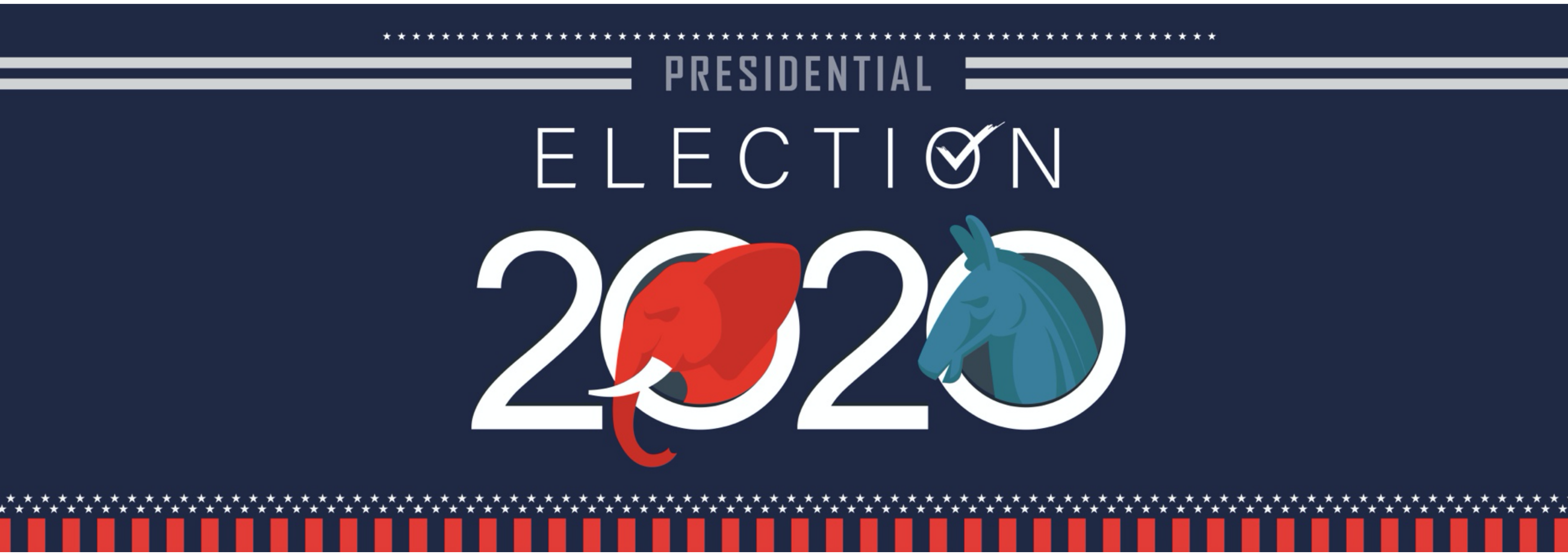
Politics and Portfolios
A Historical Look at Elections and Markets



Throughout the next few weeks, over 230 million eligible voters can take to the polls and/or mail to cast their vote for the 46th U.S. President. In addition to the race for the President, there are 35 seats (out of 100) up for grabs in the U.S. Senate and all 435 seats in the House.[1] While both Presidential candidates have cited that this is the most "important election of our lifetime," every election is important and typically quite contentious. This election may seem more rancorous and divisive given the increasing presence of social media in our everyday life, the fact that our country is still navigating through a deadly pandemic, racial tensions are as intense as we witnessed in the late 1960s, income inequality is near a 50 year high, our fiscal deficit is ~15% of nominal GDP and mail in voting is being highly scrutinized.

In this white paper, we will not endorse either political candidate. Instead we will focus on what we know and not speculate on what we do not know. We will aim to ease the unnecessary anxiety over the upcoming election and emphasize that underlying economic fundamentals are more important when looking at your long-term investment cycle than who takes the seat in the White House.

