US PRESIDENTIAL ELECTIONS AND THE STOCK MARKET

There will be a steady stream of opinions from pundits and prognosticators about how the election will impact the stock market. As we explain below, investors would be well-served to avoid the temptation to make significant changes to a long-term investment plan based upon these sorts of predictions.

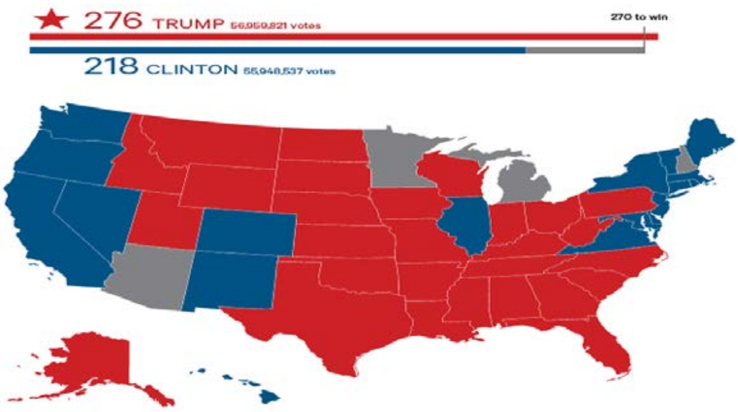
Efficient Financial provides a bespoke investment solution for our clients by specialising in low-cost institutional class portfolios that are globally diversified across multiple asset classes.

AT Efficient Financial we stress to our clients the negative effect that market timing can have on their portfolios and the need to believe in the investment strategy that we have implemented for them.
The markets are always volatile but having the discipline to stay the course and essentially ignore the 'noise' is essential in having a meaningful investment experience.

That said there are often times of anxiety and a need for reassurance.

The very recent election of Donald Trump as the 45th President of the United States of America is a case in point. Despite many polls predicting that, some with up to an 80% probability Hillary Clinton would win, like many other elections and referendum of late, including Brexit, the result went the other way.

US PRESIDENTIAL RESULTS



Source: Bloomberg as at 10am, Wednesday 9th November 2016

Even though the polls were moving in the weeks prior to the election, a bit of heightened volatility was expected in the markets from the fact that the markets were pricing in a different outcome. The markets are digesting the news and the surprise factor, and it is expected that this will continue over the next couple of weeks.
What is helpful to keep in mind is that normally happens in election processes, and sooner or later markets always go back to fundamentals. They basically go back to look at the economy.

Research shows that in every election, volatility increases—particularly in election years where there is a change of party in the presidency. Basically, data analysis shows there is 30% - 40% higher volatility in years where the election leads to a change of party - higher volatility than normal. And if you add to that the surprise factor i.e. the fact that the markets were expecting a different outcome, clearly that's understandable. However, markets are much less ideological, much more pragmatic than the political discourse.

And, again, markets do go back to fundamentals, do go back to the economy, shifting the focus back to the key drivers of the market as opposed to the political, electoral process itself.

WHAT TO DO

Basically, just stay focused and keep perspective, and above all, don't make drastic changes to your portfolio. It's always good advice, but it's interesting to understand a little better why we always say that.
On the one hand is really the difficulty of predicting a very nuanced process in terms of how what starts as a political proposition or proposal ends up as an actual policy being implemented and what impact that has in the markets. Timing the markets is very difficult.

There are a couple policies in Trump's platform that have received broad support across the economic and political spectrum. Economists of all colours basically have been supporting the idea of some sort of tax reform - particularly corporate tax reform. Infrastructure spending also that goes with that.

By sticking with a globally diversified, multi asset class portfolio you are well positioned to maintain your objectives while also taking note that this is another event that causes some volatility in the market but that it will stabilise.

