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Presidential Elections and the Market

What November 3rd Means for Investors

Well, the silly season is upon us. We know it is coming every four years but don't really think about it until we start getting those annoying campaign phone calls and notice the ever-increasing number of political ads on television. On the one hand, elections are one of the great wonders of our great country. That "we the people" can choose those who will govern us is such a blessing, especially when the norm for most of world history has been that the one who ruled a nation was not the one who won the vote but rather the one who had wielded the sword. On the other hand, politics can bring out some of the worst impulses in us. We can see this on social media, where normally friendly folks can really heap on the hyperbole for the candidate they favor and the vitriol on the candidate that they really, really don't like. Sometimes that vitriol can even spill over into questioning the intelligence of friends and family members who differ with them, leading in some cases to some pretty awkward Thanksgiving dinner conversations.

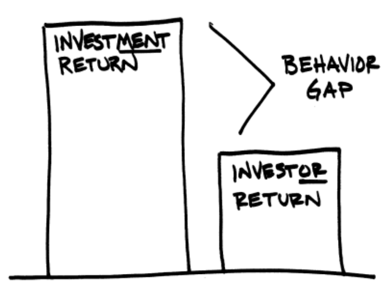
Elections, of course, do matter a great deal. The policies and approaches to governance of the candidates for president have the potential to have deep impacts on our country and our lives as individuals. What will happen to my taxes? What will the election mean about education for my children and grandchildren? Will health care be strengthened or weakened? Will the foreign policies of the candidates make it more or less likely that we live in a safer world? These are all critical questions that we want answers to and elections are a means for us get those answers.

Because in recent years our passions when it comes to our politics have become so heightened, our emotions cannot help but become inflamed. The challenge that can come into play when it comes to our investing, however, is when we make emotional investment decisions based upon the latest pre-election poll, or even more so when the election results roll in and our preferred candidate lost. If we are not careful, we can become like Chicken Little, feeling that the sky is falling, and end up making decisions about jumping in or out of the market based upon those feelings.

I wanted in this short paper to address the need to keep our wits about us when others are losing theirs in this unusually heated election season, and to demonstrate the futility of overreacting to an election when it comes to our portfolios.

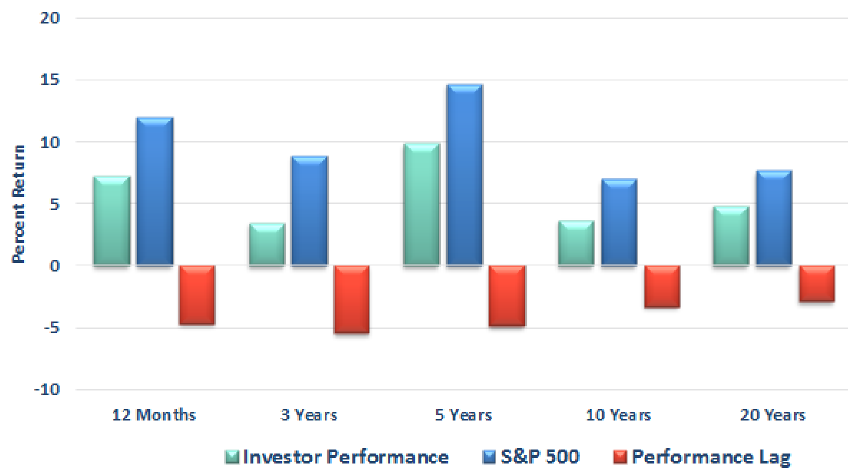
How emotions impact portfolios

I have long observed that for many people there is a significant gap between what the markets do and the performance of their own portfolios. This can be attributed to many factors. The degree to which taxes and fees impact your money can be a factor, as can poor choices in what investments make up the portfolio. But I believe the research shows that the biggest reason why so many investors underperform the markets is because of what I have called "The Behavior Gap," which I define as those decisions that we make or fail to make, often based upon emotions, to jump in and out of the market. Driven by greed we can buy when the markets are at their height and through fear, we end up selling when they are low … not a recipe for success.



The real measure of our personal financial wellbeing is not what the Dow or the S&P 500 indices do, but rather how well our own portfolio performs in light of our goals, time horizon and comfort level with risk. Emotionally driven decisions to buy or sell based upon things like an election can make it much harder to create the outcomes we desire.

The bigger the behavior gap is in our personal experience; the greater will be the difficulty in meeting our retirement goals. Dalbar is a research firm that seeks to quantify this gap. In their annual study, “Quantitative Analysis of Investor Behavior,” Dalbar demonstrates how significant the gap can be by showing the difference between how the S&P 500 performed over the lagging 20-year period ending in 2017 and how investors in their study actually fared in comparison:



Past performance is no guarantee of future results, but it is quite startling to see such a significant performance lag for the average investor, a lag often caused by their own investment behavior.