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The Uncertainty of Polls

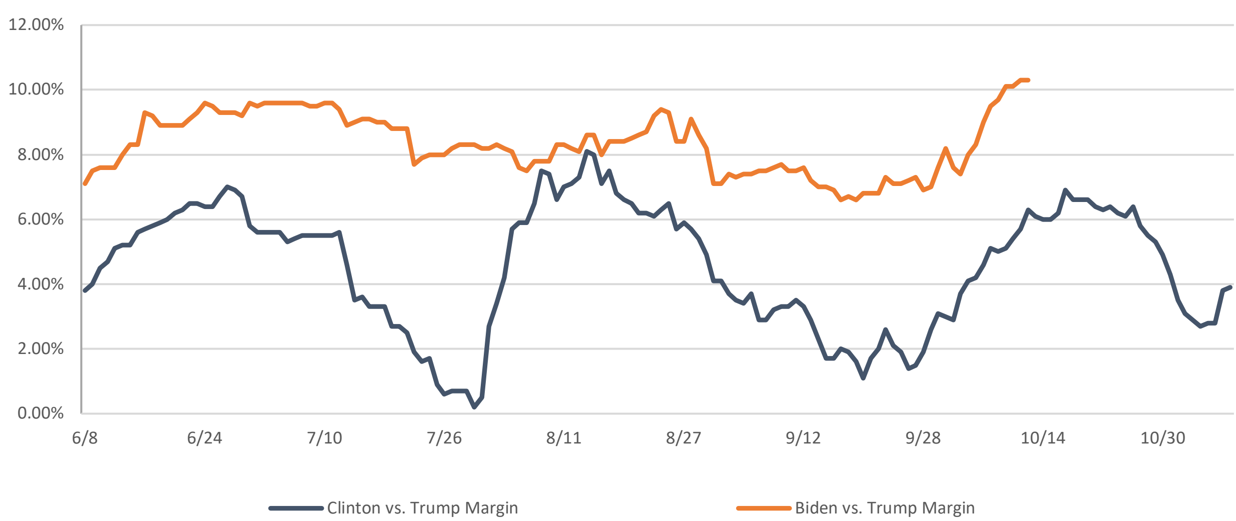
Understandably, there is skepticism about polls considering how inaccurate they were in 2016. Not only in forecasting the U.S. Presidential election but also in predicting that the UK would vote to leave the European Union. Different polls use varying methods of gathering and analyzing their data, and if you want to find a poll that confirms your view, you are likely to find one. In this analysis we used FiveThirtyEight which is a polling website that aggregates a variety of polls depending on their historical accuracy and sample size. According to FiveThirtyEight, Joe Biden has widened his lead over President Trump in recent weeks (from 7 to nearly 10 points).[2] What differs between the polling predictions now vs. 2016 is that in the middle of October 2016, Clinton only had a 6-point lead over Trump. In addition, she never earned over a 50% chance according to FiveThirtyEight polls to win the 2016 Presidential election while Vice President Biden has consistently been over 50% since September. Lastly, former Vice President Joe Biden's marginal lead has been consistent over the past few months, while Hilary Clinton saw significant volatility before ultimately losing to Donald Trump. **(Chart 1).**

Chart 1

Biden has Consistent Marginal Lead over Trump Compared to Clinton

Footnotes: Data is June 8th of 2016 and 2020 election cycle. Current is as of October 12, 2020.

Source: FiveThirtyEight.com, Verdence Capital Advisors.



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What we know about the part the economy and stock market play in election results

Donald Trump joins a small group of Presidents that saw a recession start in an election year. Historically, a recession that starts in an election year does not bode well for the serving party. In fact, in two of the three instances since 1929 that the U.S. economy entered a recession in an election year (1948, 1960, 1980), the party in office lost. Given the self-inflicted recession that began in 1Q20, history suggests this presents a headwind for President Trump. Some other headwinds include high unemployment and a low approval rating which have been catalysts for past Presidential losses.

In contrast, the President has a significant tailwind—the equity market. Despite the bear market in the first half of 2020, it has been accompanied by the strongest and quickest move out of bear market territory in history. In the past 23 elections, the performance of the S&P 500 has been a good predictor of the Presidential winner. If the market is higher, the incumbent party typically wins. If the market is lower, a new party typically takes over. As can be seen in **table 1**, in only three of the 23 instances did this predictor not work. In 1980, the market was higher, but Jimmy Carter went on to lose to Ronald Reagan. It is important to highlight that the trailing three months for President Trump has been the best trailing three months since 1928.