Initial expected reaction to Trump victory

Time period	Non Election Years	Presidential Election Years
Q4	4.0%	1.7%
Whole Year	8.3%	6.1%

Source: Bloomberg

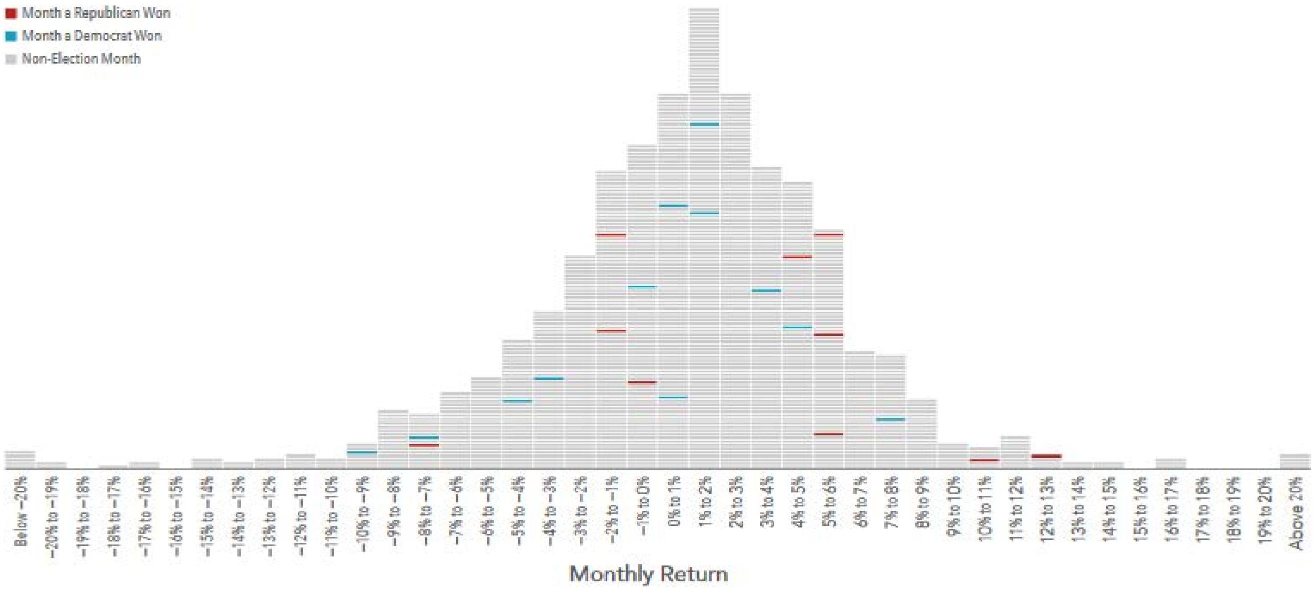
SHORT-TERM TRADING & PRESIDENTIAL ELECTION RESULTS

Trying to outguess the market is often a losing game.
Current market prices offer an up-to-the-minute snapshot of the aggregate expectations of market participants. This includes expectations about the outcome and impact of elections. While unanticipated future events—surprises relative to those expectations—may trigger price changes in the future, the nature of these surprises cannot be known by investors today. As a result, it is difficult, if not impossible, to systematically benefit from trying to identify mispriced securities. This suggests it is unlikely that investors can gain an edge by attempting to predict what will happen to the stock market after a presidential election.

Over the long run, the market has provided substantial returns regardless of who controlled the executive branch.

