financial, we believe the economy has been in recovery from the recession since June. It's likely we are in a growing economy with rising inflation, which would signify the top right quadrant of this chart. Rather than trying to predict the future, our focus is on investments that help you diversify over all four quadrants, and help prepare your portfolio for all cycles of the economy.




# STICK TO THE BLUEPRINT

Every four years, the U.S. presidential election brings uncertainty – something the human mind, and markets, tend to dislike. If you're concerned that the markets will dive or thrive based solely on who is in the oval office, historic trends would lead us to believe that anxiety is not rational. Throughout the last century, the long-term performance of the markets has revealed little correlation with government policies.

In addition to this pattern of apolitical growth, there is the fact that the U.S. president has only indirect influence over the economy – by design. This is in part because of the separation of powers outlined in the Constitution. Though the executive branch does wield a great deal of power, the checks and balances of American government mean that the credit – and blame – cannot be neatly traced back to a single leader or party.

At Mission Financial, we want to encourage you to avoid making investment decisions based solely on an election. We recommend staying grounded, and sticking to your tailored blueprint designed to help you fulfill your financial goals.

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