Election Year	S&P 500 Return 3 Mo Before Election	Incumbent Party
1928	14.91%	WON
1932	-2.56%	LOST
1936	7.92%	WON
1940	8.56%	WON
1944	2.29%	WON
1948	5.36%	WON
1952	-3.26%	LOST
1956	-2.58%	WON
1960	-0.74%	LOST
1964	2.63%	WON
1968	6.45%	LOST
1972	3.05%	WON
1976	-0.09%	LOST
1980	6.66%	LOST
1984	4.80%	WON
1988	1.91%	WON
1992	-1.22%	LOST
1996	8.17%	WON
2000	-3.21%	LOST
2004	2.16%	WON
2008	-19.48%	LOST
2012	2.45%	WON
2016	-1.90%	LOST
2020	10.96%	?

Table 1

The Stock Market as a Predictor for the Presidential Election

Footnotes: Data is trailing three months prior to election day. 2020 is trailing return as of October 12, 2020. Source: Strategas Research Partners, Bloomberg Finance LP, Verdence Capital Advisors.

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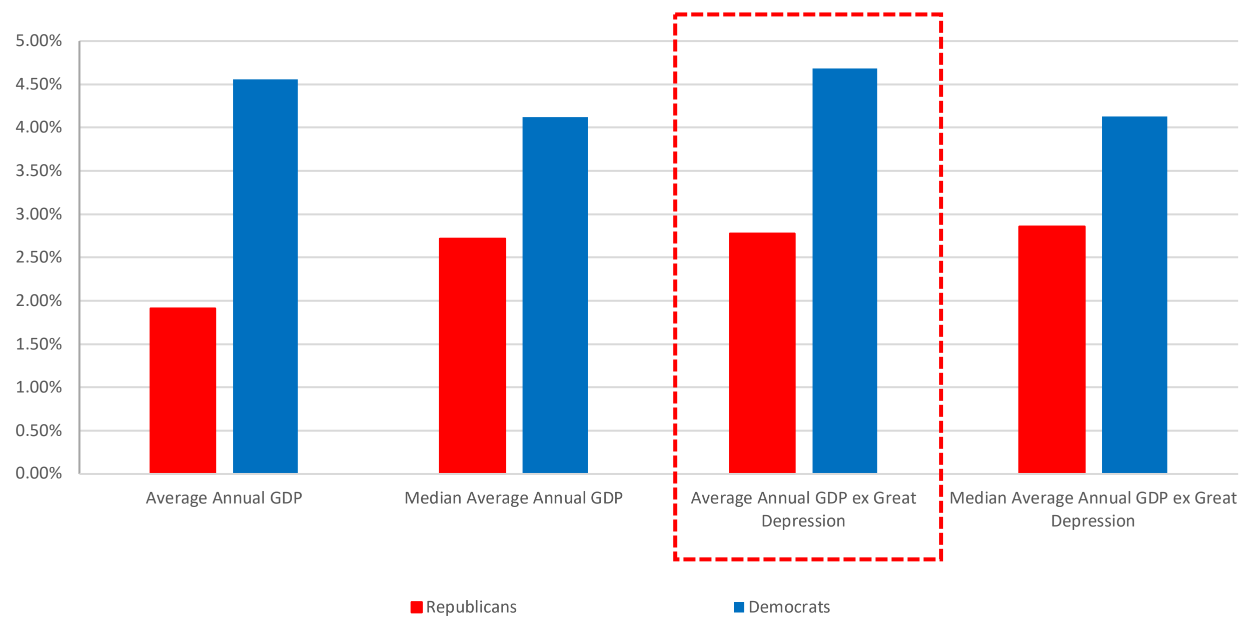
Is one party better for the economy than the other?

If you simply use historical statistics, it would tell you that Democrats have seen better annual GDP than Republicans and even have done better if you exclude the Great Depression which was overseen by Republicans. **(chart 2).** What we do know about this analysis is that it can be misleading. It is important to remember that Presidential elections occur every four years and the average business cycle since the Great Depression has lasted approximately four years.[4] Therefore, a new President or party can benefit from an economic cycle that is moving into expansion territory after a downturn or be at a disadvantage of policies administered from a prior political party that cause the economy to move into recession.

