CETERA® INVESTMENT MANAGEMENT

Election 2020: Don't Vote with Your Portfolio

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The viral pandemic has largely overshadowed politics, but as we get deeper into September, we are reminded that this is an election year. The party conventions are behind us and the debates are agreed upon. The election news cycle and campaign ads are ramping up. Make no mistake, this will be one of the most contentious elections in our lifetime. But what does this mean for the markets, and more importantly, your investments? We will attempt to answer these questions in a thoughtful and objective manner. First, we'll take a step back and review the current election landscape, and then discuss factors that could decide the election and its possible ramifications. Finally, we will review the potential implications and risks posed by the election.

The Current Election Landscape

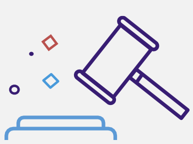
The Presidential Race

To become president of the United States, a candidate needs 270 electoral votes. Looking beyond national polls and examining state polls instead can help gauge which candidate will get each state's electoral votes. As with past elections, swing (or "purple") states are the most critical in these calculations. The 2020 swing states appear to be Florida, Pennsylvania, Ohio, Georgia, Michigan, North Carolina, Arizona, Wisconsin, Iowa, Nebraska, and Maine, listed in descending order of number of electoral votes.

While current polling favors Democrat Joe Biden, that can change quickly; plus, as we saw in 2016, polls don't always accurately predict who will win. And while the presidential election gets most of the headlines, who controls Congress—the House of Representatives and the Senate—and by how much is extremely important. If the president does not have a strong congressional majority, it will be difficult to pass new legislation.

The House of Representatives

To gain control of the House, a party must have over 219 representatives. Currently, Democrats have 235 and Republicans have 199. Republicans would have to gain 20 seats to get a majority, which seems unlikely. However, what might be more important isn't which party controls the House but the margin by which they do. If Democrats lose seats, it would make it harder for them to get legislation without compromising.



The Senate

Since there are 100 senators, the math on gaining control of the Senate is easier—a party needs a simple majority of 51, unless the same party occupies the White House. If the Senate is split 50/50, the vice president is the tie breaker. Republicans currently have a narrow advantage and this chamber of Congress will typically go the way of the presidency. However, it is important to note that many of the key Senate races are in swing states. Again, if one party gains a large advantage here, it will likely mean fewer compromises are needed to get legislative agendas passed.

Factors that Could Decide the Election

We are monitoring many different data sources or clues on who will win the election, but we are cautious on reading too much into any one data point or giving it too much sway over investment decisions. (We will speak more to that in the next section.)

Election results are driven by many factors and every election year is different. Historically, good stock market performance *before* an election is good for the incumbent. The challenger tends to win when stock market performance is struggling leading up to the election, as shown below. On average, year-to-date market returns are usually about 10% when the incumbent wins, versus only 3% when the challenger wins.

S&P 500: Returns from January 1 to Election Day				
Election Year	**Winner**	**Party**	**Incumbent Party?**	**Return (%)**
1948	Truman	Democratic	Incumbent	5.1
1952	Eisenhower	Republican	Challenger	7.4
1956	Eisenhower	Republican	Incumbent	2.5
1960	Kennedy	Democratic	Challenger	-8.3
1964	Johnson	Democratic	Incumbent	14.6
1968	Nixon	Republican	Challenger	8.9
1972	Nixon	Republican	Incumbent	11.9
1976	Carter	Democratic	Challenger	17.8
1980	Reagan	Republican	Challenger	23.5
1984	Reagan	Republican	Incumbent	4.7
1988	Bush I	Republican	Incumbent	14.9
1992	Clinton	Democratic	Challenger	3.2
1996	Clinton	Democratic	Incumbent	18.1
2000	Bush II	Republican	Challenger	-1.6
2004	Bush II	Republican	Incumbent	3.1
2008	Obama	Democratic	Challenger	-30.3
2012	Obama	Democratic	Incumbent	15.6
2016	Trump	Republican	Challenger	6.6

Winning Party	Average
Incumbent	10.1
Challenger	3.0
Democratic	4.5
Republican	8.2
Election Years (1948 – 2016)	6.6

Source: Cetera Investment Management, FactSet, Standard & Poor's. Returns shown are total return, which include dividends.

This predictor makes sense, because stock markets are leading indicators. If the stock market is doing well, that can be an indication that investors are optimistic about the future and that could be viewed as positive for an incumbent. But there are other data to consider, and we will be watching labor market indicators such as the unemployment rate and jobless claims. The higher the unemployment rate and number of jobless claims, the less satisfied people may be with the incumbent and vote for the challenger. Jobless claims have been falling since May; however, they are still at very elevated levels, with weekly claims near 1 million. The unemployment rate is near 10%, and while better than many expected, it's far higher than pre-pandemic levels, when weekly jobless claims were closer to 200,000 and the unemployment rates were under 4%.

