State of Play

Bulls, bears and ballots

1 February 2024

In the ever-changing landscape of global politics, investors often find themselves on the edge of their seats during election cycles, pondering the potential impact they may have on their investment portfolios. However, as we delve into the intricate dance between politics and investments, it becomes apparent that the relationship might be less significant than conventional wisdom suggests. In this week's edition of State of Play, we explore the dynamic between elections in the UK and the US and the resilience of investment portfolios in the face of political shifts.

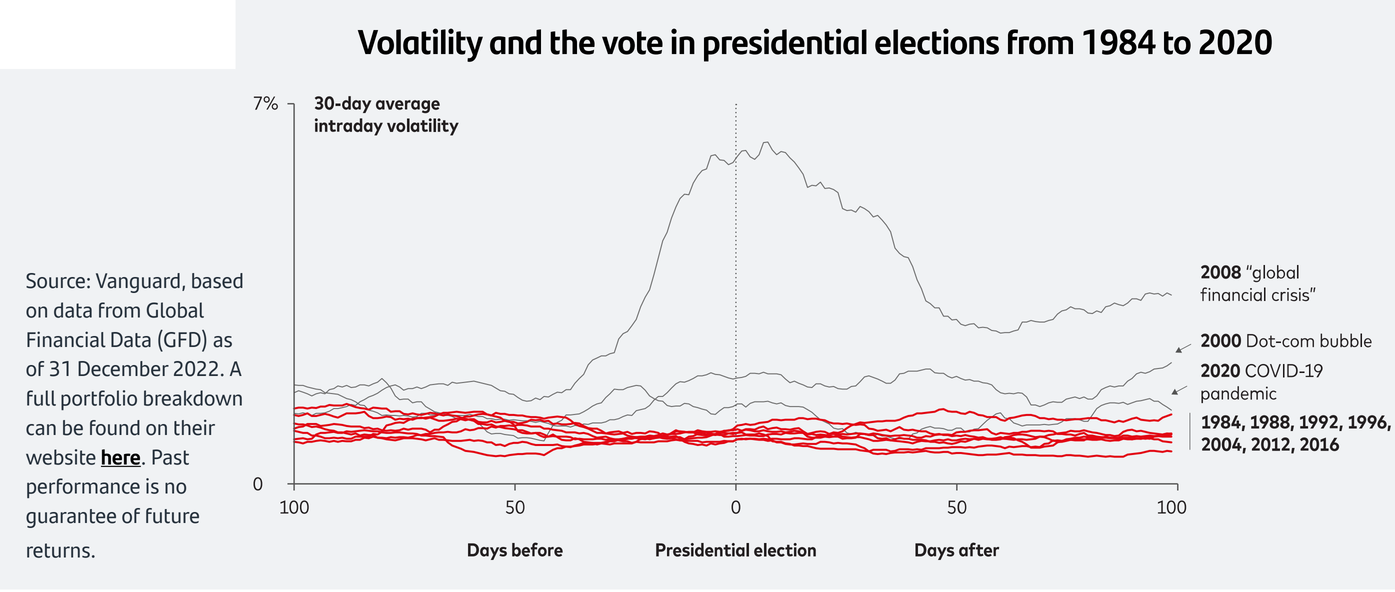
Key highlights from this week's State of Play

- What does history tell us?
- Market efficiency and information flow
- Economic policies vs market realities
- Global perspectives
- Market update

What does history tell us?