Chart 2

Democrats Have Historically Done Better for the Economy...Or Have They?

Footnotes: Data is from 1930-2019. Source: Bloomberg Finance LP, Verdence Capital Advisors.



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Where history is relatively consistent is in the timing of recessions in a Presidential term. Going back to 1929, 60% of the U.S. recessions have started in the first year of a Presidential term (regardless of if it is its first or second term) **(table 2).** This is because most Presidents, regardless of their first or second term, want to make the tough choices as soon as possible so that it hopefully can translate into a better economic environment for the midterm elections and then be far enough away from the re-election campaign in the event it causes economic disruptions.

As a long-term investor you will have to accept many swings in the economic and political landscape over time.

Table 2

Most Recessions Have Begun in First Year of Presidential Term

Footnotes: All recession from 1929-2020.
Source: NBER, Verdence Capital Advisors.

Recession Dates		Year of Presidential Term
Aug-29	Mar-33	1
May-37	Jun-38	1
Feb-45	Oct-45	1
Nov-48	Oct-49	4
Jul-53	May-54	1
Aug-57	Apr-58	1
Apr-60	Feb-61	4
Dec-69	Nov-70	1
Dec-73	Mar-75	1
Jan-80	Jul-80	4
Jul-81	Nov-82	1
Jul-90	Mar-91	2
Mar-01	Nov-01	1
Dec-07	Jun-09	3
Mar-20		4
Year 1		**60%**
Year 2		**7%**
Year 3		**7%**
Year 4		**27%**

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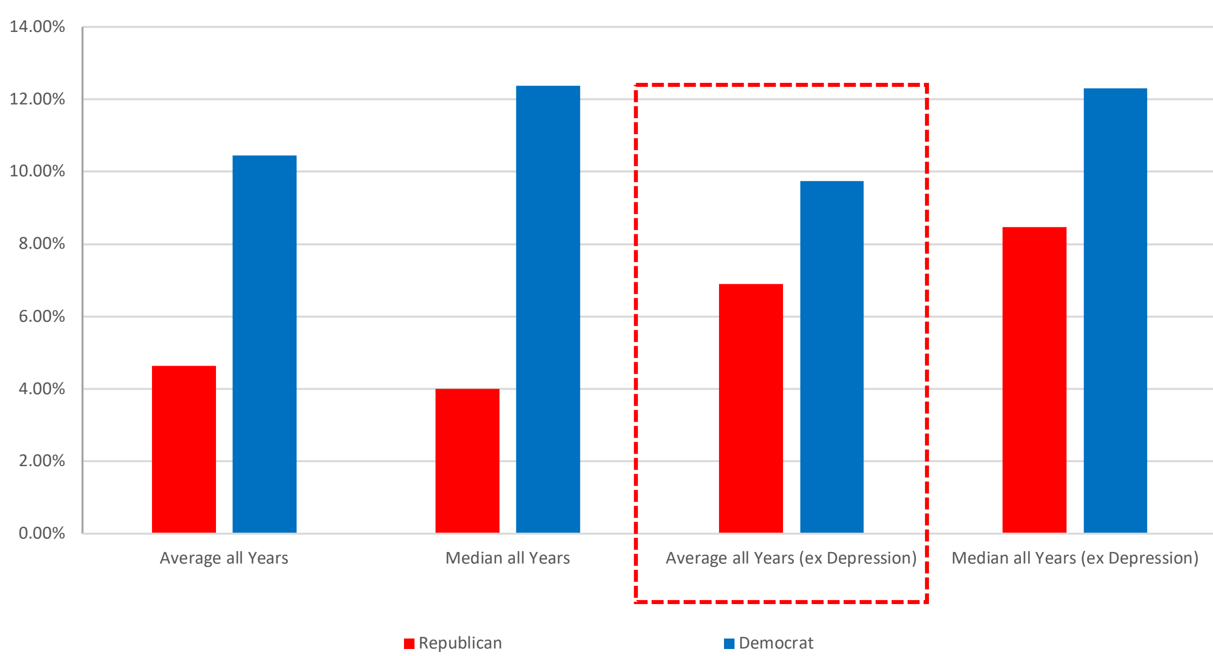
What do we know about which party is better for the equity markets?

