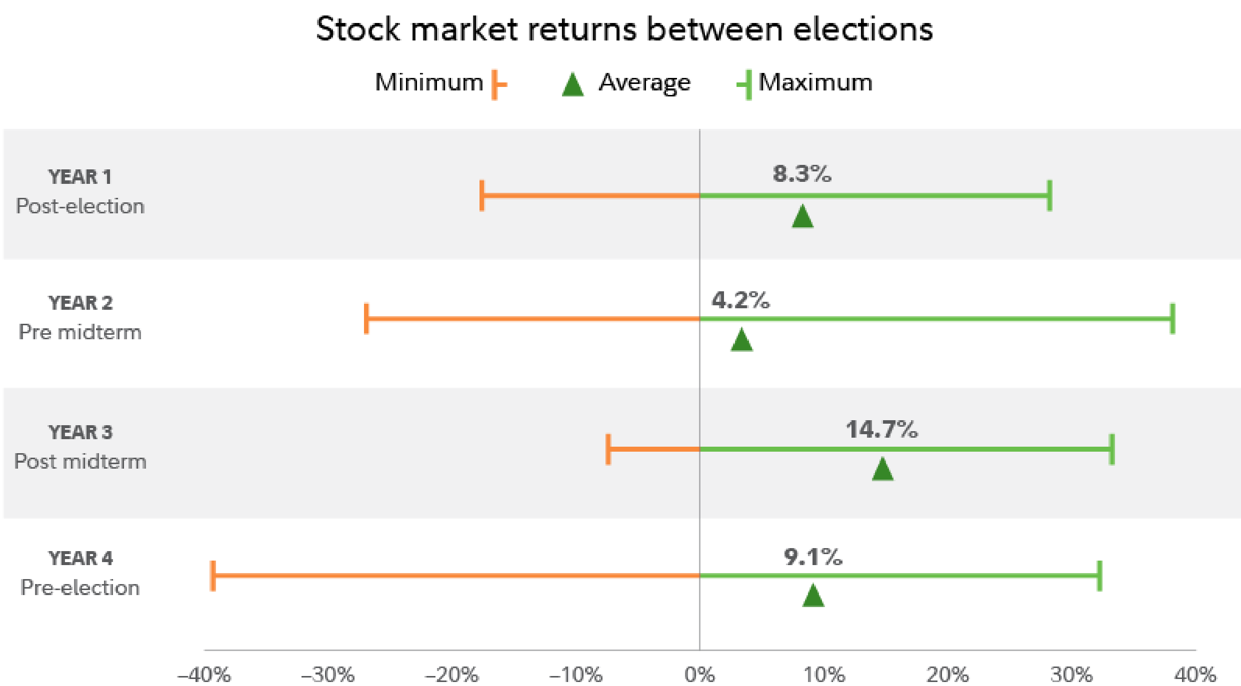
Election Outcomes And Market Reality

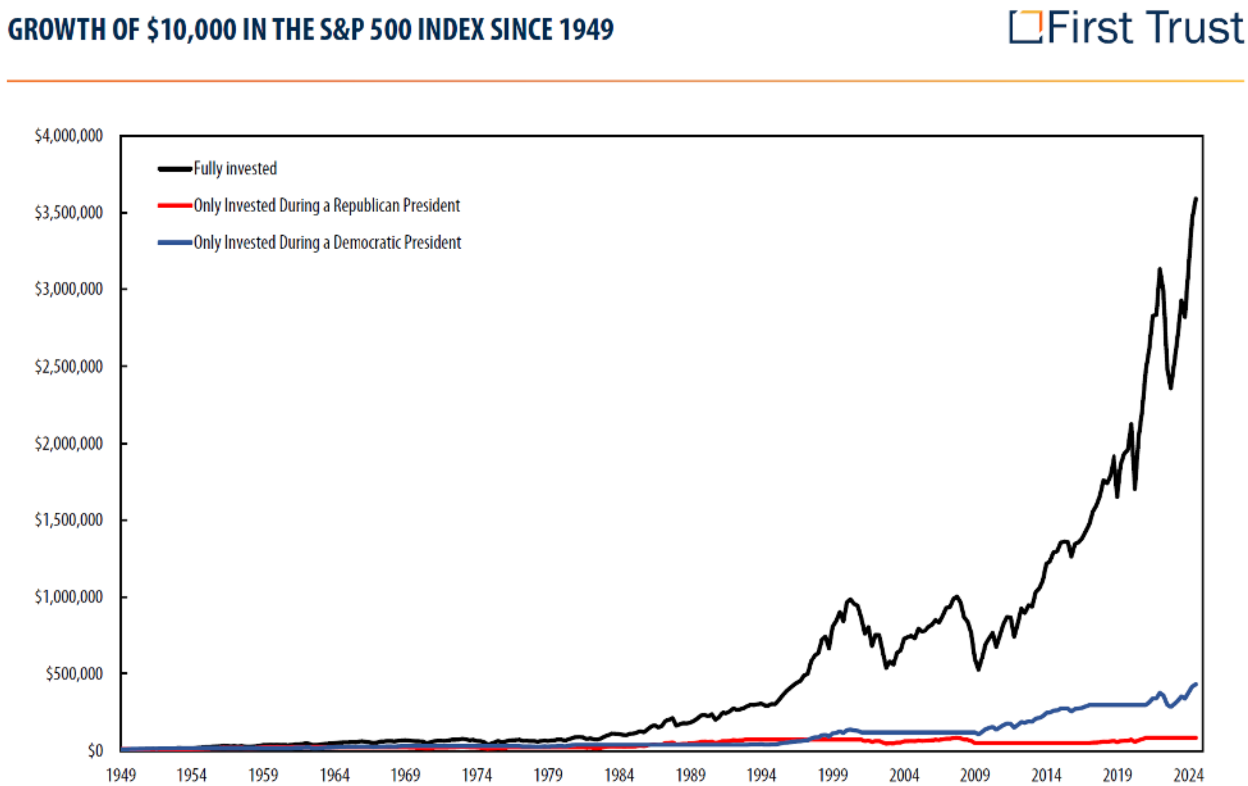
Q3 2024 Client Letter

With another election approaching, many are focused on how the outcome and the winning party might affect the financial markets. But what does history tell us about how elections truly affect your investments? We thought it would be reasonable to remind everyone during this abnormally noisy time that election years are generally bullish for asset prices as we have witnessed so far in 2024. Making investment decisions based on who occupies the White House is generally not ideal, as global markets are influenced by a much broader range of factors. Not only has this historically been a losing strategy, but it also risks derailing one's own financial plan by prioritizing short-term decisions over long-term objectives. The chart below from Fidelity demonstrates that since 1950, U.S. stocks have averaged 9.1% in election years.



Source: https://www.fidelity.com/learning-center/trading-investing/election-market-impact

Notice that each year within the four-year election cycle has shown positive average returns, though the range of historical outcomes varies significantly, as highlighted by the orange and green bars. Should we blindly assume that 'markets always go up' and overlook the current economic conditions and the global macro backdrop that is presenting itself? Of course not. However, we must respect the long-term data, which consistently shows that patient investors who stay the course are rewarded over time. When considering the broad market impact of investing with a political bias, compare the S&P 500 index returns if one stays fully invested during the election season, versus making investment decisions based on the outcome of a specific political candidate. The magic of compounding has an undefeated track record and has consistently delivered for investors, as long as you have a sufficiently long timeframe in the market.



Source: https://www.ftportfolios.com/Commentary/Insights/2024/7/3/election-client-resource-kit---june-2024

So how does the stock market even relate to elections then? Can we draw any conclusions from a rising stock market with what is happening in politics or which way an election outcome could go? Our firm has pointed out that many investors and analysts still give too much importance not only to elections and their potential impact, but also traditional interest rate models, historical price to earnings ratios, global risk on/off metrics, or backward-looking economic data to arrive at an outlook for the stock market. Asset prices are now hugely driven by central bank policies, which directly shape liquidity conditions, rather than traditional fundamentals. Remember when no one could leave their home during the COVID-19 lockdowns and the economy was going down the tubes, yet Central Banks collectively inserted $10 trillion of stimulus in a short amount of time into the economy through various forms? It just so happens that global stocks, which are closely tied into the global liquidity