BIG SIOUX
WEALTH MANAGEMENT

October 6, 2020

Good Afternoon,

Over the past few weeks, we have understandably had many clients ask how the elections this November might impact their investments. We will be sending out another video as we get closer to the election. Our next video will provide our thoughts on how we believe different sectors of the stock market, as well as the overall economy will be impacted under the different election scenarios. For today, we will lay out our general views regarding the election and offer several charts and statistics that will hopefully help you to keep your emotions in check during this highly uncertain period.

The reality is, nobody knows who will win this election or how it will directly impact the market. One statement I have continually heard over the recent weeks is, “this election is a coin toss.” There are a number of long-term trends that pollsters use to try and predict elections. But because the presidential election happens only once every four years, it's hard to put too much credence into any one prediction based on these trends. With that caveat, I will share some of the information that stood out to me from the 15+ conference calls I have attended over the past month – most of which were hosted by some of the biggest firms on Wall Street.

According to Ned Davis Research, it's very rare for an incumbent party to win reelection when there is a recession or a 20% drop in the markets during the election year. We have seen both of these things occur in 2020. Historically, since 1952 under these circumstances, the incumbent party has been 0 for 6 [1]. However, as we know anything can happen in the year 2020.

Interestingly, stock market performance leading up to an election has been a good indicator of the election outcome. InvesTech Research released a study reviewing stock market performance leading up to previous presidential elections. They found that the market’s performance in the three months leading up to a presidential election has forecasted the winner correctly 87% of the time. Simply put, if an incumbent candidate’s stock market had gains over the three months leading up to the election, he was likely reelected. If an incumbent candidate’s stock market saw losses over the three months prior to an election, we was generally defeated. There have been 23 presidential elections since 1928. In 20 of the 23 instances, stock market performance correctly predicted the presidential election winner [1].

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Does the Stock Market Predict the Presidential Election?

Market Performance in the 3 months Preceding Election Day

Election Year	S&P 500 3 Month Gain/Loss	Incumbent Party	Stock Market Accuracy
1928	13.6	Won	☑
1932	-2.6	Lost	☑
1936	7.9	Won	☑
1940	8.6	Won	☑
1944	2.3	Won	☑
1948	5.4	Won	☑
1952	-3.3	Lost	☑
1956	-2.6	Won	☒
1960	-0.7	Lost	☑
1964	2.6	Won	☑
1968	6.5	Lost	☒
1972	3.0	Won	☑
1976	-0.1	Lost	☑
1980	6.7	Lost	☒
1984	4.8	Won	☑
1988	1.9	Won	☑
1992	-1.2	Lost	☑
1996	8.2	Won	☑
2000	-3.2	Lost	☑
2004	2.2	Won	☑
2008	-19.5	Lost	☑
2012	2.5	Won	☑
2016	-1.9	Lost	☑
Accuracy: 20 out of 23 (87.0%)			

Source: InvesTech Research. Past performance is not indicative of future results.