Dalbar summarizes the impact of the study: “The gross underperformance of the average investor clearly displays what has been the case for over twenty-five years--irrational decisions lead to inferior results.” And an election can indeed by a very ripe opportunity to make irrational decisions.

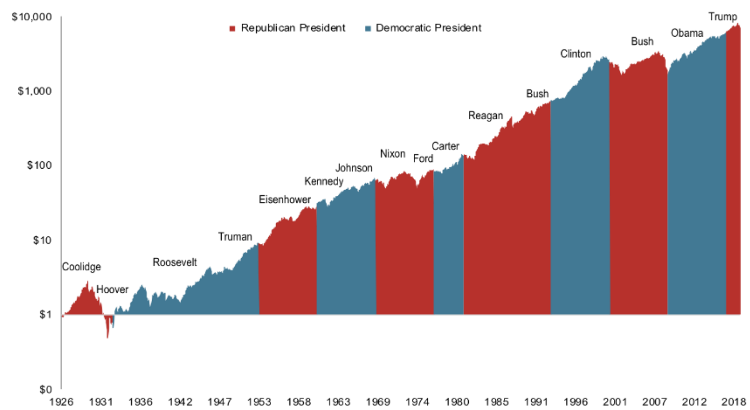
My candidate lost … do I sell?

All of us have had the experience of waking up the day after an election that we were really passionate about with a disappointment in the election outcome that makes us almost want to stay in bed. We don’t agree with the policies of the person who won, and are worried about the impact those policies might have on the country and our own financial world. This can affect the way we view the economy and how we think our money will do in light of the election result. The risk for the long-term investor is to overreact to their disappointment and make buy/sell decisions they may later regret.

To illustrate this, let’s take a look at the elections of both President Trump and President Obama, and how the markets ended up responding to those elections:

If you were to do a Google search on the predictions that were being made in the week leading up to the last presidential election on November 8, 2016, you will find article after article predicting that in the unlikely event that Donald Trump would win, the markets would fall like a stone in water, with a recession and hard times sure to follow. The night of the election when Trump ended up being declared the winner, the futures markets indicated stocks were indeed going to drop sharply with the opening bell, with fears of much worse to come. In reality, the markets ended up to the positive the day after the election and then went on to have an average rate of return of around 14% in the three years that followed.

Going back another eight years, there were voters who were disappointed when Barack Obama won the election in 2008, worried perhaps that his economic policies would be harmful to the economy and their portfolios. Well, if they had jumped out of the market after election night in 2008, they would have missed out on a dramatically growing market that saw the S&P 500 jump 23.45% in 2009 and 12.78% in 2010.



I do not write what I just did to pass judgement one way or another on whether the policies of President Trump or President Obama may or may not have contributed to that market growth. My point is that if because of emotion and fear an investor would have jumped out of the market based on the election result, they would have missed out on some very solid years of growth. The chart shows how historically the markets have performed during the terms of our presidents since 1926.

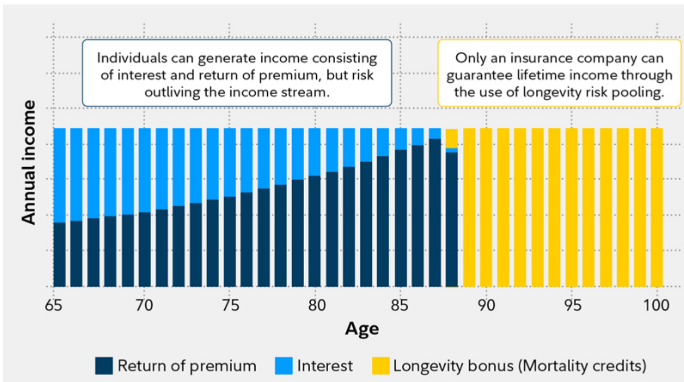
The obvious take away from the chart is that although there is short term volatility, the long-term upward trajectory of the markets can be clearly seen in the administrations of both parties. And long-term trajectories can only be enjoyed by investors that stay disciplined for the long-term.

Reliable income during turbulent times

In his classic book, “Stocks for the Long Run”, author Jeremy Siegel studies stock market returns since 1802. What he found is that there is a big difference in how the markets perform in the short term as opposed to how they do in the long run. Regarding money invested for shorter periods of time, he wrote: “In the short run, stock returns are very volatile, driven by changes in earnings, interest rates, risk, and uncertainty, as well as psychological factors, such as optimism and pessimism as well as fear and greed.” Conversely, when Siegel looked at the markets over long time frames, what he found is that in the 200 year history of the market that he studied it became apparent that investors who could buy and hold quality stocks for a minimum of a ten year holding period saw their odds of losing money become very low.

