

Elections, stock market returns & our savings.

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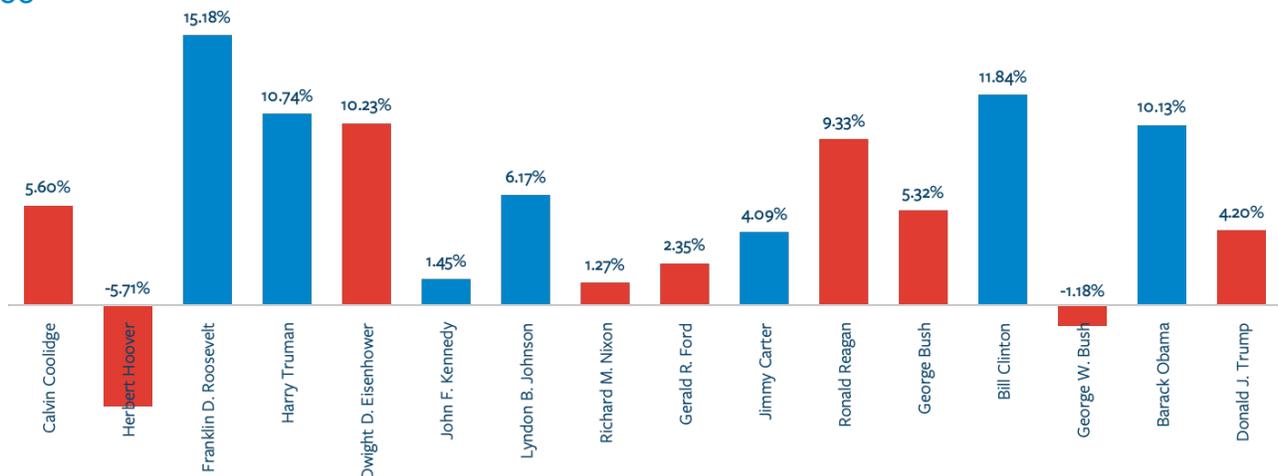
The U.S. presidential election is in two weeks. Politicians, economists, and the rest of us have opinions about what the results will mean. Investors are concerned about its implications to their lifelong savings.

This article attempts to look at the big picture and step away from the noise and current affairs that may cloud the investment decision-making process.

Does blue or red mean higher future stock market returns?

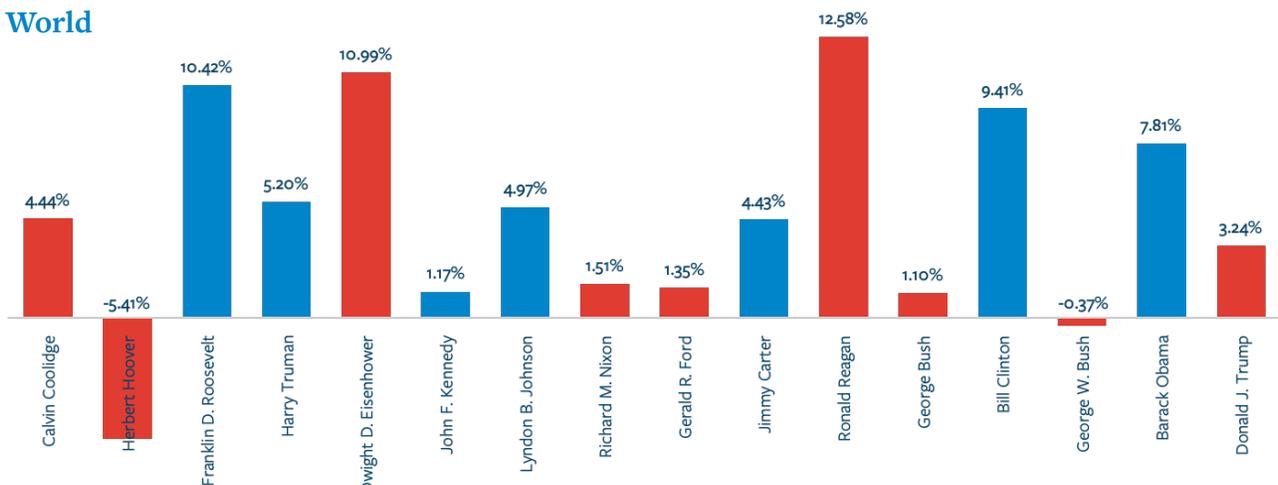
Since 1927, the United States has had 9 Republican and 7 Democratic presidents. On average a Democratic president held office for two terms (8 years) and the Republicans just over 5 years¹. The charts below illustrate the S&P 500 index's and MSCI World index's annualized returns during each party's term.

