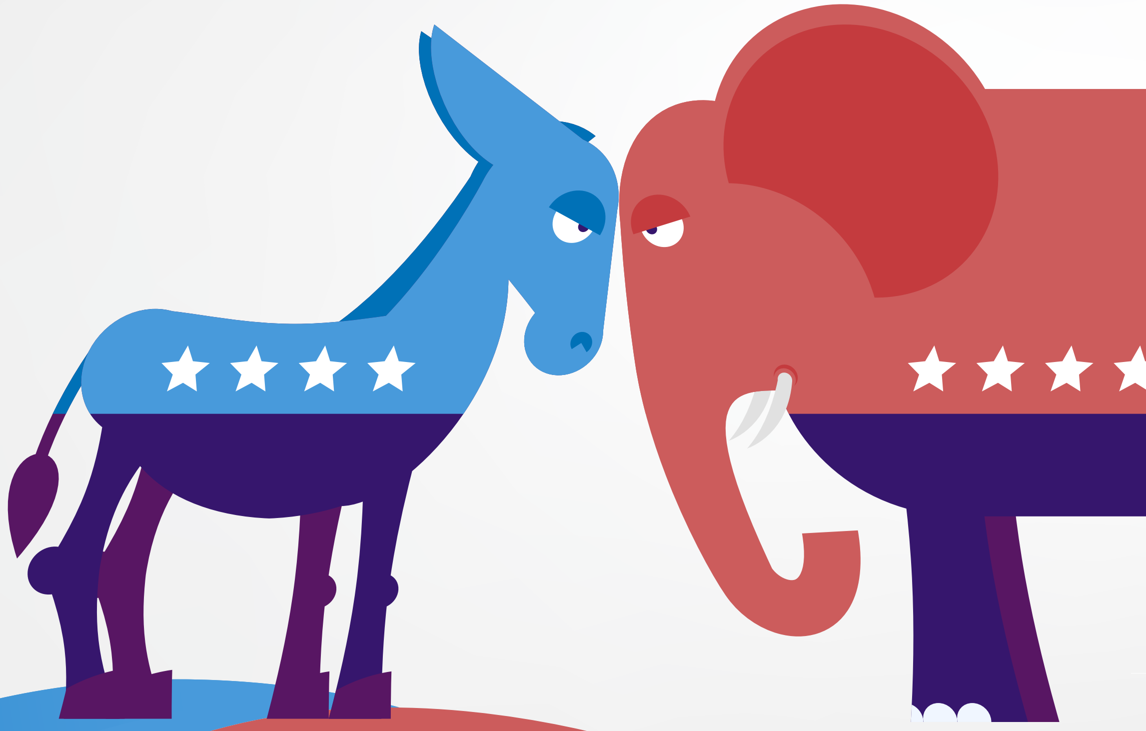
Trump vs. Biden: Do Markets Care Who Wins?



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The weather is getting cooler, autumn foliage is appearing on the trees, and the smell of pumpkin spice is in the air.* And since this is a presidential election year, our airwaves and mailboxes are filled with political ads. We're heading into the final stretch of election season, where the 59th U.S. presidential election will occur on November 3 between the incumbent, President Donald Trump, and the challenger, former Vice President Joe Biden. 2020 has been a monumental year in so many ways,** and the election will be more in focus than usual because of the pandemic.

There are fewer avenues than in years past to divert our attention, like travel, sporting events, and going to a movie theater. So, the main event this fall is the election, when tens of millions of Americans will be glued to their TVs with a bucket of popcorn—or a glass*** of something a little more potent—in hand, anxiously waiting for the results. Check out the sidebar on the right if you need a refresher on the United States Electoral College—it will make it easier to understand the political pundits on election night.

At Cetera Investment Management, our initiative is to provide independent research to ensure that our clients are prepared no matter what the investment landscape looks like. This is true irrespective of which political party has power or which candidate wins the election. Our focus is solely on investing and markets, and absent any rooting interest for any particular candidate or any political party. As we outlined in our September election commentary, Election 2020: Don't Vote with Your Portfolio, there are potential investment ramifications based on the election outcome—but they might not be as significant as some are led to believe. Looking out over the next four years, the investment opportunities based on the election's outcome are more likely to be felt at the sector or industry level, as we noted in that publication, and not across the markets.

In this commentary, we will explore the path to electoral victory for each candidate, assess the likelihood of a delayed result, and examine stock market returns during the previous 18 post-WWII Presidential cycles. It's been a long election season already, but buckle up—we're in the final stretch!

* Particularly if you are anywhere near a Starbucks. Oh wait—statistically, you are.
** We're sticking with "monumental"—feel free to insert your own adjective.
*** Or a bucket. We won't judge. It's been that kind of year.