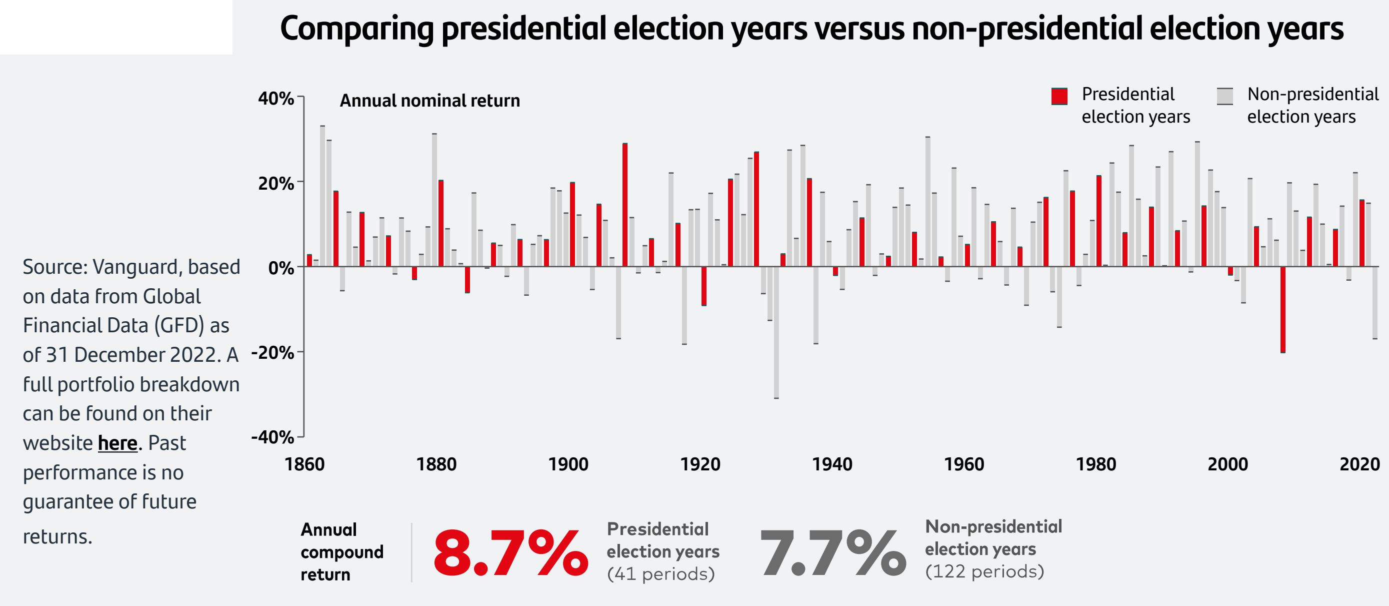
Before considering any potential impacts on the upcoming elections, let's first take a step back and examine the historical data. Numerous studies, including research conducted by renowned passive fund provider Vanguard[1], consistently show a surprising trend – the long-term impact of elections on investment portfolios is remarkably limited. While short-term market fluctuations might be observed surrounding elections (see chart below), the overall trajectory tends to be more influenced by economic fundamentals, global events, and corporate (company) performance.

Volatility and the vote in presidential elections from 1984 to 2020



Source: Vanguard, based on data from Global Financial Data (GFD) as of 31 December 2022. A full portfolio breakdown can be found on their website **here**. Past performance is no guarantee of future returns.

A study[2] published by Vanguard identified that, on average, markets have displayed a swift rebound after election-related volatility, with the economy and corporate earnings (i.e. company profits, which are usually calculated over a quarter or fiscal year) acting as more robust indicators of market behaviour. As captured on the next page, a 60% stock and 40% bond Portfolio shows no statistical difference in election years vs non-presidential election years, with election years actually capturing a marginally higher annual compound return than non-election years.[2] This historical perspective serves as a valuable anchor and a reminder to investors to focus on the broader economic landscape rather than short-term political noise.



Source: Vanguard, based on data from Global Financial Data (GFD) as of 31 December 2022. A full portfolio breakdown can be found on their website **here**. Past performance is no guarantee of future returns.

To further illustrate this point, the chart below[3] captures the performance of the S&P 500 Index (a US market index that comprises the 500 largest US-based companies by market capitalization – introduced during last week's State of Play) 12 months before and 12 months after every presidential election since 1988.

Election Year	Elected President	Performance over 12M before election date	Performance over 12M after election date	Calendar year return (S&P 500)
1988	George H.W. Bush	9.4%	22.2%	12.4%
1992	Bill Clinton	7.4%	10.8%	4.5%
1996	Bill Clinton	19.7%	33.0%	20.3%
2000	George W. Bush	4.50%	-21.9%	-10.1%
2004	George W. Bush	7.6%	6.4%	9.0%
2008	Barack Obama	-35.8%	8.2%	-38.4%
2012	Barack Obama	13.1%	24.4%	13.4%
2016	Donald Trump	1.7%	21.5%	9.5%
2020	Joe Biden	7.5%	39.9%	16.3%
Average	-	8.4%	9.3%	8.0%

Source: Forbes, 17 October 2023. Past performance is no guarantee of future returns.