National polls may not be as telling as people think because the presidential election is based on the electoral college and not overall popularity. Polls in swing states will be more informative and factor more into weighting the possibilities.

Consumer sentiment polls are worth watching, too. The University of Michigan breaks these polls down based on party affiliation. As you can imagine, the challenging party tends to be less optimistic about the future than people who identify with the incumbent party. Sentiment among independent voters, however, may provide better clues as to which way the election may swing. Independents tend to have a more balanced view and fall in between the two parties in terms of their optimism for the economy. Consumer sentiment declined among all party affiliations in July but rebounded in August.

The pandemic makes the 2020 election unique. We are closely tracking social-distancing indicators that are high-frequency data points. The sooner we can get the virus under control and open more aspects of the economy, the quicker it can recover. As noted above, improving economic data tends to benefit the incumbent party. Looking at TSA check-ins, airport traffic has been steadily increasing, while restaurant reservations, as measured by OpenTable, have been growing over the past few months. Below is our social distancing recovery dashboard through September 7. Click here for our updated dashboard.

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Social Distancing Recovery Dashboard

High Frequency Metric	Pre-Shutdown (March 7)	Jul 11	Jul 18	Jul 25	Aug 1	Aug 8	Aug 15	Aug 22	Aug 29	1-Week Change	4-Week Change
Driving Mobility Tracker (Level)	118.8	136.0	138.3	138.6	140.2	142.0	144.1	142.7	136.7	↓	↓
Public Transit Mobility Tracker (Level)	101.1	50.0	51.7	51.5	52.5	53.0	54.7	56.0	55.5	↓	↑
Walking Mobility Tracker (Level)	116.0	119.9	123.4	122.6	124.4	127.9	133.0	138.6	134.4	↓	↑
Airport Travelers vs. 1 Yr. Ago	-10.3%	-73.4%	-74.4%	-74.7%	-73.8%	-72.8%	-71.3%	-70.7%	-71.2%	↓	↑
Restaurant Reservations (U.S.) vs. 1 Yr. Ago	-4.7%	-62.3%	-61.9%	-61.6%	-58.5%	-56.9%	-53.7%	-50.2%	-47.2%	↑	↑
Restaurant Reservations (California) vs. 1 Yr. Ago	-5.6%	-70.0%	-72.6%	-70.1%	-66.5%	-63.1%	-61.8%	-62.2%	-57.1%	↑	↑
Restaurant Reservations (New York) vs. 1 Yr. Ago	-8.4%	-81.3%	-76.4%	-77.3%	-74.8%	-74.8%	-69.7%	-65.3%	-64.3%	↑	↑
Restaurant Reservations (Florida) vs. 1 Yr. Ago	-6.7%	-57.2%	-60.1%	-59.5%	-58.7%	-56.6%	-50.0%	-47.6%	-34.4%	↑	↑
Restaurant Reservations (Texas) vs. 1 Yr. Ago	-1.7%	-63.6%	-62.3%	-60.3%	-54.1%	-50.7%	-47.4%	-44.2%	-41.9%	↑	↑
Weekly Unemployment Claims (Millions)	0.21	1.31	1.31	1.42	1.44	1.19	0.97	1.10	1.01	↑	↑
Weekly Same Store Sales vs. 1 Yr. Ago	6.0%	-6.9%	-5.5%	-7.5%	-8.7%	-7.1%	-3.4%	-2.8%	0.6%	↑	↑
Weekly Mortgage Application Index (Level)	280.7	325.2	305.4	310.9	306.1	300.7	306.6	308.9	310.2	↑	↑
New York Fed Weekly Economic Index	1.42	-7.19	-6.96	-7.60	-7.20	-6.76	-6.07	-6.16	-4.91	↑	↑
High Yield Bond Spread (End of Week)	5.64%	6.14%	5.74%	5.29%	5.16%	5.06%	5.26%	5.25%	5.00%	↑	↑

Sources and Notes: Cetera Investment Management, FactSet, Apple (Driving, Public Transit, and Walking Mobility), Transportation Security Agency (Airport Checkpoint Passenger Traffic), OpenTable (Restaurant Reservations), U.S. Employment and Training Administration (Weekly Unemployment Claims), Johnson Redbook Service (Same Store Sales), Mortgage Bankers Association (Weekly Mortgage Application Purchase Index), Federal Reserve Bank of New York (Weekly Economic Index), Bank of America Merrill Lynch (High Yield Bond Spread). The 7-day average is used for metrics that are daily (Driving Mobility, Airport Travelers, and Restaurant Reservations). Data is pushed forward 1-week for the following metrics because there is a 1-week data release lag: Unemployment Claims, Same Store Sales, Mortgage Application Index, and New York Fed Weekly Economic Index. For the 1-week and 4-week change, an up arrow indicates the metric is improving and a down arrow indicates the metric is weakening.