[1] United States House of Representatives. https://history.house.gov/Institution/Electoral-College/Electoral-College/
[2] National Popular Vote. https://www.nationalpopularvote.com/5-45-presidents-came-office-without-getting-most-votes-nationwide
[3] 270ToWin.com. https://www.270towin.com/states/Ohio

BACK TO CAMPUS—OR AT LEAST, BACK TO COLLEGE

The Electoral College
As outlined in the Constitution, the U.S. presidential election is determined by the Electoral College. Each state has electors that cast their vote for the candidate who wins the plurality of the state's voters.[1] Two states, Maine and Nebraska, are the exception and have a split electorate based on their Congressional districts.[1]

Acing Math and Geography
The number of electoral votes assigned to each state (and Washington, D.C.) is determined by the sum of a state's House and Senate representatives in Congress.[1] Each state has two senators, with House representation based on population. In total, there are 538 electoral votes among the 50 states and Washington, D.C. Hence, the candidate with 270 or more electoral votes wins.

"Most Likely to Succeed"? Not Always "Most Popular"
There have been five presidential elections, including two out of the last five, in which the winning candidate won the Electoral College but lost the popular vote.[2]

Permanent Spring Break
Geographic migration can significantly alter the number of electoral votes for a state or region over time. The northern states of Illinois, Michigan, New York, Ohio, and Pennsylvania had a total of 149 electoral votes in 1960. In the 2020 election, they combine for only 103 electoral votes. In the last 60 years, population growth has slowed in the North and accelerated in the Sun Belt, increasing the number of electoral votes in the warmer states. The combined electoral votes for Arizona, California, Florida, Georgia, and Texas has increased from 82 in 1960 to 149 in 2020.

That's *The* Buckeye State
Does the path to the White House go directly through Ohio? The candidate who received the most votes in Ohio went on to become President in 17 out of the last 18 elections, including every election since 1964.[3] Ohio's 18 electoral votes could make it the tipping-point state if this year's election is close.

The Path to 270

The most important number on November 3 is 270. That's the number of Electoral College votes needed to win the election. The 2016 election is a great example of why those 270 Electoral College votes are so important. Hillary Clinton received nearly three million more votes nationally than Donald Trump, but secured only 232 electoral votes—74 fewer than Trump's 306.[4] It was a close election, with neither candidate receiving more than 50% of the popular vote nationally, and the margins were relatively narrow in several swing states. Political pundits were shocked on election night because Clinton had been leading in the polls, albeit by a narrowing margin as election day approached.

As of this writing, Joe Biden has a 10.6% lead over Trump in the national polling average, according to polling aggregator FiveThirtyEight.[5] Biden also holds an edge in several critical battleground states, although the margins are smaller relative to his lead in national polls. We anticipate that Biden's lead will get slimmer as we approach election day, as was the case in 2016 for Clinton. While Trump trailed at this point in the polls four years ago as well, Biden's lead is larger than Clinton's in 2016,[6] and Biden has a national polling average above 50%. Biden's path to victory is maintaining a lead above the margin of error in the polls, while flipping in his favor enough of the key swing states Clinton lost so he can secure more than 270 electoral votes.

If history is any guide, don't count out the incumbent, and that is an advantage for Trump. An incumbent has run for re-election 11 times in the post-WWII era, and lost only three times, and it hasn't happened in 28 years. Moreover, there were extenuating circumstances surrounding the three incumbent losses. Gerald Ford lost in 1976 as the incumbent, but he held office because Richard Nixon resigned over the Watergate scandal. Jimmy Carter lost to Ronald Reagan in 1980 as the incumbent and George H.W. Bush lost his reelection bid to Bill Clinton in 1992. The connection between these two incumbent losses was the fact that a recession occurred while both Presidents were in office. Although the circumstances aren't identical, the U.S. economy entered a recession this year because of the economic fallout from COVID-19.

However, this year's recession might not matter to voters as much as it did in 1980 and 1992 because the economy was essentially shut down to slow the spread of a global pandemic. Also, Trump holds a slight lead over Biden when it comes to the economy based on polling.[7] Trump's path to victory is securing the key battleground states that he won in 2016. If the polls are under representing his support as they did in 2016, then we could have a repeat of the last election when Trump wins as the underdog.

