EP102: Should you trade on the US Election?

Marcelo: Welcome to the Empowered Investor Podcast. My name is Marcelo Taboada, and I'll be joined today by my co-host, Jackson Matthews. Jackson, how are you?

Jackson: I'm doing well, Marcelo. I'm very excited to be back on the podcast. We have a great topic today. So, Marcel, what are we talking about today?

Marcelo: So, we're talking about the U.S. election and its lasting impact in the stock market. Jackson, this is a fascinating subject. We were talking off mic how we're getting a lot of questions from investors and clients about what happens if a Republican president wins. If a Democrat president wins, contrary to popular belief, the impact of a presidential election in the stock market, it's not what people think it is.

I think we're wired to think this way because the news always feels like there's a call to action, or things are going to be worse than what they are. I think that gets amplified in social media and the way the news cycle works. But tell me, why do investors fear volatility in the stock market?

Jackson: One of the natural things that presidential candidates do when they're in the election race is they try to invoke strong emotions within voters.

It's good and bad emotions that come up, but oftentimes people feel a lot of instability and uncertainty because a lot of big changes are about to occur.

Marcelo: It makes sense. When it comes to the economy, the Federal Reserve is independent. They set up monetary policy. But fiscal policy, social policies, I think these things, they do have an impact in the stock market, but to believe that one president over another will have an impact where you have to shift your portfolio or do something is just wrong, because there's so many things at play here.

Jackson: You said that they do have an impact, and You might be right about that. They do have a short-term impact, but when you zoom out on a graph and you look at the large scale of things, it's usually quite positive over the long term. And so that's what people have to keep in mind. They have to zoom out and take a bigger look at things and really understand that while there might be short term volatility based on certain changes that occur over the long term, it's pretty positive.

Marcelo: That's good advice for when you become an investor and you're trying to think about. Your retirement, and how does this fit your approach? We always come back to that quote, the portfolio is like a bar of soap. The more you play with it, the smaller it becomes. I still remember, I was having a conversation with Keith during the 2016 election, because that was a big one.

I think the polls were showing that Democrats were going to win, and Trump was this outsider that people knew from TV shows, and this very rough character, says what he thinks, doesn't really have a filter. The consensus was that the market was going to completely tank. If Trump won and guess what happened?

The opposite happened market rally. And I knew a few people that moved their portfolio away from the stock market. They went to cash or went into Canadian equities thinking, Hey, let's step out away from the U S because we're going to have this cataclysmic event in politics. I look politics. It's like that.

It's supposed to give you the feel that its world ending sometimes, everything that happens and I think the news are guilty of that. And don't get me wrong, like I'm a political junkie to the max. You know, I did a major in political science in university. I like books. I consume vast amounts of news. But I know there's not a call to action because the data points that you shouldn't do anything.

Just because you want to be informed, it doesn't mean you're going to be moving things around in the portfolio. But let's talk about zooming out. I think that's great because we have this graph in front of us and we're going to post this in the notes and it shows, Jackson, all the presidential elections we've had since 1926 up until 2023.

What do we see? Obviously, if you zoom in, you see that there's ups and downs in the stock market, but the long trend is to go upwards. If you invested a dollar in the S& P 500 during the first election in 1926, that we're looking at here, all the way to 2023, you would have made 10, 000. So that's through two world wars, cold war, all the cataclysmic events we've had in the world, 9 11, the dot com crisis.

You name it, you still made money, but there's more nuance than that. So, one of the other misconceptions that people have, and we touched briefly in the intro is some people believe that Republicans tend to be better than Democrats when it comes to business and the stock market. So, we have a lot of data points here.

And so, tell me what nuance do we find in this long-term graph?

Jackson: You can't really pinpoint an exact trend because it's a little bit unpredictable. But since 1926 to 2023, there's been 24 presidential elections. So, of those 24 election years, 20 of those years were positive stock market years, and four of them were negative.

Marcelo: So, you invested a dollar, you made some money in four of them, you would have lost money.

Jackson: Exactly. Over the long term, it's quite positive. But even further than that, during election years, The average return is 11.6%. While in all other years, so in years where elections did not occur, the average return is 12.4%. So, it's not that big of a difference. It's really hard to spot a trend, whether for the good or for the bad. So, the big picture here, the big thing to follow is that you should stay in the market. Time in the market is better than timing the market. And further to that, the highest return during election years was 43.

6% and that was while the Republicans were in office. The lowest return during election years was minus 37% and that was while the Democrats were in office. Well, okay, what are you thinking here, Marcelo, that Republicans might be better for business wise? Hold that thought because in all other years, so in years where there was no election, the highest return was 54% and that was achieved while the Democrats were in office.

The lowest return in all other years was minus 43% and that was while the Republicans were in office.

Marcelo: Essentially, it can happen under any president or any party that the stock market can do better, and the economy will do better.

