Richard Bernstein Advisors

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RBA Quick Insights

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How to (not) invest in the election

Profits, not politics, drive markets

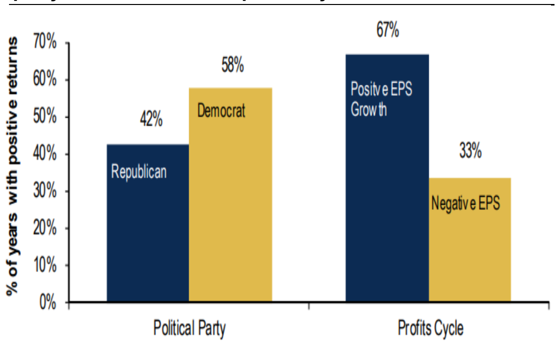
Every four years, the entire country goes into a frenzy over who is going to win the election and what the implications will be, and the investing community is no exception. Our inboxes are filled with election-related investment primers, scenario baskets and countless invitations for conference calls with Washington policy experts and pollsters. As is usually the case in financial markets, when all eyes are on a single event, that event is rarely what ends up being the main driver of lasting returns. One of my favorite charts from Bank of America shows that — in contrast to corporate profit growth, which has historically had a very strong relationship with market performance — the political party in the White House has not had a large statistical impact on whether the stock market goes up or down (see Chart 1).

Even with perfect foresight, trading based on politics seems questionable at best

Never mind that investors too often overlook the importance of the make-up of Congress or the compromises required in order to follow through on the ambitious campaign promises. Even if you could predict the election and policy outcomes with absolute certainty, investing based on those outcomes would have still had a very dubious track record. The biggest market gainers and losers over the course of an administration are often the complete opposite of what "the experts" had predicted, even after the election results were known.

In 2016, Donald Trump ran on deregulation and protecting American manufacturing, so it was no surprise that in the month following the election, the best performing sectors were Financials (+19%) and Energy (+9%), two of the most highly regulated sectors. The next-best performing sectors were Industrials and Materials — symbols of traditional American manufacturing — which also returned 9%. Regardless of political affiliation, it seems difficult to deny that President Trump did indeed follow through on those campaign promises. Energy and Financials have both seen meaningful deregulation, and much of the tensions with China are directly tied to the president's efforts to support domestic manufacturing. Yet if you look past the knee-jerk market reactions, it is painfully clear that the underlying fundamentals of those sectors have overwhelmed any benefit from the administration's policy support. Since the initial gains, Energy and Financials have been the worst performing sectors, and all four of those initial market leaders have underperformed the S&P 500® by over 25ppt (Chart 2). Similarly, after initially outperforming China by 7ppt in the first month, the S&P 500® has since underperformed by 17ppt. This is not a political statement on the policies, but a clear example of why investors are better served staying focused on fundamentals and keeping politics out of their portfolios.

Chart 1: % of positive yearly returns based on political party and the S&P 500® profits cycle: 1928-2018



Note: based on price returns before 1936; total returns since
Source: S&P, FactSet, Bank of America

Chart 2: S&P 500® sector returns in the one month after 2016 presidential election vs. subsequent performance through 10/23/2020

	Absolute Return		Relative Return	
	11/8/16-12/8/16	12/8/16-10/23/20	11/8/16-12/8/16	12/8/16-10/23/20
Financials	19%	16%	+13ppt	-51ppt
Energy	9%	-53%	+4ppt	-119ppt
Industrials	9%	35%	+4ppt	-31ppt
Materials	9%	40%	+4ppt	-27ppt
Communications	8%	36%	+3ppt	-30ppt
Discretionary	7%	97%	+2ppt	+31ppt
Info Tech	1%	172%	-4ppt	+105ppt
Real Estate	1%	33%	-4ppt	-34ppt
Health Care	-1%	71%	-6ppt	+5ppt
Staples	-3%	43%	-8ppt	-23ppt
Utilities	-3%	57%	-9ppt	-10ppt
S&P 500®	**5%**	**66%**		

Source: Richard Bernstein Advisors LLC, Bloomberg, S&P

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