[4] CNN. https://www.cnn.com/election/2016/results/president

[5] FiveThirtyEight. https://projects.fivethirtyeight.com/polls/president-general/national/

[6] Zitner, A. (September 2020). Biden Holds Bigger September Poll Lead than Clinton Did. Wall Street Journal. https://www.wsj.com/articles/biden-holds-bigger-september-poll-lead-than-clinton-did-11601125200?st=tfx0qkn98nggm6u

[7] ABC News/Washington Post Poll. https://www.langerresearch.com/wp-content/uploads/1217a2The2020Election.pdf

Despite Joe Biden leading in the polls, and the unemployment rate remaining at an elevated level, the betting markets view the race as a toss-up. One wildcard factor, however, is Trump's COVID-19 diagnosis. It is hard to assess how Trump's re-election bid will be impacted by his health status. As we have seen twice in the last five elections, getting the most votes nationally doesn't win the election. It is not the candidate who is the most popular nationally but the candidate who can secure those 270 electoral votes (or more) who wins. The election is likely to come down to nine battleground states that represent 141 electoral votes. These states are Arizona, Florida, Georgia, Iowa, Michigan, North Carolina, Ohio, Pennsylvania, and Wisconsin. Complicating things is that each of these states has a unique socioeconomic makeup with variations in demographic trends—the winner will be the candidate who navigates those differences and performs best in those nine toss-up states.

Expect the Unexpected

2020 is the year of "expect the unexpected" and election night will be no different. In fact, there is a good chance that we won't know who won on November 3. As stated earlier, the election is expected to be tight based on electoral projections, which is reflected in the near split in betting market odds for each candidate. That alone increases the chances of the vote tally being "too close to call" in some of the key swing states. Moreover, the number of mail-in ballots is expected to exceed prior elections, potentially delaying the results for several weeks. Nearly a quarter of votes were cast by mail in the 2016 election[8] and that figure could climb to around 40% based on a Pew Research Center poll of registered voters.[9] Eight states, including critical battleground states Michigan, Pennsylvania, and Wisconsin, won't begin counting mail-in ballots until election day.[10] Eighteen states will count mail-in ballots after election day if the ballot is postmarked by the state's deadline (either the day before or on election day, depending on the state).[11] Tallying mail-in ballots is often a slow process because there can be several manual steps to count the ballot. If the election is close and mail-in ballots trickle in slowly, the odds of a contested election also rise. All these factors increase the likelihood of a delayed result, which we can only hope will be short-lived if that scenario plays out.

The good news is that delayed results and contested elections are rare, but there is a recent precedent: the 2000 presidential election. That election came down to the state of Florida, where a recount showed George W. Bush leading Al Gore by a razor thin margin of only 537 votes out of the nearly six million cast—0.009%—in the Sunshine State. The results were contested by Gore, and the winner was finally decided five weeks after election day when Gore conceded to Bush following the Supreme Court's decision to uphold the validity of Florida's results. We aren't saying a delayed result will definitely happen, but we should all prepare for that outcome. A delay increases uncertainty, and uncertainty increases the chances of market volatility.

[8] U.S. Election Assistance Commission. The Election Administration and Voting Survey: 2016 Comprehensive Report. https://www.eac.gov/sites/default/files/eac_assets/1/6/2016_EAVS_Comprehensive_Report.pdf

[9] Gomez, V. and Jones, B. (August 2020). Pew Research Center. https://www.pewresearch.org/fact-tank/2020/08/26/biden-supporters-in-states-where-it-is-hardest-to-vote-by-mail-are-most-concerned-about-voting-this-fall/

[10] National Conference of State Legislatures. https://www.ncsl.org/research/elections-and-campaigns/absentee-and-mail-voting-policies-in-effect-for-the-2020-election.aspx

[11] National Conference of State Legislatures. https://www.ncsl.org/research/elections-and-campaigns/vopp-table-11-receipt-and-postmark-deadlines-for-absentee-ballots.aspx

4-Year Presidential Cycles

In the 18 post-WWII four-year Presidential cycles, the S&P 500 had an average annualized return of 11.7% per cycle. The average annualized gain was 15.3% under Democratic administrations and 8.8% under Republican administrations **(Figure 1)**. As the historical data demonstrates, while the Republican party is more often associated as being business friendly and more focused on lower taxes and fewer regulations, that doesn't always result in better stock market returns. Of course, higher returns under Democratic administrations aren't necessarily a direct result of policy, either. From our perspective, stock market returns are more closely a function of the business cycle and whether equity markets are in a structural bull or bear market.

As an example, the returns while Barack Obama was in office were well above the historical average during his two terms in office. Obama entered office while the economy was bottoming after the fallout from the financial crisis. Although economic growth was moderately subdued versus most post-WWII recoveries, the U.S. economy remained stable and avoided another recession during the remainder of Obama's tenure. It was a strong environment for equities, aided by a low-interest-rate policy from the Federal Reserve, and a downward trend in the unemployment rate. That trend continued into Trump's tenure in the White House, and the economic expansion lasted into early 2020—prior to COVID-19 shutdowns reversing the path of the economy. George W. Bush, on the other hand, entered office shortly after the dot-com tech bubble was deflating, and in his final year the 2008 global financial crisis resulted in a global stock market crash. These two events led to negative returns for both of Bush's four-year terms in office. It is also important to note, that the president doesn't make laws, Congress does, so who controls Congress has a larger impact on policy decisions than the president.