Exhibit 1 shows the frequency of monthly returns (expressed in 1% increments) for the S&P 500 Index from January 1926 to June 2016. Each horizontal dash represents one month, and each vertical bar shows the cumulative number of months for which returns were within a given 1% range (e.g., the tallest bar shows all months where returns were between 1% and 2%).
The blue and red horizontal lines represent months during which a presidential election was held. Red corresponds with a resulting win for the Republican Party and blue with a win for the Democratic Party. **This graphic illustrates that election month returns were well within the typical range of returns, regardless of which party won the election.**

Exhibit 1: Presidential Elections and S&P 500 Returns; Histogram of Monthly Returns
January 1926–June 2016



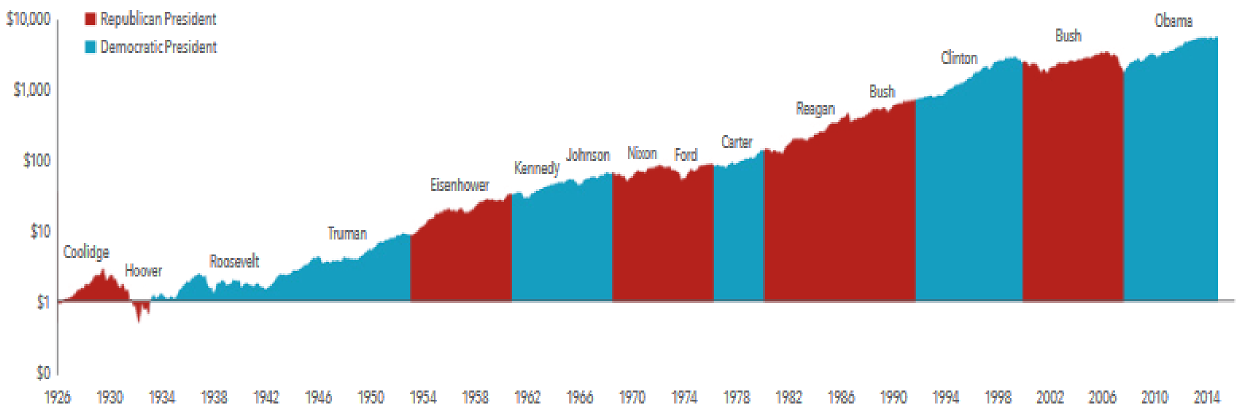
Past performance is not a guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. The S&P data is provided by Standard & Poor's Index Services Group.

LONG-TERM INVESTING: BULLS & BEARS ≠ DONKEYS & ELEPHANTS

Predictions about presidential elections and the stock market often focus on which party or candidate will be "better for the market" over the long run.

Exhibit 2 shows the growth of one dollar invested in the S&P 500 Index over nine decades and 15 presidencies (from Coolidge to Obama).

Exhibit 2: Growth of a Dollar Invested in the S&P 500
January 1926–June 2016



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This data does not suggest an obvious pattern of long-term stock market performance based upon which party holds the Oval Office. The key takeaway here is that over the long run, the market has provided substantial returns regardless of who controlled the executive branch.