S&P 500



In USD. Monthly data from 1927-01-31 to 2020-07-31 for S&P500 Index. Source: Alpha Architect. Annualized return calculated using average monthly return for each president.

MSCI World



In USD. Monthly data from 1927-01-31 to 2020-07-31 for MSCI World Index. Source: Alpha Architect. Annualized return calculated using average monthly return for each president.

At a glance, one may conclude that a Democratic president will result in higher future stock market returns. A fair inference given the average annualized return during the Democratic presidential terms was 8.51% compared to 3.49% with a Republican leader.

But wait, shall we take a closer look at the sample data.

This year is the 59th U.S. presidential election. Most academic and practitioner’s research in this area have scrutinized the past 24 election outcomes leaving out the first 35 results. Leaving out such a large sample of data gives me pause. How would the data look if we went back to the first election in 1788? Would we lead to a different conclusion?

Suppose we believe history has information that can provide insight into future returns. In that case, our objective becomes twofold: do we have the highest confidence that these insights are reliable, and how do we protect ourselves from relying on a pattern that may be there just by chance?

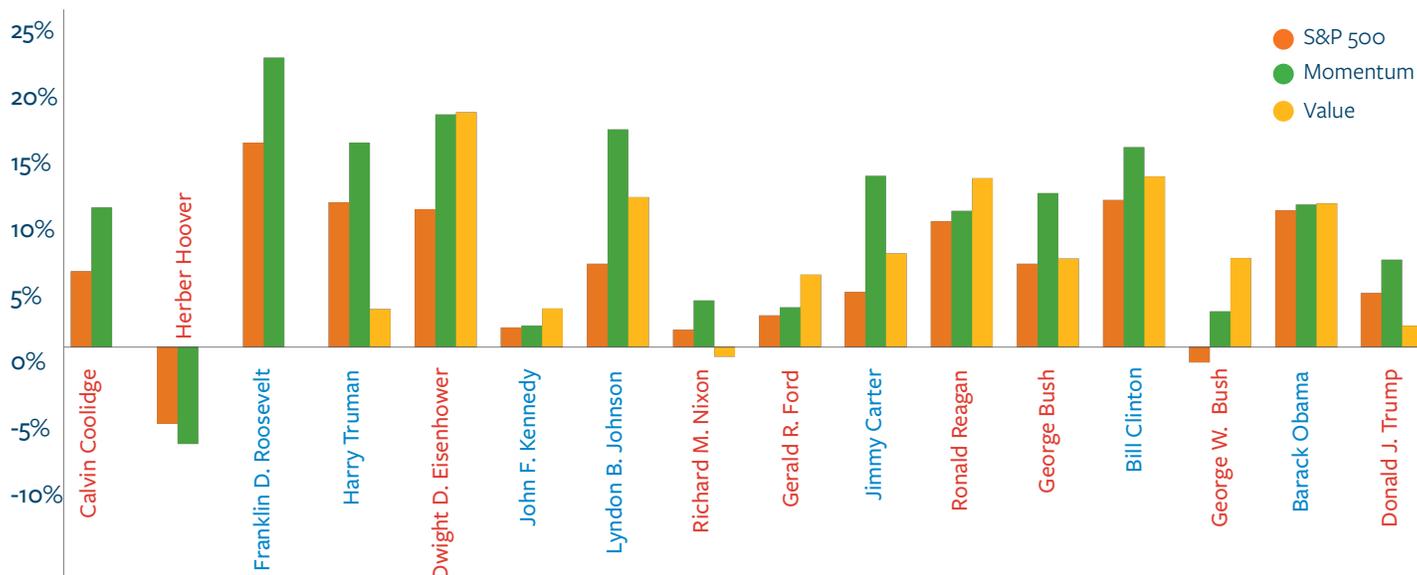
Within this framework, there is a strong argument to support that there is no reliable link between future stock market returns and the Presidential office.

