Our Perspectives: Don't Stress About Elections and Politics, Focus on Long-Term Investing

Homestead Funds

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With a major election on the horizon, emotions are running high. Investors may be wondering if they should make changes to their investments. While political issues are excellent at grabbing headlines and dominating the national conversation, the true connection between politics and market performance is much weaker than you might expect. Ultimately, it's far more effective to plan investment decisions around your long-term goals rather than around short-term uncertainties like politics.

Politics and Investments Have a Surprisingly Weak Relationship

Wherever you sit on the political spectrum, you might suppose there is a clear connection between political trends and market performance. Many people tend to assume that Republican leadership is better for stocks, with the party's reputation for prioritizing business interests and lowering taxes and regulation. Yet, stock market returns have historically been stronger under Democratic presidents in the U.S. Since 1952, stock markets under Democratic presidents have posted average real returns of 10.6% per year (annualized), while Republican presidents have presided over average gains of 4.8% per year.[1] Still, researchers who have dug deeper into the relationship generally agree: The connection between politics and markets is weak, at best.

But you may ask, what about taxes, regulatory changes, government spending and the general tenor of confidence from presidents? Don't those issues matter? Even on these inputs, presidents only have a marginal influence. In many major policy zones, they need Congress to finalize their initiatives. A president's policies often take years to pass into law and even longer to demonstrate some clear impact.[2] To be sure, presidents can appoint cabinet leaders and Federal Reserve governors, whose choices in office could contribute to growth or contraction. But even those actions take months or years to produce tangible outcomes, which are undeniably several steps removed from the person sitting in the Oval Office.

[1] For the period 1952 to June 2020. Forbes, "We Looked At How The Stock Market Performed Under Every U.S. President Since Truman — And The Results Will Surprise You"

[2] Investopedia, "Presidents and the Stock Market"

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Indeed, it seems that most of the stock market's performance under specific presidents or parties is determined by another force altogether: luck. It's down to the timing of things that are truly out of a president's control: jumps in technology or other productivity drivers, economic growth around the rest of the world, inflation trends, oil price shocks, pandemics and so on. These factors (among many others!) have a far greater impact on markets than any president or political party.[3]

After Upsets, Markets Are Surprisingly Resilient

For those who still aren't convinced, consider this: Markets disrupted by political surprises or upsets have proven surprisingly resilient. Stock markets fell 6.6% when President Eisenhower suffered a heart attack but recovered by 2.3% the day after. When John F. Kennedy, Jr. was assassinated, markets tumbled nearly 3% but fully recovered the next day. On the evening of President Trump's 2016 election, overnight futures tumbled more than 5% — triggering the stop-trading mechanism — yet markets closed up more than 1% the day after.

Here's how U.S. stocks reacted to major political news in the past.

		S&P 500 Price Returns	
Disrupted Event	Day of Event	Market Reaction	Following Market Day
Eisenhower's heart attack	Sunday, September 25, 1955	-6.62%	2.28%
JFK assassination	Friday, November 22, 1963	-2.81%	3.98%
Trump's surprise election*	Wednesday, November 9, 2016	-5.0%	1.11%

Source: Yahoo! Finance, *Forbes, Here's How The Stock Market Has Performed Before, During, And After Presidential Elections

We see these short turnarounds as another bit of evidence suggesting that politics just aren't that influential to investment returns. Political leadership can have some impact on the economy and the markets, but the force is far weaker than the many other influences that figure in to investment values.

Mindset Shift: Focus on the Long Term

While politics gobble up a fair share of the news flow, they probably shouldn't determine your longer-term investment plan. For mutual fund investors, we see three clear reasons why a long-term perspective is a far more accurate compass when it comes to making investment decisions:

1. A long-term plan is the best way to use a mutual fund. Mutual funds are already diversified by Design: They contain many holdings and span a range of sectors and companies. As a basket of holdings, they are also "valued" once a day, at closing. For this reason, mutual funds are not meant to be day-traded (sold or repurchased in the same day); they are a poor tool for making short-term bets.