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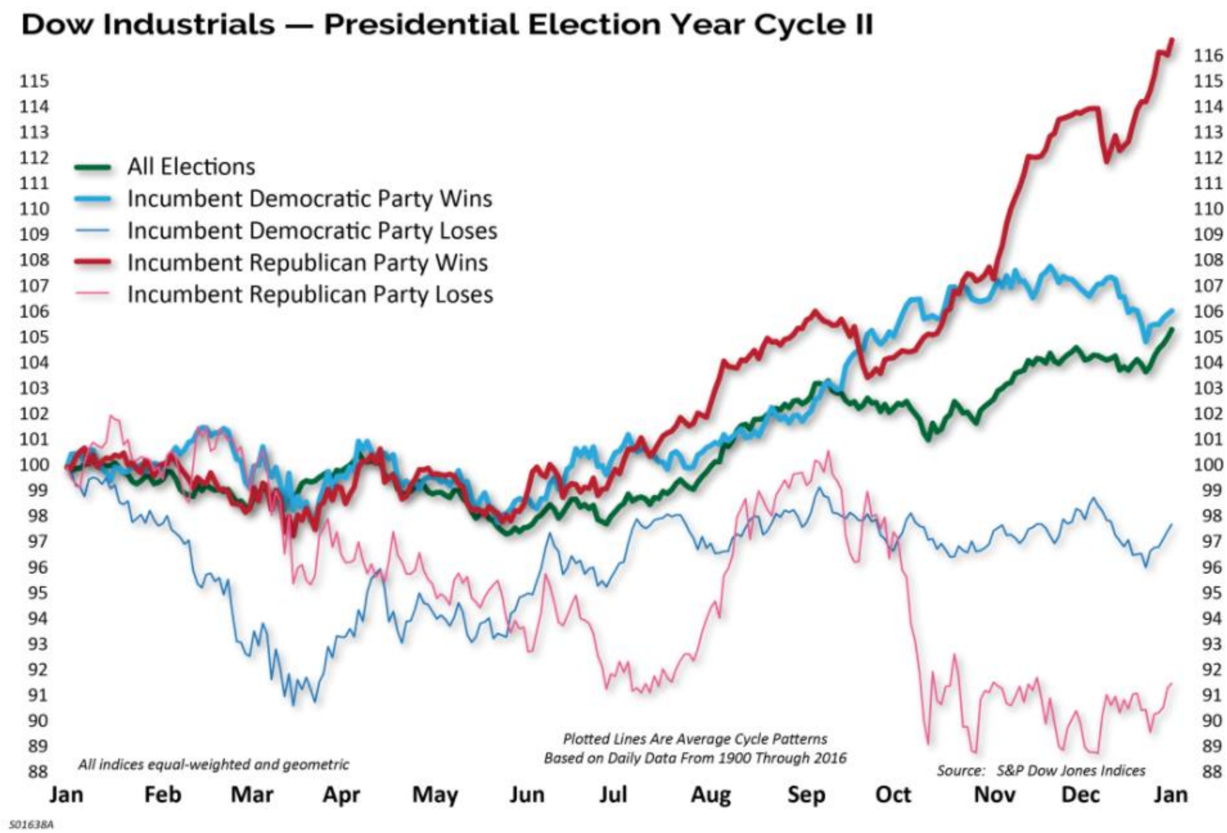
When comparing incumbent presidential election outcomes, markets tend to do better in an election year when an incumbent Republican wins [2].



