PRATO CAPITAL

The 2020 Election and your Financial Life Plan

Often investors make changes to portfolios in anticipation of perceived outcomes that will happen after Presidential elections. Does a proactive strategy provide different outcomes to investors over the long-term?

The Politics of Today

The upcoming election for President is getting closer and the noise from both the political ads and media coverage is getting louder every day. Social media and the 24-hour news outlets certainly help feed this frenzy.

Since very few voters are still undecided with the election this November, and most are firmly entrenched in their beliefs, we would like to provide a little perspective on how bitter politics has been in the past.

It has been over 200 years since a sitting Vice-President was involved in a duel with pistols when Aaron Burr shot and killed the former Secretary of the Treasury, Alexander Hamilton. Politics today could be worse.

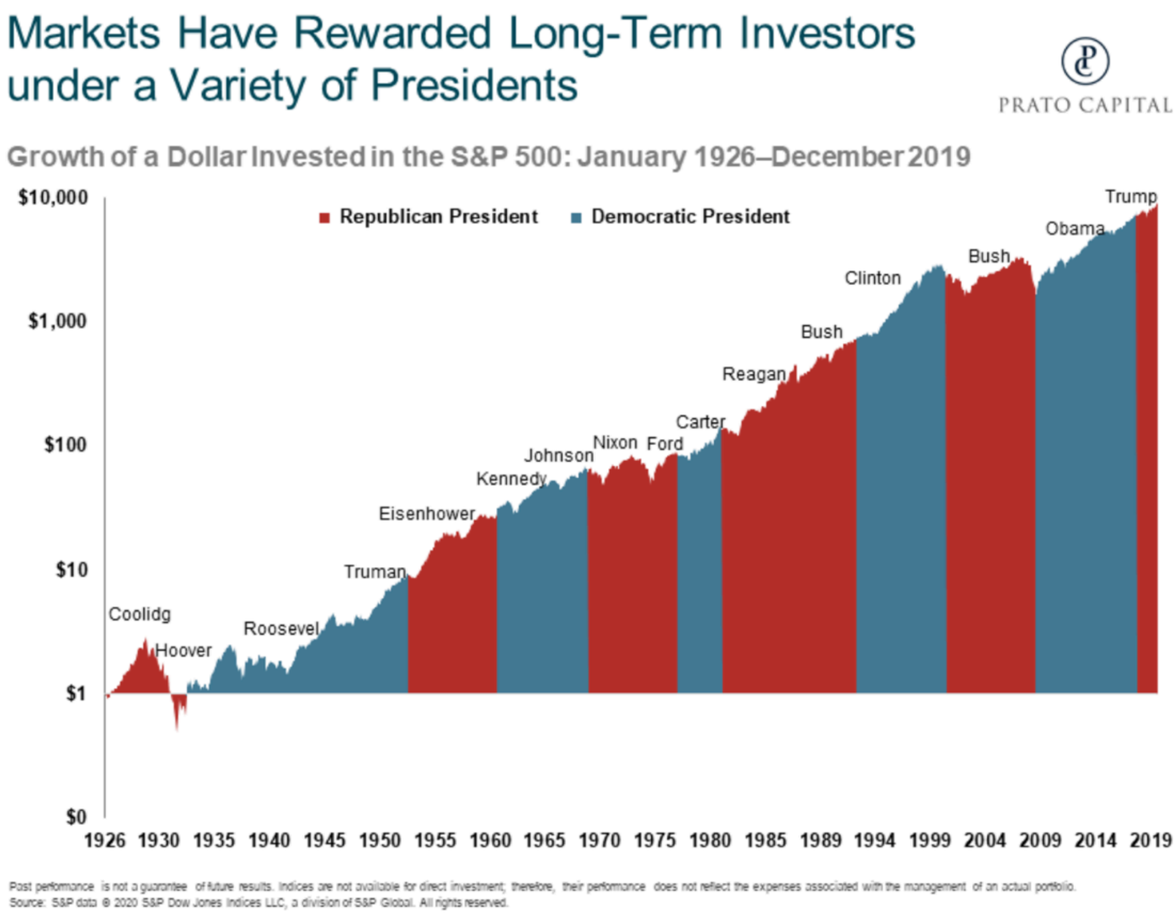
What effect does the President have on stock market returns?

With every presidential election, there is much speculation about which candidate will be better for the stock markets and an investor's portfolio. There is no shortage of 'experts' lining up in front of the cameras to give their opinions about how the markets will go up if one candidate is elected versus the other candidate. The opinions are just that – the so-called experts guessing what the future may hold.

At Prato Capital, we believe this adds considerable noise surrounding both the markets and the election. When using history as a guide, we may be able to see more clearly if the individual in the White House really has an impact on stock market performance.

Since 1929, the S&P 500 has averaged more than a 10% annual return. This includes economic events like depression, several recessions, and multiple wars. It has also included 15 different Presidents. In Exhibit 1 below, we see the growth of the S&P 500 over the terms of Presidents from both political parties. With very few exceptions the S&P has grown without any distinction concerning the occupant of the White House.

Exhibit 1: Growth of S&P 500 over Presidential Terms



Source: Dimensional Fund Advisors.

