



Wealth Watch

October 2020

"No Wrong Turns, Only Unexpected Paths"

~Mark Nepo

When it comes to the crossroads of investing and politics, I find the words of wisdom quoted above as written by bestselling author Mark Nepo constructive. While we all have deep-seated political inclinations, one should avoid allowing them to unduly influence long-term investment decisions. Over time, there is money to be made in any market and under any administration or congressional composition, regardless the political party.

That being said, what might we expect in the near term given various potential outcomes of 2020's hotly-contested elections? Which types of investments and sectors of the economy might be most affected—for better or worse? We will explore these topics in the pages that follow.



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What You Need Know:

- While September was the first negative month after five, overall Q3 posted solid results
- Markets have been volatile but generally resilient amid a heated political climate/election season
- Historical market action around presidential elections provides insight but may not be indicative of 2020 expectations
- Positive economic and industry-specific prospects can be anticipated despite election outcome
- Post-election years are typically positive regardless of winner
- Remain invested and focus on your long term investment strategy

Your wealth, well managed.

Asset Class
Index Performance*
Year to Date as of 9/30/20

US Investment-Grade Bonds	6.79%
US Large Cap Stocks	5.57%
International Bonds	4.77%
Money Market (Cash)	0.73%
High Yield Bonds	0.62%
International Emerging Market Stocks	-0.91%
Alternative Investments	-1.14%
International Developed Market Stocks	-6.73%
US Small Cap Stocks	-8.69%
Commodities	-12.08%
Real Estate	-19.09%

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Market Performance

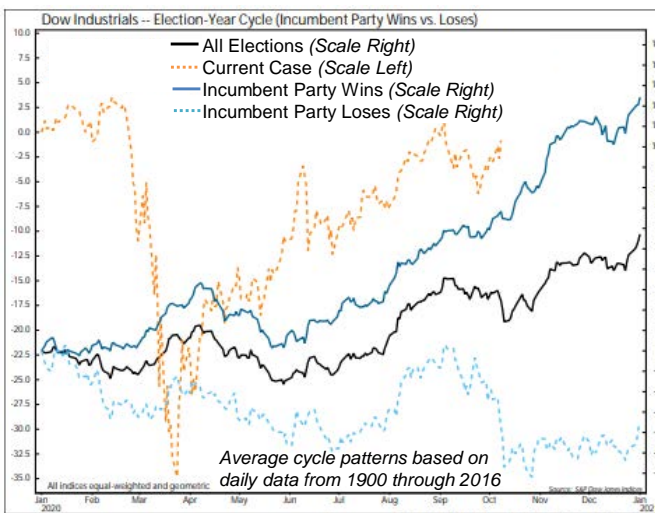
Following five consecutive months of gains, the markets turned negative in September. Indeed, every major asset category was negative for the month. For the third quarter as a whole, Emerging Markets stocks were the single best performing category (+9.7%) followed closely by commodities (+9.1%) and large cap US stocks (+8.9%). Generally stocks outperformed bonds, domestic outperformed international, large cap outperformed small cap, and growth outperformed value. Over the year-to-date period, which includes the dismal decline of the first quarter, bonds lead the pack while commodities and real estate have posted the weakest returns.

WestStar Tactical Strategy

As discussed in the last edition of the Wealth Watch newsletter, our tactical strategy currently emphasizes small cap stocks over large cap. This strategy had helped through August but ended up detracting from performance for the quarter given September’s reversal. Research indicates that small cap stocks, which tend to be more cyclical in nature, typically outperform large cap amid economic recovery and, as such, our tactical strategy remains unchanged. Within Fixed Income our allocations to high yield and international bonds helped in the third quarter, as those categories significantly outperformed US Investment-Grade bonds. We are also maintaining our de-emphasis of Real Assets due to our expectation of mild near-term inflation and our neutral-weight of Alternative Investments given our expectation for persistent volatility.

Politics and Markets

The chart below shows how the stock market behaves on average during presidential election years going back to the year 1900. We find that, regardless of political party, the market typically rises when the incumbent party wins and declines when the incumbent party loses. This relates to uncertainty—markets prefer the known to the unknown. By this historical standard one might expect the market to rally if Trump is reelected and decline if Biden is elected. This may not be the case in 2020, however. Setting aside market preferences for specific policies for a moment, Biden’s familiarity via extended tenure in government hailing from corporate-friendly Delaware including 8 years as vice president may provide some level of solace to markets in regard to the “unknown” factor. Should he win the election, the market might feel fairly confident in what to expect, thereby avoiding an “uncertainty selloff.” The point is that markets may feel they know what to expect should either candidate claim victory and will be primed to adjust accordingly. But what of specific policy proposals—will they make a difference?