Jackson: During those 20 positive years, so out of the 24 election years, 20 of them were positive. 10 of those 20 years were while Democrats were in office and 10 of them were while Republicans were in office. Republicans were in office. It's essentially a coin flip, it's pretty even.

Marcelo: Perfect. So, there's some data points on that. You're saying essentially we've gotten great returns with Democrats.

We've gotten great returns with Republicans. I think a great example is you look at Ronald Reagan, for example, the market saw returns under his presidency of about 15.8%. Whereas if you turn the coin and you say, show me a Democrat that's done as good, you look at Bill Clinton, his return was 17.6% when he was in office.

And these were annualized returns. Correct. It's a myth then that the stock market will do better on the Republicans versus Democrats. And I think if you tune in the news, that's some of the narratives that we see all the time. It doesn't stop. I pick up the Financial Times every morning and they're always like narratives about, if the Republicans win, the market will rally.

It'll be better for trade. It'll be better for this. It'll be better for that. If the Democrats win, there's going to be more taxes. I mean, not to get political here, but there's always this sense that if the Democrats win, it's going to be bad for the economy because they tend to favor more social programs, more taxation, but obviously it's not true.

Jackson: I think all this to say is that Both parties have presided over different periods of market growth and contraction. And so essentially, they're not the biggest driver of market performance.

Marcelo: Yeah, absolutely. But the other thing that we want to do today, Jackson, is I mentioned some cataclysmic events.

Jackson: And yeah, Marcelo, you take a huge interest in history and different events that have happened in the past.

So please take us through a couple. of different time periods where different presidents have been in office and tell us some of the data points there.

Marcelo: One of the things that sometimes clients do ask, I mean, not all the time, because we spend a lot of time with clients when they become clients of the firm, educating them about how to invest and long-term approach and not to move things around.

We don't face that many questions, but occasionally we do get a person asking. The Ukraine war, the election, like, should I do something about my portfolio? And I always point them to this idea that the stock market trends upward in spite of all these cataclysmic events that we've had through history. So, you think about what we're looking at here.

And the first event I want to talk to you about is the great depression. We think about the economy collapsing, almost 50% GDP collapses. It's the worst economic crisis that we've seen in history, probably. The U. S. economy completely collapses, unemployment skyrockets, I think the total unemployment reached 25% during the presidency of FDR, Franklin Delano Roosevelt.

If you invested $1 in 1933, when he became elected, and you would have stayed invested up until the end of his presidency, you would have made $4.61. So that is a great return. You went through the whole period of the depression. That's also the period where the new deal was passed. And a lot of the social institutions and the social safety net, social security was implemented in the United States.

And that had a huge positive impact in the economy. The next event I want to talk to you about is obviously World War II. We come to the brink of human extinction. There is the first atomic bomb was thrown under Harry Truman. Let's see what the market did during those years. So, if you look at Truman, for example, he became president in 1945 until 1952. So, the atomic bomb was dropped under his presidency. And if you invested $1, you would have made $3.10. You still made money. You know, the market didn't collapse. The highest unemployment that we saw under his presidency was 7.9%. We see again, cataclysmic event. The world was shocked by an atomic bomb.

You still made money in the stock market. The next crisis we had, it's a big one. It's the Cuban missile crisis. So that's another one that. We're in the midst of the cold war. The world is in the brink of collapse. We have this huge danger of nuclear bombs being thrown, not atomic bombs, and nuclear bombs are way more destructive than an atomic bomb.

Kennedy was the president during that period. So how did the market do? Kennedy, as we all know, was assassinated, so it was a short presidency. But if you invested $1 when he became president in 1961, up until the end of his presidency in 1963, in October, you would have made $1.39. So you still made money during this bad period of the economy.

The other one that's interesting, in my opinion, is the Bush years.

Jackson: Which Bush? Son?

Marcelo: The son. Correct. Okay. Were you born 911 or no?

Jackson: Yeah, 98.

Marcelo: Okay. Do you remember where you were?

Jackson: No, I was three years old.

Marcelo: I mean, you can still have memories, but I think that's one of the events that everybody who lived through it will always remember where they were.

So that Bush was the president during that year. And that was a tough decade for the U S market because 2000, you had the dot com crisis, then you had 911, and then you had the financial crisis of 2008. That's one presidency where we find that people, if you invested $1, when Bush became president, Bush's son, you would have lost money.

So, you lost about 20 cents on the dollar.

Jackson: Now that was in the U. S. stock market.

Marcelo: Correct. That's interesting you mentioned that because one of the things that we've seen that diversification, you avoid those things.

Jackson: So yeah, because the Canadian and the international market, they still persevered through those tough times.