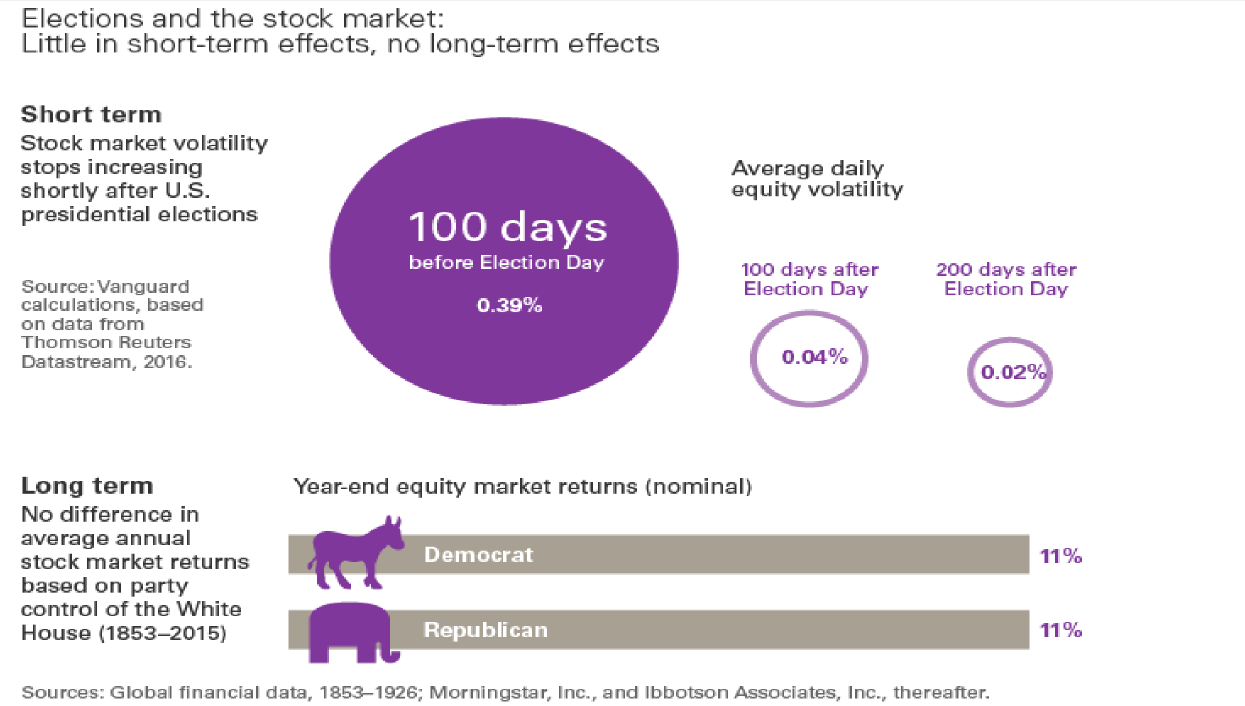
The following is an extract from a paper by:
Jonathan Lemco, Ph.D. Senior Strategist in **Vanguard Investment Strategy Group** & former Professor of Political Science at Johns Hopkins University.

While the often contentious presidential election is over, you may still be worried about how a leadership change in Washington will affect your portfolios. While presidential elections do add a layer of uncertainty—and the markets don't like uncertainty—they typically don't have a long-term effect on market performance.

"The outcome of the election is meaningful because markets inevitably react, and having some context for short-term market movements can help investors manage expectations," said Jonathan Lemco, Ph.D., a senior strategist in Vanguard Investment Strategy Group and former Professor of Political Science at Johns Hopkins University. **"But in the end, short-term developments are less important to our success than the big-picture trends that will shape markets in the years ahead."**

Elections can have a short-term effect, and stock market volatility has tended to spike prior to Election Day. But volatility typically stops increasing shortly after Election Day. And then the volatility stabilizes 100 and 200 days after the election, once the markets have had a chance to digest the news.
From there, based on data going back to 1853, stock market performance is virtually identical no matter which party controls the White House.

Elections and the Stock Market - Little in short term effects, no long term effects



"This is one more reason why investors should focus on more meaningful factors when it comes to their portfolios, such as diversification and controlling costs," Lemco said.
Other factors are more important in the long run.

It may be helpful to remember that many factors influence market behaviour. The most important is market valuations, but others include globalization; technology; demographics; the Fed and the economy; and unforeseen events, such as wars and natural disasters.

For example, while the S&P 500 experienced some of its strongest gains during the presidency of Gerald Ford (August 9, 1974–January 20, 1977), this was primarily because stocks were attractively valued following the bear market of the early 1970s that ended shortly after President Ford took office.

CONCLUSION

Equity markets can help investors grow their assets, but investing is a long-term endeavour.
Trying to make investment decisions based upon the outcome of presidential elections is unlikely to result in reliable excess returns for investors. At best, any positive outcome based on such a strategy will likely be the result of random luck. At worst, it can lead to costly mistakes. Accordingly, there is a strong case for investors to rely on patience and portfolio structure, rather than trying to outguess the market, in order to pursue investment returns.

If you have any queries or would like more clarification or information about this or any matters concerning your portfolio please let us know and we'd be happy to arrange a chat.

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