The big takeaway here is, be it red or blue, there is a high likelihood that capital markets will continue to be profitable to its investors.

What about Value and Momentum?

These days there is debate about the idea of Value still being a valid source of higher expected returns. On the other hand, given the recent performance of Momentum stocks, the debate about Momentum may have quieted for now. It is not my intention to weigh in on these debates in this article but rather, try to extract information that can link past presidential elections and subsequent performance of Value and Momentum stocks.

The chart below illustrates the annualized returns for Value and high Momentum stocks in US markets during each Presidential term.



In USD. Monthly data from 1927-01-31 to 2020-07-31 for S&P500 Index. Monthly data for Value and Momentum from Ken French Data Library. Value returns are the top decile returns measured by Earnings/Price. Momentum monthly returns of top 10% stocks. Annualized return calculated using average monthly return for each president.

Momentum is a clear winner here. On average high Momentum stocks returned 9.37% compared to 6.02% for Value. Herbert Hoover's (D) government, the markets annualized -5.71% while Momentum stocks returned -7.25% only to deliver the 21.51% during FDR's time in office.

Second runner up - Value. During the Obama administration, Value stocks outperformed the S&P500 by 0.54% and the current regime, it has underperformed by 2.64%. Since Truman's officeⁱⁱ Value stocks on average have outperformed the S&P500 by 1.57%.

Once again, there does not seem to be a reliable link between a subset of stocks and the elected office.

So... now what?

Today the elections are all over the media and may continue to dominate the headlines into 2021. The election outcome will affect many of our lives through changes in policy or regulation or other issues. All investors, individual and institutional express their views of expected future outcomes into market prices when they buy and sell securities.

As money managers and investors, engaging in a prudent exercise to help separate the signal from the noise becomes a crucial part of the investment process.

If you are in doubt about your investment portfolio's future success, take a step back and ask if the changes you are contemplating increase your confidence in what you'd like to achieve.

Glossary:

S&P 500® Index: The S&P 500® Index is composed of 500 selected common stocks most of which are listed on the New York Stock Exchange. It is not an investment product available for purchase.

MSCI World Index: The MSCI World Index is a broad global equity index that represents large and mid-cap equity performance across all 23 developed market countries. It covers approximately 85% of the free float-adjusted market capitalization in each country. It is not an investment product available for purchase.

Earnings to Price: Compares a company's total earnings before extraordinary items for the last fiscal year end relative to its total market cap capitalization (Price per share multiplied by total shares outstanding). All NYSE, AMEX, and NASDAQ stocks.

Momentum: Total returns of stocks over the prior 12 months excluding the last month.

ⁱPresidents

President	Party	Months in Office
Calvin Coolidge	Republican	24
Herbert Hoover	Republican	48
Franklin D. Roosevelt	Democrat	144
Harry Truman	Democrat	96
Dwight D. Eisenhower	Republican	96
John F. Kennedy	Democrat	24
Lyndon B. Johnston	Democrat	72
Richard M. Nixon	Republican	60
Gerald R. Ford	Republican	36
Jimmy Carter	Democrat	48
Ronald Reagan	Republican	96
George Bush	Republican	48
Bill Clinton	Democrat	96
George W. Bush	Republican	96
Barack Obama	Democrat	96
Donald J. Trump	Republican	43

ⁱⁱEarliest available US Earnings/Price data is 1951-07-31.

Source: Wikipedia

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