Figure 1: Presidential Stock Market Returns

S&P 500: 4-Year Presidential Cycle Returns

		4-Year Term		
President	**Party**	**Start Date**	**End Date**	**Annualized Return (%)**
Truman	D	1/20/1949	1/19/1953	22.9
Eisenhower	R	1/20/1953	1/20/1957	20.5
Eisenhower	R	1/21/1957	1/19/1961	9.5
Kennedy	D	1/20/1961	1/19/1965	13.4
Johnson	D	1/20/1965	1/19/1969	8.6
Nixon	R	1/20/1969	1/19/1973	6.6
Nixon	R	1/20/1973	1/19/1977	1.6
Carter	D	1/20/1977	1/19/1981	11.7
Reagan	R	1/20/1981	1/20/1985	10.8
Reagan	R	1/21/1985	1/19/1989	18.6
Bush I	R	1/20/1989	1/19/1993	14.7
Clinton	D	1/20/1993	1/19/1997	18.6
Clinton	D	1/20/1997	1/19/2001	16.3
Bush II	R	1/20/2001	1/19/2005	-1.5
Bush II	R	1/20/2005	1/19/2009	-6.1
Obama	D	1/20/2009	1/20/2013	17.5
Obama	D	1/21/2013	1/19/2017	13.5
Trump	R	1/20/2017	9/30/2020	13.5

Party	**Average**
Democratic	15.3
Republican	8.8

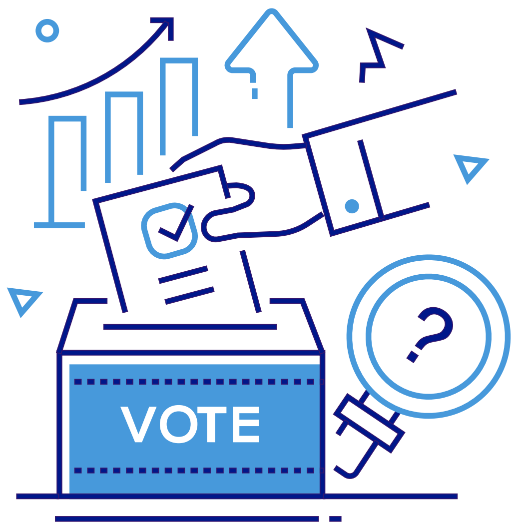
Source: Cetera Investment Management, FactSet, Standard & Poor's. Returns shown are total return, which include dividends. President Trump's 4-year term is incomplete. The most recent month-end date (9/30/2020) was used as the end date.

In our view, we do not think it is prudent to mix politics with investing, as financial markets are global by nature and impacted by a multitude of events and transactions outside the purview of Washington. No matter who wins in November, each candidate faces the same structural challenges and opportunities over the next four years. On one hand, equity valuations are near a multi-decade high, bond yields remain near record lows, the annual budget deficit is the largest on record, and the economic recovery is on an uncertain path because of COVID-19. With that said, the Federal Reserve is likely to remain accommodative for many years, borrowing costs remain low for both consumers and corporations, a vaccine for COVID-19 could become available early next year, and technological innovation will continue on a global scale no matter who resides in the White House over the next four years.

Final Stretch

We are in the final stretch of the 2020 presidential election. Former Vice President Biden is leading President Trump in the polls, but in the world of politics, a lot can change in a matter of days. The Democrats are the favorites to retain a House majority in Congress and it is a toss-up in the Senate. From the perspective of equity markets, does it even matter who wins the presidential election? Based on historical stock market returns, it might not. The same structural challenges and trends will be present no matter who occupies the White House. In the 18 post-WWII presidential cycles, the S&P 500 generated a positive return 16 times, and the average return was positive under both parties. We certainly don't want to dismiss the importance of our electoral process and the issues that each candidate advocates, but when all is said and done, history has shown that mixing politics with investing hasn't been a good strategy.

This year marks the 150-year anniversary of the Fifteenth Amendment, which prohibits the government from denying voting rights based on race, and the 100-year anniversary of the Nineteenth Amendment, which granted women the right to vote. Our voting rights shouldn't be taken for granted, and November 3 provides all of us with an opportunity to express our political views and vote in a free election. In these divided times, it is our hope that more unity is in our future, no matter which political party is in power over the next four years. From the Cetera Investment Management team, we wish you a safe and healthy fall, and don't forget to clear your calendar—or have your ballot in the mail by your state's deadline—to vote on Tuesday, November 3.



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Glossary

The S&P 500 is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe

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