Marcelo: And by the way, that's a great point. People may argue, okay, like the U. S. stock market, it's trended upward, cataclysmic events, U. S. elections have Pretty much no effect on the stock market long term. The same thing happens in Canadian markets, emerging markets, international markets. The world is a globalized world.

You know, you look at the fall of the Berlin wall in the 1990s. The world opens up. There's more trade. China enters the World Trade Organization. We have a lot of globalizations. Everything's connected, but you still see trending upwards. So, there's no effect. And the last one I want to talk to you about is Donald Trump.

Trump, a lot of people were like, he's business acumen. Now it is a bit different when it comes to him because he was also a president during the COVID pandemic. And we saw a huge dip in the stock market that was a quick recovery. But if you invested $1 in 2017, January, when he became president, you would have made $1.81. You still made money in the stock market. Not as amazing as other presidents, but you still made money. I think Biden is the same thing.

Jackson: I think I'm spotting a trend here, which is, and you can confirm this for me, but throughout tough times and tough periods with different presidents in office, Humans and corporations tend to persevere.

Marcelo: Yes.

Jackson: So, I think that's one of the biggest messages. We're trying to convey to our listeners

Marcelo: That's a great point. I think Morgan Housel talks about this. He talks about this idea of when there's great need, people tend to be at their best and they're most innovative. If you look at the U. S. economy, for example, one of the periods of most innovation was right after the Great Depression.

And it's because people had to do something to eat and have incomes. I walked you through the Great Depression, the Cuban Missile Crisis, World War II when they dropped the atomic bomb. These are events that, it's not a regional war like what we're seeing in Ukraine. These are like huge events. They're human tragedy for a lot of people and we're not taking away from that, but it's affecting the stock market.

It's simply not there. We know now that the presidential elections don't affect the stock market, what does drive the stock market to perform?

Jackson: It's more than macroeconomic events. It's more of the monetary policies, the technological advancements. And like you said, it's human ingenuity and David Booth, the founder of dimensional fund advisors is huge on this.

He always says how during tough times, during tough economic times, It's not going to be one president that gets us out of the rut. It's going to be humans and a population and their human ingenuity as a whole who tends to persevere over time.

Marcelo: I love that. I was thinking when we were preparing for this podcast, I tried to think about an analogy.

I think it's a bit like a forest. You think about the ecosystem in a forest. There's not one thing that affects that ecosystem. There are many different players. The stock market is the same. It is millions and millions of human beings buying and selling different things. Traders, presidents, civic institutions, all performing at the same time.

Jackson: If you look at that forest, is it easy to pinpoint the one thing that is allowing that forest to flourish?

Marcelo: No.

Jackson: It's kind of like the stock market.

Marcelo: It's the same thing. So, when you think about presidential elections, they don't have an impact in the way we think, but the media sells it to us. And again, the stock market, like you said, I've said this many times in the podcast, it is a mid-grinder of opinions.

It's the accumulation of millions of millions of people interacting every day. And the stock market incorporates that available information and projects into the future. That's why it's so hard to know. You look at it in the data, like not only you shouldn't move your portfolio when you have presidential elections, but also when you think about anything that moves the needle, so to speak.

Earnings or, you know, Political events or geopolitical events. It's been proven that it's hard because the data is there. So, Jackson, what are some of the takeaways?

Jackson: One of the takeaways is that presidential elections is always going to get a lot of screen time and it's always going to be at the forefront of People's minds, but like we just discussed it doesn't have a lasting impact and a long term impact on the markets and your portfolio so I think it's super important to keep your investment objectives in mind, your long term goals in mind, to set the right asset allocation, have your portfolio working for you in a smart way, and don't make changes based on certain emotions that you're feeling because when you look at the grand scheme of things, over a hundred years of data, it doesn't actually have a massive effect on the long-term.

Marcelo: A hundred%. And I think you. Shouldn't be discouraged from reading the news and being informed and reading books and wanting to learn about history but take it for what it is. It is entertainment. It does have an effect, but it doesn't have an effect in the stock market in the way we believe it does or the way the media sells it to us.

What we do here with clients is we're trying to build long term portfolios so they can have the lives that they've envisioned. We're not trying to hit a home run or move things around in the portfolio. At the end of the day, it's our responsibility to show them that you don't move things around in a portfolio and having a solid investment philosophy, like that North Star is worth a lot.

Jackson: Yeah. Control what you can.

Marcelo: Absolutely. So, listen, that was a good episode. Thank you for joining me. Also, congratulations on your engagement. Thank you. I can't believe it. We should have talked about that at the beginning, but it's all right. I've been out of the podcast for what? Three months now. I wasn't a father when I started.

Jackson: Now you have a three-month toddler.

Marcelo: Yeah, not a toddler, but baby and it changes everything, but it's great to be back. We'll post all the graphs that we talked about in the notes. Thank you for listening.

Jackson: Thank you so much.

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