Outside of economic data and socially distancing metrics, we are watching for more legislation around fiscal stimulus. Additional fiscal stimulus could continue to support the economy by replacing income for people who have lost their jobs. By temporarily replacing people's incomes, the government has minimized the negative impacts of stay-at-home orders and social distancing restrictions. Since a better economy could help incumbent Republican President Donald Trump, additional fiscal stimulus could help him indirectly; however, not passing legislation could help him as well, as he could leverage an ensuing blame game to his advantage.

Implications

The bottom line of understanding the current election landscape and monitoring all these indicators is simply to hedge the implications of who wins. Should you position your investments around the potential outcomes? The answer is probably not.

Regardless of who wins the election—Democrat or Republican, incumbent or challenger—market reactions *after* the election and up to inauguration day have historically been muted. In the table below, you can see the returns are similar regardless of the winning party, and except for the outlier under President Barack Obama's presidency, the numbers are even more similar. (Larger forces were at play after Obama won the election, since we were in the depths of the financial crisis, as with George W. Bush's election when he took over during the dot-com bubble.)

S&P 500: Returns from Election Day to Inauguration Day						
Election Year	**Winner**	**Party**	**Incumbent Party?**	**Election**	**Inauguration**	**Return (%)**
1948	Truman	Democratic	Incumbent	11/2/1948	1/20/1949	0.3
1952	Eisenhower	Republican	Challenger	11/4/1952	1/20/1953	10.0
1956	Eisenhower	Republican	Incumbent	11/6/1956	1/21/1957	3.9
1960	Kennedy	Democratic	Challenger	11/8/1960	1/20/1961	9.5
1964	Johnson	Democratic	Incumbent	11/3/1964	1/20/1965	1.6
1968	Nixon	Republican	Challenger	11/5/1968	1/20/1969	2.0
1972	Nixon	Republican	Incumbent	11/7/1972	1/20/1973	6.3
1976	Carter	Democratic	Challenger	11/2/1976	1/20/1977	5.2
1980	Reagan	Republican	Challenger	11/4/1980	1/20/1981	7.3
1984	Reagan	Republican	Incumbent	11/6/1984	1/21/1985	1.5
1988	Bush I	Republican	Incumbent	11/8/1988	1/20/1989	4.8
1992	Clinton	Democratic	Challenger	11/3/1992	1/20/1993	3.8
1996	Clinton	Democratic	Incumbent	11/5/1996	1/20/1997	9.2
2000	Bush II	Republican	Challenger	11/7/2000	1/20/2001	-6.0
2004	Bush II	Republican	Incumbent	11/2/2004	1/20/2005	4.4
2008	Obama	Democratic	Challenger	11/4/2008	1/20/2009	-19.9
2012	Obama	Democratic	Incumbent	11/6/2012	1/21/2013	4.6
2016	Trump	Republican	Challenger	11/8/2016	1/20/2017	6.6

Winning Party	Average
Incumbent	4.1
Challenger	2.1
Democratic	1.8
Republican	4.1
Election Years (1948 – 2016)	3.1

Source: Cetera Investment Management, FactSet, Standard & Poor's. Returns shown are total return, which include dividends.

We don't want to discount the importance of the election on market performance or the short- or long-term implications of key policy decisions. However, who sits in the White House is only part of the story. Congressional gridlock caused by slim margins of control or a split Congress could derail policy agendas, with significant implications.

With debt-to-GDP levels near World War II highs, spending more money could be challenging for both parties. In addition, both would likely be reluctant to cut spending immediately with the impacts from social distancing measures still being felt. Furthermore, tax cuts or tax hikes may not come for a while, as tax legislation is very difficult to pass without a firm majority in Congress.

As we broadly assess the impacts of each party's legislative agenda, we are not opining on what is better or worse for America. Parties implement policies with long-term objectives in mind, and policies such as healthcare reform, tariffs, or changes to the minimum wage could all have negative short-term impacts, with the longer-term impacts of these policies—likely to be studied and debated for years to come—are out of the scope of our analysis.