The average S&P 500 return for each presidential term based on the political party is Republican Presidents averaging 6.3% and Democratic Presidents averaging 13.5%. Does this mean that a Democratic President is better for investors?

Several academic studies have looked at this difference in returns based on political parties[1]. The studies included factors like timing, consumer sentiment, and the international environment. In the end the results of these studies were inconclusive with one of the studies concluding the difference as a “puzzle”. Without more conclusive data pointing to the advantage of one political party over the other, we do not recommend investors change portfolios or Financial Life Plans based on the political party affiliation of the occupant of the White House.

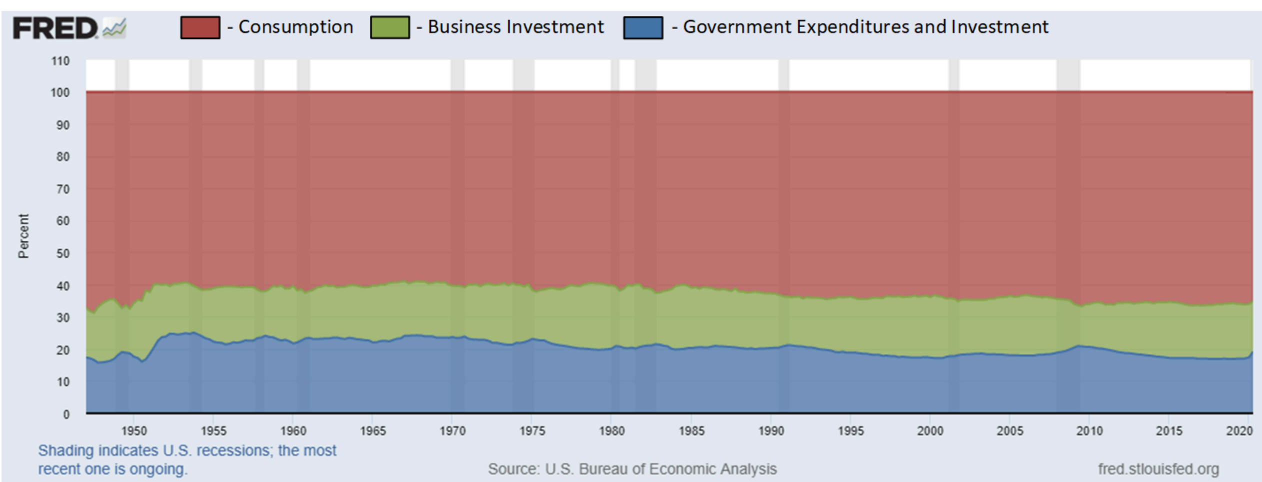
Economic Policy Effects and Stock Market Performance

Before every election the voters hear about how each candidate will change economic policy to correct a real or perceived economic issue. We also hear how the other candidate has a plan that will 'stifle competition' or 'destroy business'.

One way to look at how business adapts to changing political landscapes and changing economic policy is to look at the share of Gross Domestic Product (GDP) that business provides and how it may change over time.

Exhibit 2 below shows the percentage of GDP that includes consumer consumption (spending), business investment, and government investing and spending from 1947 to 2020. Except for small changes around recessionary periods (indicated by vertical gray shading) the percent share of business investment towards GDP (indicated by the green band) has remained relatively constant. Within about ±2% of the average. This includes 19 presidential terms with tax rates going up and down, trade disputes and trade agreements, the Korean, Vietnam and Iraq/Afghanistan Wars, and implementation of Medicare, Medicaid, and the Affordable Care Act to name just a few of the economic changes over the past 74 years.

Exhibit 2: Shares of Gross Domestic Product: Consumer Consumption, Business Investment and Government Expenditures and Investment, 1947 – 2020.[2]



Source: FRED, Federal Reserve of St. Louis

Most companies are in business to make a profit. Successful companies adapt to different and changing economic situations when needed to remain successful. This is the main reason that the stock market has rewarded long-term investors without regard to the political party in charge.

Conclusion

At Prato Capital, we recommend everyone that can vote, please go vote. Not just for the Presidential candidates but for all the other federal, state, and local elected officials that have an impact on our everyday lives through legislation and policy.

Contrary to what we may hear in political ads and from the pundits in the media, *history has proven that the President has very little direct impact on anyone's 401k or stock market portfolio.* The real risk to an investor's portfolio, and more importantly their *Financial Life Plan*, is trying to predict the future direction of the stock market based on *opinions by overreacting* to the headlines and "breaking news" in the media.

As for your portfolio and Financial Life Plan, we strongly recommend maintaining your Financial Life Plan driven investment strategy, as it is based on your risk tolerance and life goals. Doing so will give you the greatest probability of meeting your current and future financial goals.

> *"We will continue to ignore political and economic forecasts which are an expensive distraction for many investors and businessmen."*
> **– Warren Buffett**

[1] Alan S. Blinder and Mark W. Watson, "Presidents and the Economy: A Forensic Investigation", Woodrow Wilson School and Department of Economics, Princeton University, November 2013, https://www.princeton.edu/~mwatson/papers/Presidents_Blinder_Watson_Nov2013.pdf.

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[2] Data from U.S. Bureau of Economic Analysis, Shares of Gross Domestic Product: retrieved from FRED, Federal Reserve Bank of St. Louis;

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