The performance of the equity market is connected to the performance of the economy so it is not surprising that our historical study would show us that Democrats tend to deliver better annual returns for equity investors. Like the analysis on the economic environment and the party in the White House, the return analysis for the S&P 500 can be distorted by massive volatility in the aftermath of the Great Depression, the Great Recession and several wars. The one key takeaway from **chart 3** is that if you simply look at the average of all years since 1928 and exclude the Great Depression, the average annual return for both parties is attractive (~7% for Republicans and ~10% for Democrats). In addition, history proves there is little to no difference in who wins in the one year after the election. As can be seen in **chart 4 (next page)**, the average return (~5%) is basically the same in all the years after a Presidential election regardless of whether an incumbent wins or a new party wins.

Chart 3

Democrats Deliver Better Equity Returns…Or Have They?

Footnotes: Time period reflects all years from 1928-2019. Ex Great Depression includes 1934-2019. Source: Bloomberg Finance LP, Verdence Capital Advisors.



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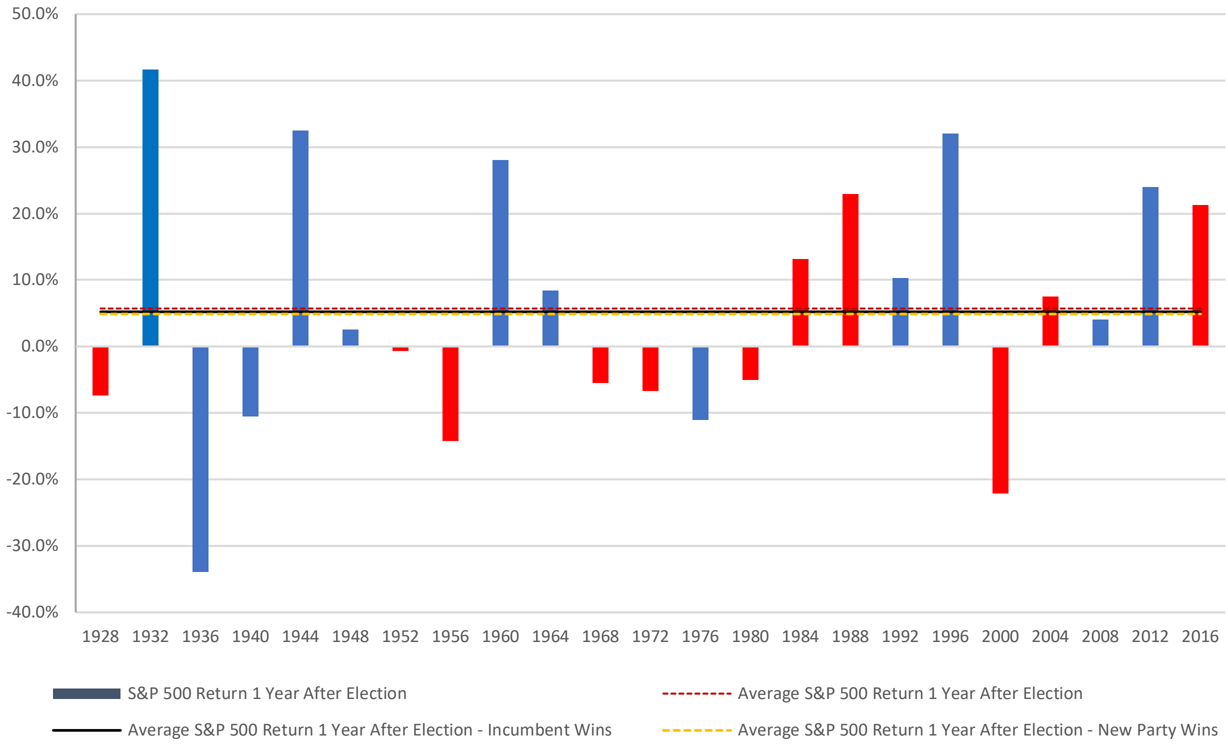
The average return (~5%) **is basically the same** in all the years after a Presidential election, regardless of whether an incumbent wins or a new party wins.