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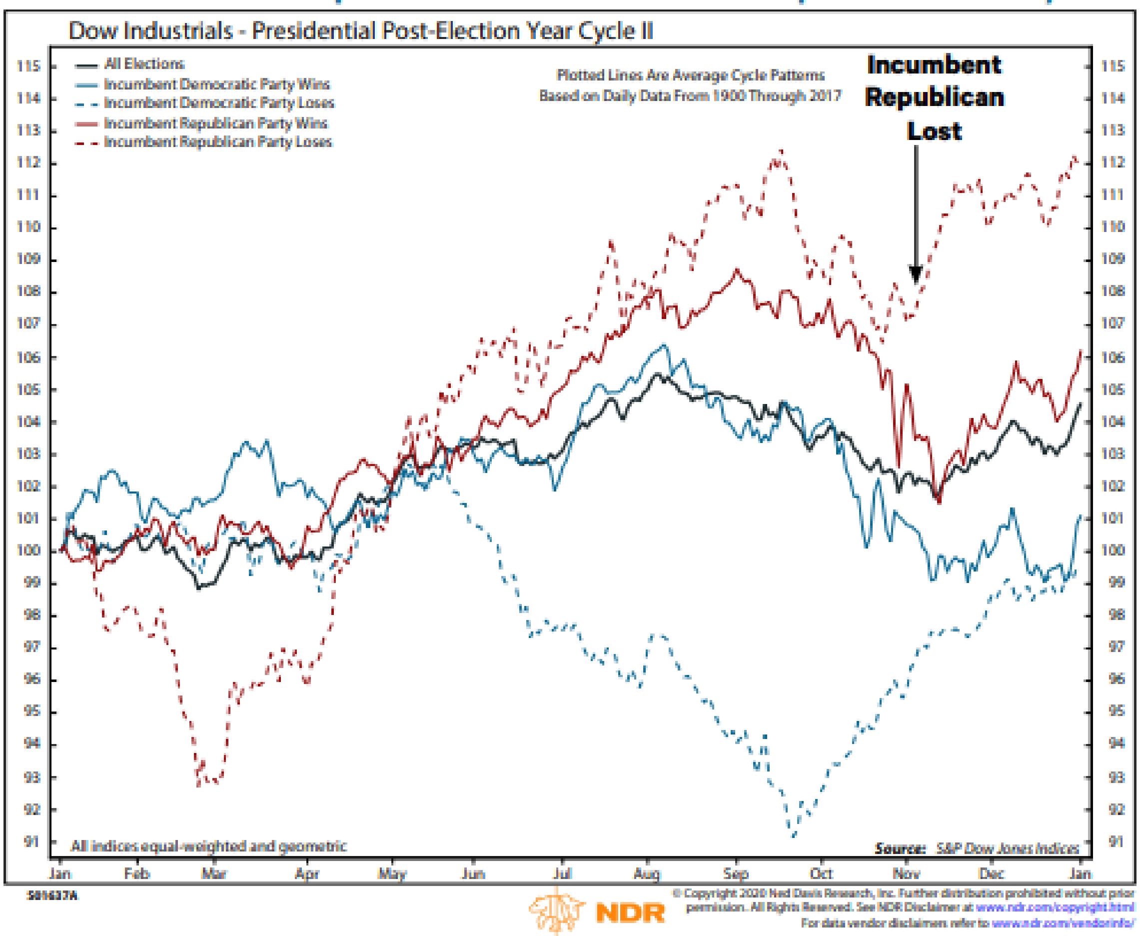
Ironically, markets have historically tended to do best in the year following the election when the Republican incumbent loses [2]. This is caused largely by investors becoming overly positive and negative leading up to the election. Worries among both parties are typically over-embellished, which often leads to a reversal of the market.