2. A long-term plan maximizes time *in* the market rather than trying to "time" the market. A long-term plan is all about setting the right mix of investments for your needs and allowing those investments the time to ride out bumps and capture the long-term gains in markets. Gains tend to build on one another with the power of compounding, for patient investors. This strategy frees you from trying to "time" the market – guessing where the peaks and valleys are in the bumpy day to day.

3. A long-term plan takes emotions out of decisions. Decision-making is not always a reliable process. In other words, your emotions in one moment can drive you to choose things you wouldn't pick from a different state of mind. Remember how your mom would tell you to "sleep on it" when it was time to make a big decision? With the benefit of experience, we can all recognize that different emotional states drive us to weigh risks and rewards differently. Having a long-term plan makes it less likely that emotions will unduly factor into your decision making.In that way, it removes the burden of managing stresses and emotions.

The power of compounding is a mathematical principal. It is not a promise of any investment's future return.

[3]University of Chicago Booth School of Business, "Political Cycles and Stock Returns"

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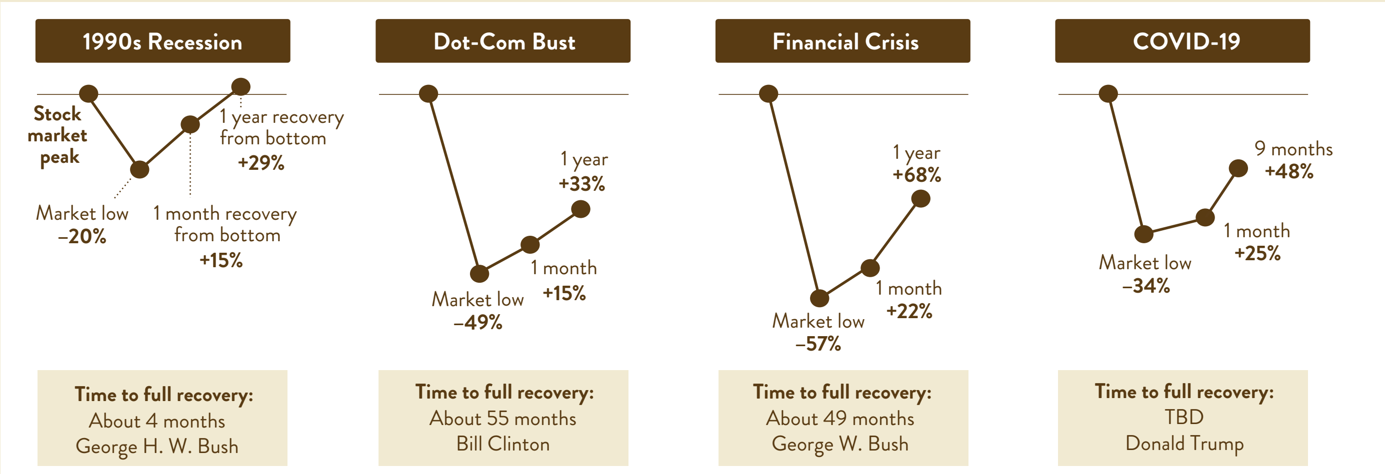
After Lows, Strong Stock Market Recoveries



Source: Homestead Funds' calculations. Stocks represented by price returns of S&P 500 Index.

THE POWER OF THE LONG-TERM PLAN

A long-term plan allows mutual fund investors to:

- Make the best use of a diversified mutual fund
- Maximize time *in* the market, rather than trying to "time" the market
- Take short-term emotions out of the decision-making process

What to Expect From Election Season

While the connection between political leadership and market performance is weak, we can point to another relevant market trend: increased volatility. In previous election years, there was some tendency for markets to get more volatile ahead of Election Day.[4]

What does increased volatility mean? Bigger or more frequent swings in stock prices, essentially. Still, this is a factor clearly out of any investor's control. We see a lot more value in sticking to the aspects you can control: making a long-term plan that's right for you and putting it into action.

Diversification does not ensure a profit or protect against loss, but it is a way to help manage investment risk.

[4]Forbes, "Here's How The Stock Market Has Performed Before, During, And After Presidential Elections"

Past performance does not guarantee future results.

The S&P 500 Stock Index is a broad-based measure of U.S. stock market performance and includes 500 widely held common stocks.

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