Chart 4

One Year After Election is Good Regardless of Winner

Footnotes: Time period reflects all election years from 1928 to 2016. Source: Bloomberg Finance LP, Verdence Capital Advisors.



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Past performance is not indicative of future returns

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How concerned should we be with a Democratic full sweep?

Since there is nearly zero chance that Republicans can win back control of the House, the close race for the Senate is creating some anxiety. Republicans have a small majority in the Senate (53 vs 47). However, there are several key states that could decide the Senate's fate which include North Carolina, Montana and Iowa.[3] If Democrats regain control of the Senate, they would obtain a "full sweep" and control the House, the Senate and the White House. While some may assume this means tax hikes are a done deal, we think it is too soon to suggest what kind of agenda items he may be able to get passed even with a "full sweep." For example, a "full sweep" was unsuccessful for Bill Clinton to pass his highly campaigned for comprehensive health care plan.

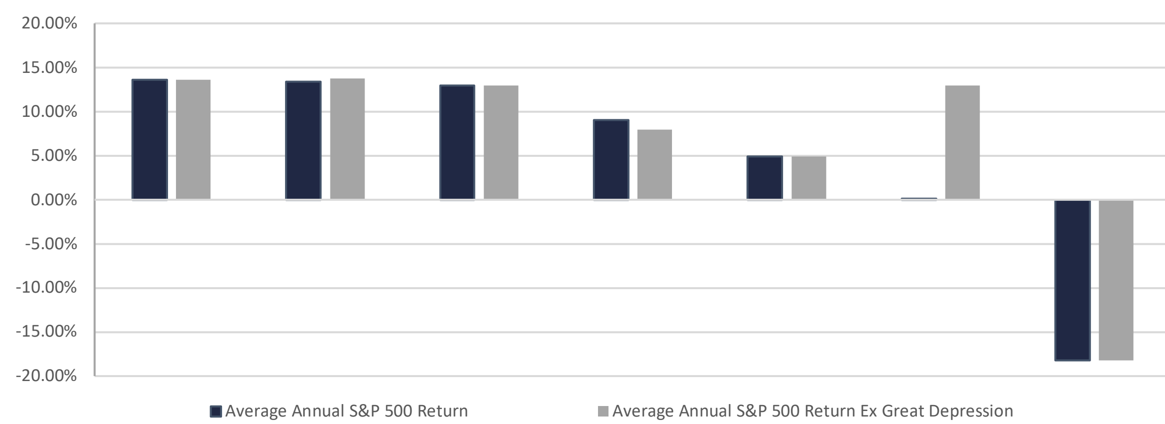
Remember that getting broad based tax reform is difficult, even with a full sweep. This may be why we have only seen two major tax overhauls in the past 30+ years. The current economic climate will be an overriding factor on tax changes. Even if Joe Biden were to win and get control of the Senate it will be difficult to make sweeping tax reform if the economic recovery is still uneven due to the negative effects of the pandemic and unemployment is still elevated.

What history does tell us is that investors do not necessarily like a "full sweep." As seen in **chart 5** equity investors prefer to have gridlock in Washington (where not one party controls all three branches). This may be because with gridlock there is less of chance of getting massive changes to legislation. The type of legislation that could spark volatility in the equity market. Instead status quo is better as investors like what they know. The best three combinations have included a split Congress or President. In fact, our current composition (Republican President, Republican Senate and Democratic House) has delivered equity investors the second-best annual returns.

Chart 5

Equity Investors Prefer a Gridlocked Government More than a "Full Sweep"

Footnotes: Time period reflects all years from 1929-2019. Ex Great Depression includes 1934-2019.
Source: Bloomberg Finance LP, Verdence Capital Advisors.