With that said, if Biden wins, he could eliminate the state and local tax deduction (S.A.L.T.) caps which impact Democrat-controlled states more. This could decrease demand for municipal bonds in these states, as high-income earners may need fewer tax-free bonds. Biden may fight to raise the federal minimum wage to $15 an hour, which would increase wages for lower-income earners, but businesses would likely have to make do with fewer workers, potentially causing an increase in unemployment. The short-term result would likely hurt corporations. A Biden presidency could also push to socialize healthcare, but this could be challenging with the current budget deficits, and he would need a firm majority in Congress to get this done.

A president has more control over trade and regulations, though. We saw this when President Trump took office and deregulated many industries and shook up global trade by putting tariffs on a host of goods from many different countries, including China. If Biden were to win the election, we would expect him to undo much of this and increase regulations on the oil and gas industry, banking, and insurance. While this would likely be greeted negatively by investors, Biden would also likely drop many tariffs, although possibly not right away, on China. Reduced tariffs would act as a tax cut for U.S. consumers and would be viewed positively by investors.

Possible Opportunities

Democratic Sweep (Blue Wave):

- Large cap companies
- Multinational corporations
- Utilities sector
- REITs

Trump Win (Mixed Government):

- Smaller cap companies
- Value companies
- Energy sector
- Consumer services sector
- Industrials sector

Diving deeper into sectors, utilities and real estate investment trusts (REITs) would likely be viewed more favorably in a Biden presidency, as these sectors could be more immune to the effects of tax increases. Utilities can pass them on to consumers, and REITs are not taxed at a corporate level. These sectors are less cyclical, or less sensitive to the market, if investors feared a market decline. A Biden presidency may also favor larger corporations, which tend to have lower effective tax rates than smaller corporations. Smaller corporations, along with value stocks, tend to be more sensitive to the overall economy. Larger multinational corporations may also stand to benefit more from freer global trade and the removal of tariffs.

A Trump victory, on the other hand, could help more cyclical asset classes and sectors such as smaller and value stocks, and the consumer services, energy, industrials, and technology sectors. The energy sector would benefit dually from less regulation and potentially fewer taxes as that sector tends to have a higher effective tax rate. We are generalizing, of course, and each company within a sector has different factors influencing its stock price. Stock markets are also forward looking, so depending on the swings in election result probabilities these factors may or may not be priced into markets already to some extent.

Risks

The biggest risk to the election is not likely to be who wins, but if there is no clear winner at all. If the election results are delayed or disputed, this could cause market uncertainty. This happened in 2000 in the infamous “hanging chad” presidential election between George W. Bush and Al Gore, where voting machines didn’t always fully or clearly punch voters’ ballots. America waited five weeks before the Supreme Court ruled on the issue and Al Gore conceded. The good news is that the S&P 500 only fell 4.24% during this period, and the decline could even be partly attributed to other factors outside the election: the S&P 500 continued to fall after the election as technology stocks were extremely overvalued and the dot-com bubble had burst. While “this time is different” may be a cliché, with a more complex array of voting issues potentially affecting the electorate, this isn’t the same situation as 2000, as neither side may be as willing to concede.

A blue wave or red wave could also pose risks as it would give one party unfettered control to pass legislative agendas with less of a check from the opposing party. Members of both parties have thrown out the idea of ending the filibuster with a majority Senate vote instead of the 60 votes currently needed. Doing so would reduce gridlock and compromise and make it easier for the party in control of the Senate, House, and the presidency to pass more ambitious legislation. We might expect investors would react negatively to a blue wave more because of legislative agenda items related to increased regulations on corporations, higher taxes, and socialized healthcare. However, some of these worries could be offset by reducing tariffs and eliminating S.A.L.T. deduction limits. Additionally, even with control of both houses of Congress, Democrats would also need a larger majority to pass legislation, as moderate Democrats would likely oppose more progressive policies. As mentioned earlier, there are limits on agenda items due to overall government debt levels, and we are in the early stages of an economic recovery. It would be hard for Democrats to spend more on healthcare or raise taxes, for instance. Likewise, it would be difficult for Republicans to implement austerity measures with the economy recovering from pandemic-related shutdowns.

Conclusion

A lot can happen between now and the election, to say the least, so we are vigilantly monitoring the developments and the range of possibilities. Regardless of who wins the presidential election, there is a lot of uncertainty about the short- and long-term implications, and who wins the majority in the House and Senate and the size of those majorities will be a significant factor in eventual outcomes. The U.S. election cycle is only one factor to consider, as the global economy and other factors can outweigh it and move markets and economies regardless of who wins. It is important to do your civic duty and vote, but not with your investments, as that can have negative outcomes. Focusing on what you can control—your risk tolerances and investment objectives—are more conducive to meeting long-term goals.

This report was created by Cetera Investment Management LLC. For more insights and information from the team, follow @CeteraIM on Twitter.

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