Unfortunately, there are two significant reasons why investors do not end up owning investments for the long run. One reason is because of the tendency to nervously get out of the market when volatility rises from things such as turbulent and disruptive elections. Learning to stay calm when others are panicking can address this. The second reason that investors may end up selling when the markets are down is when their retirement income plan is based on withdrawing money from investment accounts each month to fund their retirement. If the markets go down in value and checks continue to be cashed, losses can be locked in never to be recovered. This is where reliable lifetime income from an annuity can be of much value.

Annuities are kind of like life insurance in reverse. We buy life insurance in case we die too soon, so that our spouse and our children are taken care of. We buy annuities in case we live too long, to provide a lifetime income to take care of ourselves.

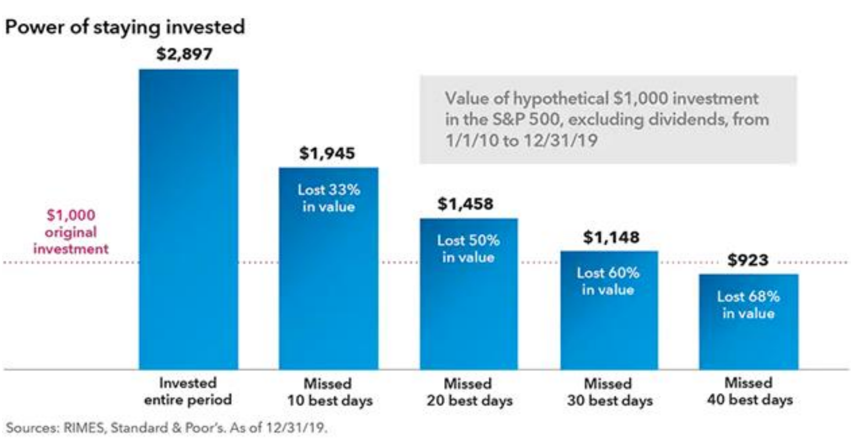


Essentially, any investment can pay you income consisting of interest that you have earned as well as spending down your own principal. An annuity is the one financial product that has the ability to continue to pay you a lifetime income even if you have spent down your original principal and all of your earnings. The insurer does this by pooling your longevity risk with many other annuity owners, much like how with life insurance they pool your mortality risk with many other life insurance owners. There are two phases to deferred fixed annuities that can provide lifetime income. The Accumulation Stage is the period of time that you may choose to leave your money in the annuity to earn interest. If it is a fixed annuity, your money would grow without exposure to market risk. The Distribution Phase would be when you choose to activate the income provisions of your annuity, at which time it would begin to pay a lifetime income that you cannot outlive.

Volatility, whether caused by disruptive political events like an election or by the normal bull and bear market cycles of the markets, can become much more manageable when our income for retirement is coming from contractually guaranteed sources like an annuity.

We are investors, not speculators

So, what is the difference between being a wise investor and a wild speculator? While a speculator is often focused on timing the market in the short term, the investor looks for quality holdings to own for the long term. Warren Buffet has wisely said that we should not own a stock for 10 minutes that we would not be willing to own for ten years. Elections are disruptive events that capture our attention, but they need not disrupt us in the pursuit of our long-term financial goals.



Political figures and campaign promises come and go over time, but it is important to remember that through the administrations of presidents from all over the ideological map, markets have been resilient and have rewarded the patience and discipline of the long-term investor.

Markets don't grow in a linear manner. It is not uncommon in a year that sees solid market gains for a significant portion of those gains to end up coming from just a handful of strong days when the markets surge. The challenge is that we do not know in advance when those quick market surges will be. If in overreaction to an election result, we jump out of the market at an inopportune time, we have the potential to miss out on those big days. The chart to the left shows how missing only a few of the best days in the market can have a profound impact on long term portfolio performance.

A steady hand on the wheel goes a long way towards not missing those "best days" because of we overreact to a disruptive election. Additionally, as we just discussed, one of the best ways to avoid missing out on those best days in the market is by having strong reliable lifetime annuity income allowing you the luxury of not *having* to sell investments when the markets go down but you still need retirement income.

We are investors rather than speculators. We are not seeking to time the markets, but rather to own quality investments that will stand the test of time. Elections are by their nature disruptive events that capture our attention, but they need not disrupt our long-term financial goals because of our overreaction to them. Elections *do* matter. It is our privilege and our duty to participate at the ballot box. So, let's all get out and vote today, but keep our eyes firmly on our long-term financial goals.

If you are concerned about how the election might affect you and your family financially, please contact me today to schedule an "**Election Protection Review**". You can call my office at 404.618.6626 or schedule an appointment through our website at www.SwanFinancialAdvisors.com. We are here for you!

Regards,

Jennifer Perri