{PMFA} Special commentary

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EXECUTIVE SUMMARY

- *With the U.S. Presidential election approaching, it's an opportune time to examine what history does and does not tell us about the relationship between U.S. Presidential elections, the capital market, and investors.*
- *Both candidates have proposed a number of policies that would have economic impacts. However, the reality of either having the ability to enact sweeping reform once in office remains doubtful.*
- *While the past can often provide useful information, investors would be well served to maintain caution when drawing conclusions about market and economic performance during past election cycles. Relying on historical data assumes that past election year returns were driven by the election itself – which is generally not the case.*
- *Election anxiety may fuel an investor's urge to "do something." Instead, we advise investors to maintain a long-term view and not allow the often negative undertones and politically motivated warnings to sway their investment decision-making.*

BLOG

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PMFA SPECIAL MARKET COMMENTARY

Presidential Elections, Government Policies, and the Capital Markets: Seeing Beyond the Noise & Staying the Course

Every four years the United States becomes swept up in the Presidential Election, and this election cycle is no exception. The buildup has been underway for some time, but it's widely believed that most Americans don't really start paying attention to the campaigns and candidates until after Labor Day. As such, we believe that it's an opportune time to address a few questions. What does history tell us about the relationship between U.S. Presidential elections, the capital market, and investors? And, perhaps more importantly, what they don't.

In some regards, this election is no different than any other. Both candidates have put forward their respective visions, and the differences are clear. Each has promised to usher in four years of progress and prosperity, although each defines what that represents differently. Many Americans may experience anxiety about what will happen if the candidate they support loses.

At this point, both candidates have proposed a number of policies that would have an economic impact, should those policies come to fruition. Tax reform and changes in the stance towards international trade could have a meaningful long-term economic impact. However, it's important to note that although both candidates will continue to push their respective agendas freely, the reality of either having the ability to enact sweeping reform once in office remains doubtful. After this election, each branch of Congress may still be led by different political parties. But perhaps more importantly, it's unlikely that either side will secure 60 Senate seats – the critical threshold needed to block a filibuster. The result is that either candidate will have to work with Congress to pass meaningful legislation, effectively limiting their power to enact their policies without broad support.

With future policy subject to such uncertainty, can the past provide useful information to evaluate the potential economic or market impact? Perhaps, but we would encourage caution on drawing any meaningful conclusions. First, the number of election cycles to consider in the modern era is extremely limited. Only 17 elections have been held since 1945, of which only six guaranteed a new President would take office. Reading into average market returns over such a small sample size is misleading at best, and dangerous at worst; small sample sizes are disproportionately impacted by outliers (such as 2008), and can be interpreted very differently depending upon how one slices the data. For example, from 1944-2015 the S&P 500 averaged a 6.0% return during the fourth year of each presidential term. Conversely, five of the nine S&P 500 bear markets since 1961 have coincided with a presidential election year. The contradiction of the two examples is evident, providing data to support either a bullish or bearish point of view.

Perhaps the most significant flaw of relying on the historical record is the assumption that election year returns were driven (or even predominantly influenced) by the election itself. That has not always been the case, as any number of economic and financial events often have a much larger impact on market performance and volatility. Recall the previous example, which noted that five of the nine bear markets since 1961 coincided with a presidential election. At face value, five out of nine years would suggest a high probability of a bear market during an election year, but this line of thought doesn't hold up against further analysis. For example, in 2008, S&P 500 declined by 38%, but the election arguably had little if anything to do with that outcome; the bursting of the housing bubble, a deep recession, and ultimately the global financial crisis were the key catalysts, none of which were tied to the election itself. Likewise, the bear market that

began in 2000 was a byproduct of the tech stock bubble, and not the change in the White House.

We know recessions and bear markets happen periodically – about once every six years since 1947 (when quarterly GDP data was first published), so there is a reasonable probability a recession could occur at some point in the next president's term, regardless of who is elected. However, at this point the U.S. economy still appears to be on solid footing. Unemployment is low and job creation remains solid. Wage growth has begun to accelerate, consumer confidence is strong, consumer spending is supportive of GDP growth, and inflation remains moderate. At the same time, valuations and growth expectations suggest that we remain in a low-return environment, and the potential exists for greater volatility as the current cycle matures.

If history is a guide, we know there will be no shortage of prognostication by the media (mainstream and otherwise) surrounding the upcoming election – from draconian warnings of severe recession and collapsing stock prices, to grandiose claims of prosperity and unprecedented growth. Much will also be written about strategies designed to make investment decisions around the upcoming election, despite the reasonably sound economic backdrop, and the pitfalls of reviewing historical data based on a limited data set and projecting the impacts of rhetoric. Such strategies may appeal to an investor's urge to "do something" in response to fears about what might happen. Instead, we advise investors to maintain a long-term view and not allow the often negative undertones and politically motivated warnings to sway their investment decision-making. A well-designed portfolio built on a foundation defined by the investor's risk tolerance, return and cash flow needs, and investment time horizon should continue to be effective and prudent, regardless of who calls the White House home in January.

If you have questions or concerns, please contact your PMFA Relationship Manager.