picture, were rapidly pushing higher into the summer after the initial two-week crash in March 2020. If global liquidity (measured by M2 money supply growth) is in an upward rising trend, stocks, gold, bitcoin, and even real estate generally follow its upward trajectory and perform well. The reverse also holds true, as seen in 2022 when M2 decreased due to central banks' aggressive fight against inflation—through quantitative tightening and raising interest rates—causing asset prices to struggle across the board. Consider different asset classes and their correlation with global M2 money supply growth (data compiled from Lyn Alden in a recent deep dive report on the relationship between asset classes and global liquidity).

	Bitcoin	SPX	VT	Gold	EEM	TLT	BND
12-Month Periods	83.2%	81.2%	72.3%	68.1%	59.9%	44.8%	44.6%
6-Month Periods	74.2%	70.3%	71.9%	74.3%	64.2%	58.2%	61.3%

Note: *SPX - S&P 500 | VT - Global Stocks | EEM – Emerging Markets | TLT – Long Term US Gov Bonds | BND – Total US Corporate Bond Market*

Source: https://www.lynalden.com/bitcoin-a-global-liquidity-barometer/

Note how Bitcoin has the most sensitivity to moves in global M2 on both a rolling 12-month and 6-month basis, while bonds have the least correlation. This may be helpful in explaining much of the large moves over the years that we've seen across many asset classes, in tandem with M2.

Election dialogue often focuses on economic and tax policies, which are crucial over the long term as they directly impact the top and bottom lines of companies navigating shifting political landscapes. It is imperative to maintain perspective, though, and resist the urge to act irrationally during times when it seems like everything going on in the world doesn't add up. A great responsibility and pleasure we have is to help clients, families, charities and companies preserve and grow their purchasing power to achieve certain goals. One of our favorite investors to learn from at CenterPoint is the legendary and thoughtful distressed credit investor Howard Marks, who started Oaktree Capital Management in 1995 and has produced an average return of about 19% annual for investors (net of fees). Marks once said, "The biggest investing errors come not from factors that are informational or analytical, but from those that are psychological." Marks frequently highlights the importance of controlling emotions during market turbulence, noting that fear and greed often lead to mistakes. He also underscores the inherent unpredictability of markets, especially during volatile periods, such as wars, elections, inflationary cycles, or even in times of relative stability. Instead of trying to forecast events, he advocates for focusing on risk management and being ready for various outcomes. The changing political seasons are a natural part of the investing environment and have occurred throughout history. While they may feel particularly intense, it's important to remember that markets have weathered countless transitions before, emerging stronger in the long run.

Sincerely,

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