Do U.S. Presidential Elections Impact Capital Markets?

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**Introduction**

Every four years, in the months leading up to the U.S. presidential election, we often get asked how capital markets will react if the Democratic or Republican candidate wins the election. It is easy to assume that the U.S. election will have a big impact on capital markets, particularly given the length of the electoral cycle and the coverage by the media. However, historical data seems to suggest that elections do not drive market returns, particularly for those investors with a long time horizon. While we cannot make predictions about the election's short-term impact on capital market performance, we would suggest clients look beyond the election and stay with their long term investment plan.

**How will the 2016 election impact markets?**

We will not attempt to predict the outcome of the presidential election and its impact on capital markets. At this point, opinion polls point strongly in favor of the Democratic nominee, Hillary Clinton, winning the election. Capital markets are likely pricing-in a Clinton victory and, should that outcome be realized, there may be little reaction from markets. This is true of most historical election periods where markets receive information on a daily basis and price in certain outcomes over a long time period. We are, however, quickly reminded of the “Brexit” scenario where polls were handicapping a “remain” vote for much of the pre-referendum period, before narrowing closer to the vote. The surprising decision of the U.K. electorate to leave the European Union resulted in a sharp sell-off across the globe with a relatively quick recovery, although some markets, such as the British pound and interest rates globally have remained at depressed levels. As with any event, a surprise in the U.S. election is possible. Given the markets are currently expecting a Clinton victory, a Trump victory could lead to short term market volatility.

Given the U.S. political system of checks and balances limits the power of the president, past U.S. election results have typically not had a material impact on markets. A victory by Republican nominee Donald Trump does not mean that capital markets should or will sell-off, but expectations of Trump’s actions and policies are wide-ranging. If Trump gains in the polls, we could see markets discounting uncertainty attached to this outcome. However, we believe that historical data from past elections seems to confirm that election outcomes rarely drive markets significantly in either direction. As shown in Figure 1, the range of historical market outcomes surrounding a U.S. Presidential election have fallen in a similar range as non-election periods. Although it appears that election periods have corresponded with higher downside risks, much of this downside experience is driven by the dramatic negative results experienced in 2008 during the financial crisis rather than being driven by the election.
What does matter?

While presidential election outcomes have the potential to move markets in the short-term, we do not believe they are a significant long-term driver of capital market returns. We believe the more important driver of capital market returns is valuations. Over the last 15 years, there have been two periods where equity markets have declined approximately 50% from peak-to-trough. In the early 2000’s, the culprit was elevated valuations for technology stocks while the 2008 global financial crisis was, in part, driven by elevated valuations in the residential housing market. While valuations should drive long-term returns, short-term returns are typically driven by a number of factors including company earnings, central bank policies, and world events (natural disasters, terrorist attacks, etc.).

Conclusion

Absent a change in portfolio objectives, we continue to recommend that investors adhere to their long-term strategic allocations (or medium-term tactical allocations, as the case may be). At the same time, investors may also want to proceed cautiously with any portfolio transitions or rebalancing scheduled around the election. While it may be tempting to make a change prior to the election, we believe those types of decisions are typically driven more by emotion than objective reasoning. Investors worried about potential shorter term downside outcomes should examine their overall portfolio risk levels and determine if a change in their strategic asset allocation policy is appropriate.
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