As you can see, the S&P 500 Index typically performed slightly better the year after the election than the year preceding it, although the differences are typically minor. Your eyes may (understandably so) be instantly drawn to the first year President Obama came into office. However, focus attention on the date (2008); the large swing in performance for the 12 months post-election and prior were not driven by the election itself but rather by the Global Financial Crisis (GFC), as the US housing bubble burst following high volumes of lending from large US mortgage brokers.

Market efficiency and information flow

One key reason for the minimal impact of elections on investment portfolios is the efficiency of financial markets and the speed of information flow. Because of this, by the time election results are announced, markets have already factored in (often referred to in industry jargon as being 'priced in') the anticipated outcomes, mitigating the element of surprise. Moreover, in today's interconnected world, information flows with incredible speed, allowing investors to adjust their strategies promptly. The rise of sophisticated analytical tools has further enhanced the market's ability to digest and incorporate political developments efficiently and quickly.

Economic policies vs market realities

While election campaigns often revolve around promises of transformative economic policies, the translation of such campaigns into real action faces numerous hurdles. Real-world constraints, legislative processes, and the need for support from different parties often dilute the impact of proposed policies. Investors, therefore, need to distinguish between campaign promises and the actual implementation of policies that can shape economic conditions. This is of particular importance in the US, where differing views between the Republican and Democrat parties often results in a gridlock; a political stalemate where government is unable to act or pass new laws because rival parties control different parts of the executive branch and the legislature. Such a situation often results in compromises and moderation of the proposed policies.[4]

Global perspectives

In an era of interconnected financial markets, global factors play an increasingly crucial role in shaping investment landscapes. While the UK and US elections undoubtedly capture headlines, the impact of these events extends beyond national borders. Recent research from J.P Asset Management highlights that shares and bonds have been tending to move in unison more frequently[5], exemplifying the greater importance of constructing portfolios with uncorrelated assets. As was previously introduced, short-term market fluctuations might be observed surrounding elections, however these effects tend to dissipate fairly quickly. However, J.P.

Morgan's research highlights how a portfolio with enhanced diversification benefits can act as a hedge against this short-term volatility, mitigating risks associated with localised political uncertainties and providing a more resilient and robust approach to market fluctuations.

Conclusion

While the media may amplify the short-term noise around electoral events, experienced investors recognise the importance of economic fundamentals, global dynamics, and corporate performance. Drawing on historical data, market efficiency principles, and sector-specific analyses, investment professionals can navigate election seasons with a measured approach. Embracing a long-term perspective and staying familiar with broader economic indicators helps to weather the storms of political change, with security in the knowledge that portfolios are anchored in the fundamentals that truly drive market movements and are sufficiently diversified to mitigate risks associated with localised political uncertainties.

Market update

This week saw the first interest rate decisions taken this year by both the US Federal Reserve (Fed) on Wednesday and the Bank of England (BoE) on Thursday. Normally markets would be holding their breath in anticipation of both central banks next moves, but both the Fed and BoE have been at pains to signal that interest rates will likely remain at the current levels of 5.5% in the US and 5.25% in the UK.

So markets didn't anticipate any change in interest rates, and as seen in yesterday and today's announcements, they will remain unchanged. However, markets will have analysed every word of Fed Chairman Jerome Powell and BoE Governor Andrew Bailey in their respective press conferences and press releases. Any clues as to the timetable for easing rates will be the key focus for markets this week as January finally draws to a close.

Also connected to the future interest rate cycle in the US will be this Friday's Nonfarm Payroll figures, a monthly measure of the number of jobs created in the US. Last month saw the creation of 216k new jobs, higher than the forecast 170k[6], leading markets to lower their expectations of a spring cut in rates as the US economy continues to show signs of robust growth. The forecast this Friday is for 175k new jobs[7], a figure much higher than this will leave the markets with plenty to digest as we move into the first week of February.

The value of seeking guidance and advice

It is important to seek advice and guidance from a professional financial adviser who can help to explain how to build an appropriate financial plan to match your time horizons, financial ambitions and risk comfort. If you already have a plan in place or have already invested, it is important to allocate time to review this to ensure this remains on track and appropriate for your needs.

Note: Data as at 1 February 2024.

[1] Vanguard, 6 October 2022
[2] Vanguard, 26 October 2023
[3] Forbes Advisor, 17 October 2023
[4] Investopedia, 26 January 2024
[5] J.P. Morgan Asset Management, 3 November 2023
[6] Trading Economics, 5 January 2024
[7] Forex Live, 26 January 2024

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