Weakness after Republican losses reverse in post-election years



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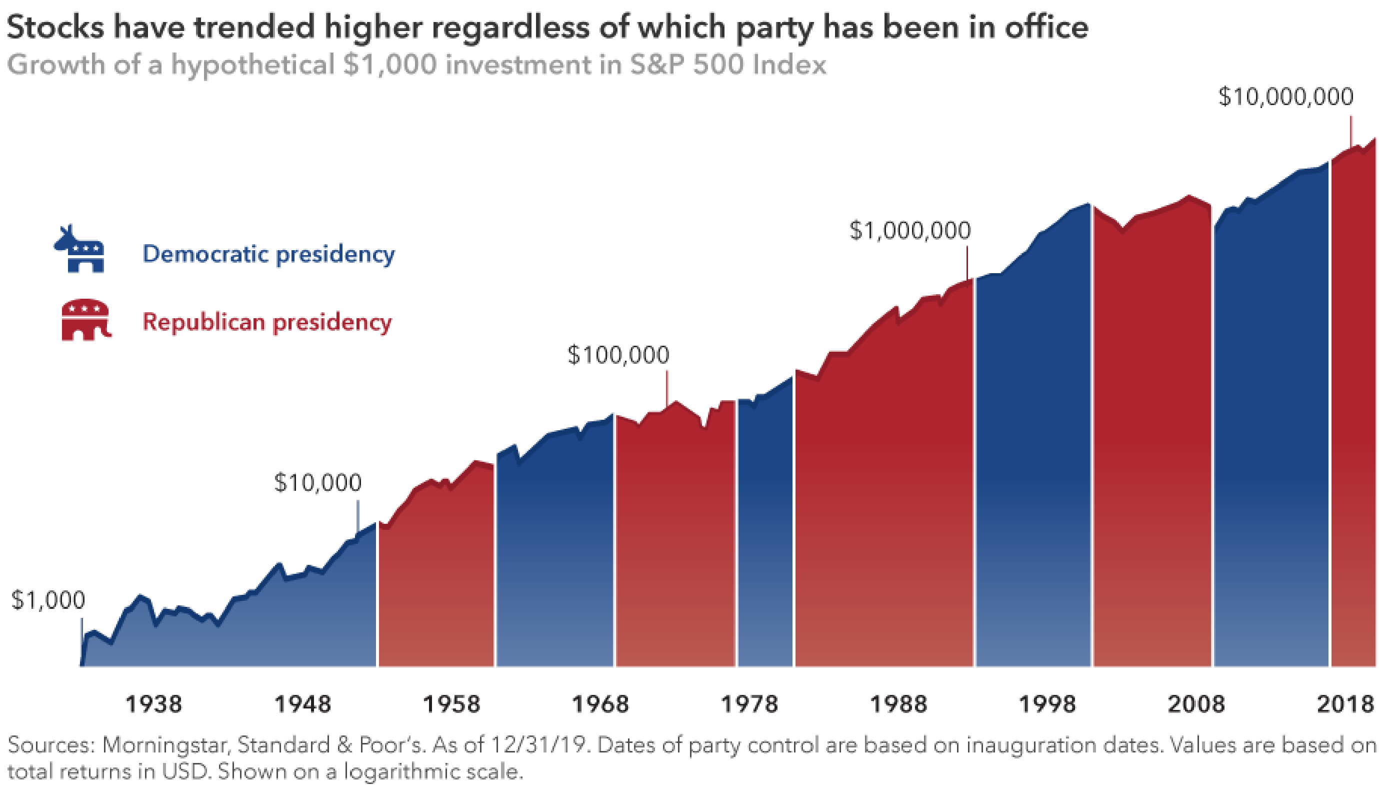
Presidential elections can be divisive and unsettling. At times, the fate of the world seems to hang in the balance, but investors would be wise to tune out the noise and focus on the long term. As shown in the below Capital Group chart, the outcomes of presidential elections have largely made no difference when it comes to long-term investment returns. "Presidents get far too much credit, and far too much blame, for the health of the U.S. economy and the state of the financial markets," says Capital Group economist Darrell Spence. "There are many other variables that determine economic growth and market returns and, frankly, presidents have very little influence over them." [3]