President	D	R	D	D	R	R	R
Senate	D	R	R	D	D	R	D
House	R	D	R	D	D	R	R

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What we know about the key differences in each candidate's agenda

At this point we have seen plans from both candidates, but the situation is still fluid. With only a few weeks until the election, there is a chance that views can change or be altered in order to satisfy likely voters. Therefore, we are going to focus on the core proposals that we have seen thus far. The main agenda item that both President Trump and Joe Biden have in common is that they want to increase government spending and want stimulus. The key differences are how to obtain the money to be able to spend and where to direct that money. President Trump wants to get additional funding primarily through another Coronavirus relief package while Joe Biden wants to fund his agenda through raising taxes for select Americans and businesses and/or repealing the Tax Cuts and Jobs Act. In **table 3**, we highlight some of the key agenda items. This is not all their views but a select few that may impact economic growth and equity markets IF they are able to be implemented.

Table 3

A Brief Look at Both Candidate's Agendas

Footnotes: Not all agenda items included. Views are most recent as of September 23, 2020. Source: Tax foundation, The Motley Fool, Council on Foreign Relations, donaldtrump.com, Verdence Capital Advisors.

Policy	Trump	Biden
Individual Income Taxes	Make Tax Cut and Jobs Act permanent. Additional middle-class tax cut.	Appeal TCJA, raise taxes for higher earners.
Corporate Taxes	Cut from 20 to 15%, offer incentives to bring manufacturing to U.S.	Raise corporate taxes to 28%.
Capital Gains	Reduce to 15% and index to inflation.	Raise capital gains for those making $1 million or more.
Trade	Ongoing pressure on China and possibly other trading partners.	No change to current tariffs but would prefer working with allies to fight China.
Infrastructure	$2 trillion to be funded by additional Coronavirus relief package.	$1.3 trillion focused on clean energy, school modernization, repairing roads and rural broadband.
Regulation	Continue to ease regulations; especially in energy.	Tighter regulations primarily in environment regulation.
Climate Change	No change.	Return to Paris Climate agreement; U.S. to be net zero carbon emissions by 2050.

Verdence View on The Presidential Election

Political parties will swing multiple times and taxes will even change at some point in an investor's long-term investment cycle. Therefore, it is dangerous to let emotions drive you to make short-term investment decisions until we know what changes will or will not take place and how they will impact your individual financial situation. We have historically seen that a candidate will campaign with aggressive plans only to move to the middle to satisfy more Americans and boost their approval ratings going into the midterm elections. In addition, we have often seen investors mistakenly make short term emotional moves in their portfolios in anticipation of what the market will do given a predicted outcome and then prove to be painfully wrong as the market reaction was wildly different than what was expected. For example, there were many predictions that the S&P 500 would fall up to 50% if President Trump won in 2016. If an investor sold in anticipation of him winning, they would have lost out on a 20%+ rally in the one year after he was elected.

We sympathize that the current state of our country may be discomforting, and the election may be bringing upon unnecessary anxiety especially regarding your investments and tax implications. We are closely monitoring any developments from a tax perspective and will make recommendations on a client by client basis IF they are needed. However, at this time it would be careless to speculate on changes on policies and what those policies may ultimately look like IF and WHEN they make their way through Congress. This is regardless of who wins the election.

Instead we remain disciplined to your long term investment objectives. History proves that economic fundamentals are more important than whoever sits in the oval office. We are modestly overweight global equities because regardless of the results of the Presidential election, the economy should be supported by historically low interest rates that are unlikely to rise until 2023 at least, the massive amount of fiscal stimulus (with more likely regardless of who wins) and the rapid advancements in Coronavirus vaccines and therapeutics. We are also holding a healthy cash positions as we expect volatility to pick up in the coming months that may offer attractive entry points. However, we will use the outlook for the economy as the overriding factor in making portfolio changes.

As always, if you have any questions about our perspective, please do not hesitate to reach out to your advisor.

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1. *270towin.com as of September 21, 2020.*
2. *Fivethirtyeight as of October 12, 2020.*
3. *270towin.com as of October 12, 2020.*
4. *All business cycles since the Great Depression from 1937-2009. 2020 is not counted due to the fact we do not have an official end date yet. NBER*

Disclaimer: