MID-CONTINENT CAPITAL

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*advice; judgment; resolution; wisdom

Tuning It All Out

There is a fun tradition every four years when portfolio managers, market strategists, and analysts pretend to be psephologists or political scientists. Like sports, it's irresistible to participate in debates about a future event that we know will have a final outcome. This is very different from investing and thinking about the markets where, of course, there is no end to the process.

Simply making election predictions is harmless enough. Guessing which direction the market might head in reaction is more dubious. Acting based on one's preferred outcome can be downright dangerous. To repeat something we have emphasized many times over the years, even if an investor knew an outcome in advance, he or she would not know how the market would respond in advance. The reaction to President Trump's 2016 election, when there was a very common view that it would be disastrous, is all the evidence one needs to support this observation. Everyone should be very humble about their ability to assess how the market will behave in reaction to the upcoming election.

And yet, there are predictions aplenty, and we see an extremely strong consensus building around three of them:

- The election has significant policy implications for investors, especially related to taxes, and a so-called "blue wave" (a Biden win and a Democrat takeover of the Senate) is seen as negative.
- The advent of significant mail-in voting, especially in key "swing states", could result in delayed results for days if not weeks, leading to market tumult.
- Investors therefore should prepare for increased volatility in the run-up to the election.

Experienced investors know that the problem with these, or any other nearly unanimously held views, is that they are almost certainly already reflected in stock prices. For example, the futures market for the VIX volatility index is quite elevated from early November all the way to year-end. This means that investors using options to hedge positions are already reflecting their nervousness about the potential for negative outcomes, including a drawn-out process. The market is already pricing in the perceived risks of a "blue wave".

What is the market *not* likely reflecting?

- That a blue wave may not produce tax and spending outcomes as severe as expected. Few presidents get everything they want, when they want it, even from a friendly Congress.
- That the election outcome may be known right away.
- That volatility may actually diminish heading into the election if the outcome starts to become more apparent.

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The markets do not particularly care about who wins, except insofar as the result could meaningfully change the trajectory of the economy and corporate profits. But neither party has a monopoly on economic expansion. Markets have performed well under Democrats and Republicans alike, and it seems very unlikely that either Trump or Biden will take any action that threatens our continuing recovery from the Covid-19 pandemic. Compared to possible tax changes or spending programs, the status of a vaccine and ultra-supportive Fed policy should be much more important over the next year or two in determining the path forward for the equity market.

In other words – and in stark contrast to the widely-held views above – the presidential election may have less impact on stock prices than normal, and market observers may be placing undue emphasis on an event that will be in the rear view mirror in a matter of weeks.

What of the economic recovery from the virus? In our last issue of *Consilium,* we noted that a rebound was clearly underway. This remains the case three months later, although the travel/leisure/hospitality segments are still extremely depressed and represent the main drag on growth. Unfortunately, there is no way to "stimulate" restaurants and cruise lines into recovery – it will require consumer confidence that these venues are safe, along with cooperative local governments. Both in turn will depend on a successful, and widely deployed, vaccine.

Historical election year signals are interesting, and we have discussed them in past issues of *Consilium* (October 2016, October 2012). "Here's what investors should expect in an election year", "what to do if Trump wins", "stock picks for a Biden presidency" – these are extremely popular subjects in the financial media and among market forecasters. But there are no parallels for what we have experienced this year in the markets and the economy – not in an election year, nor any other year. At this very unusual time, we believe investors will be best served by focusing instead on the trajectory of the recovery, and as always, emphasizing long-term investing in high quality companies with good growth prospects.

Our best election year advice remains: in the final stages of a campaign, keep your political opinions and your investment portfolio as far away from each other as possible!

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