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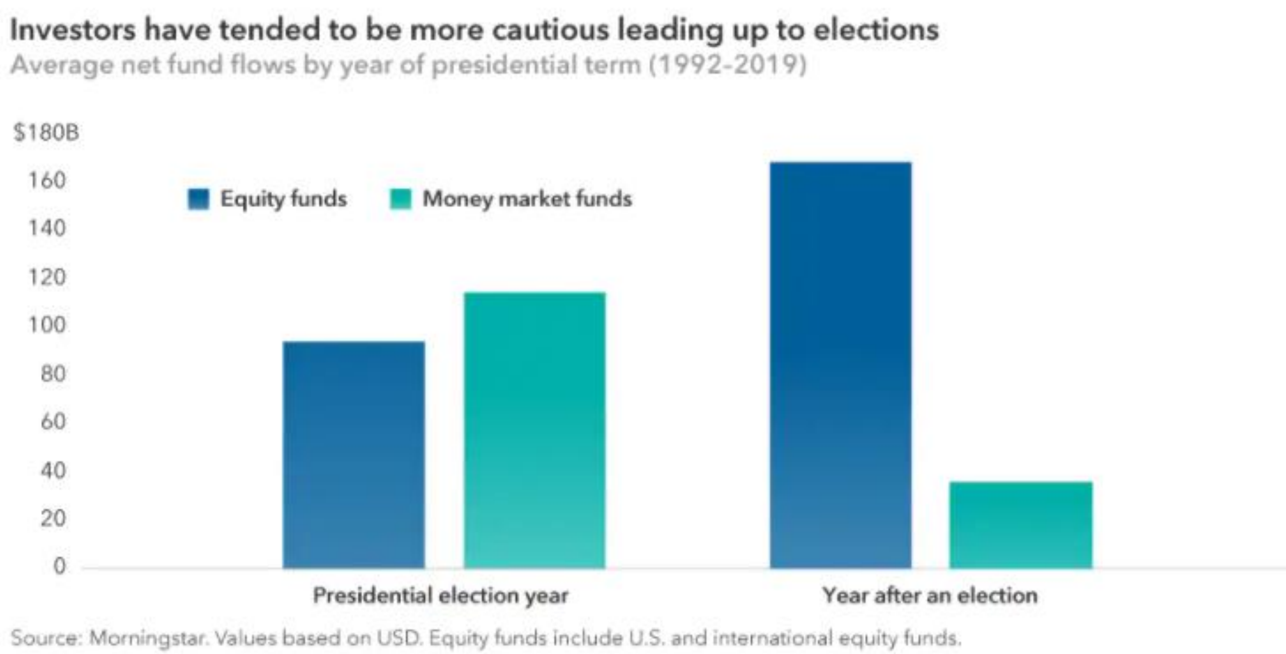
Darrell Spence of Capital Group goes on to say, “If you’re nervous about the markets in 2020, you’re not alone. Presidential candidates often draw attention to the country’s problems, and campaigns regularly amplify negative messages. So maybe it should be no surprise that investors have tended to be more conservative with their portfolios ahead of elections. Since 1992, investors have poured assets into money market funds — traditionally one of the lowest risk investment vehicles — much more often leading up to elections. By contrast, equity funds have seen the highest net inflows in the year immediately after an election. This suggests that investors may prefer to minimize risk during election years and wait until after uncertainty has subsided to revisit riskier assets like stocks.” [3]

The issue with trying to time the market is that you have to be right twice – knowing when to sell and when to buy back in. To illustrate the power of staying invested and weathering the storm, Capital Group analyzed investment returns over the last 22 election cycles to compare 3 different investment approaches: being fully invested in equities, making monthly contributions to equities, or staying in cash until after the election. The hypothetical investor who stayed in cash until after the election had the worst outcome. Meanwhile, investors who were fully invested or made monthly contributions during an election year came out on top [3]. This is shown in chart below.



In summary, don't allow elections to influence your investment decisions. History has shown us that election results have had very little impact on long-term investment returns. Regardless of the outcome, the Federal Reserve is backing the economy through printing money and we expect corporate earnings to continue their recovery. According to Fundstrat, there is $4.5 trillion of cash on the sidelines and the U.S. economy is expanding and recovering [4]. We feel these factors seem to argue stocks are still in the earlier stages of their recovery.

Another reason we encourage investors to stay invested, is that many individuals need their money to grow to reach their retirement goals. One untimely investment mistake can easily derail your financial plan and possibly take years to recover. Unfortunately with interest rates near multi-decade lows, there are few alternatives to equity investments for achieving growth. Bonds and cash are even less attractive if you believe as we do. We anticipate that the Fed will continue to be the backstop for future economic weakness through money printing, as well as Congress through continued fiscal stimulus.

The journey will most likely be volatile and emotionally taxing, but over time stocks have generally provided more growth relative to bonds and cash. I remember the 2008 and 2016 elections like yesterday. Republican and Democrat investors alike were fearful of the consequences if their candidate did not win. In both cases the market performed well. Investors who remained fearful of an Obama or Trump administration and stayed in cash missed out on some tremendous gains. I believe that no matter the outcome, or how long it takes to declare a winner, we will get through this election too.

Sincerely,

D.P.

Dustin Padgett

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