Source: Ned Davis Research

*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int’l Devel: MSCI EAFE Index; Int’l Emerg: MSCI Emerging Markets Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodity: Bloomberg Commodity In

Policy, Government, and Elections

Each candidate has outlined specific policies that would comprise a presidential agenda beginning in 2021, the implementation of which will likely hinge upon the outcome of the congressional elections. We consider three scenarios:

• **Trump/Split Congress:** If Trump retains the Whitehouse and Republicans the Senate, the perceived pro-business agenda would be a favorable aspect for markets. Recent polling shows record low favorability on the President's handling of COVID pandemic, however, and continued trade tensions with China may both be negatives. While historically this combination of president and congress has been worst for markets (as shown in the chart to the right,) it proved wrong in 2019 when markets did well. Industries that might benefit most under this scenario include Aerospace, defense and traditional energy.

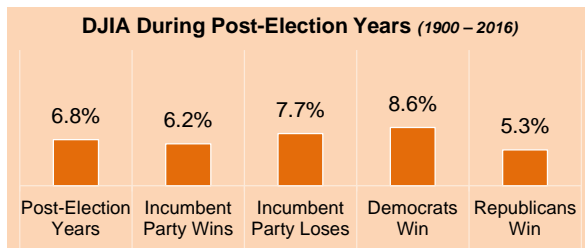
• **Biden/Split Congress:** Markets have historically preferred partisan conflict in Washington, again related to the uncertainty factor. High conflict equals gridlock which means markets can continue to function unencumbered by change. Furthermore, markets have preferred a split congress under a Democratic president (though this has only happened 3% of the time since 1901). Continued impasse on COVID stimulus could prove detrimental, however.

• **"Blue Wave":** While typically a complete Democratic sweep might be expected to negatively impact the market outlook, many Wall Street analysts are viewing this prospect favorably in 2020. Indeed, Goldman Sachs' chief economist stated a "blue wave" would prompt the firm to upgrade economic growth forecasts due to short-term fiscal stimulus and longer-term spending on infrastructure, climate, healthcare and education. Likewise, Moody's chief economist stated, "the economic outlook is strongest" under this scenario due to the same factors cited by Goldman as well as a boost on trade and immigration. While both Goldman and Moody's acknowledged a tax increase in the higher income echelons is a negative factor they agreed it would be more than offset by the aforementioned elements. Senior Economic Advisor of one of our money managers, Fort Washington, agrees as well noting, "the economy's growth potential are not (currently) being driven by tax changes." Industries that might benefit most include health care, capital goods and clean energy.

DJIA vs. Gov't Composition (1901-2020)			
President	Congress	Gain/Year	% of Time in Effect
D	R	5.21%	10.08%
D	Split	7.99%	3.35%
D	D	2.96%	33.43%
R	R	7.09%	23.50%
R	Split	-5.49%	11.18%
R	D	-2.05%	18.46%

Source: Ned Davis Research, WestStar Wealth Management

Markets in Post-Election Years

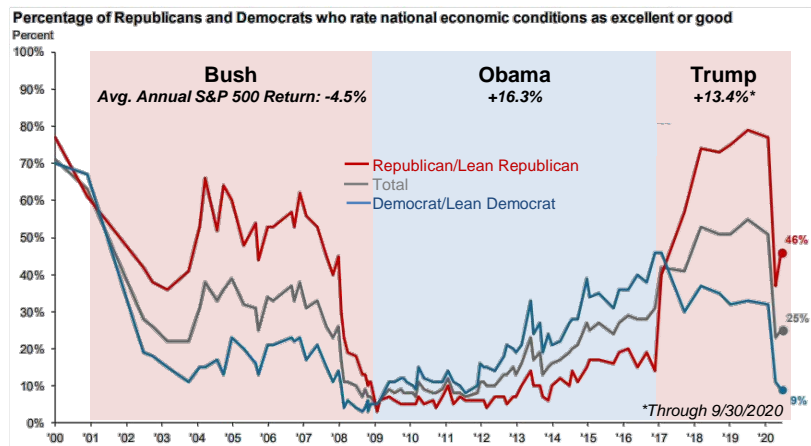


Looking at past presidential election cycles we find that in the year following the election (in this case 2021) the market performs similarly on average irrespective of who wins or loses. The chart on the left shows that the market has typically risen in the 6% - 8% range whether the incumbent party has won or lost and in all post-election years on average. So while anything can happen and past performance is not indicative of future results, stocks are typically positive in the first year of a new presidential term.

Stick to the Path: Follow Your Long-Term Strategy

"Don't confuse your path with your destination. Just because it's stormy now doesn't mean that you aren't headed for sunshine." ~Anonymous

The chart at right illustrates how people's perceptions of the economy correlate to the combination of their personal political affiliation and that of the prevailing president. Though Republicans may have been more pessimistic about economic prospects during the Obama years and Democrats the same during the Trump years, allowing politics to influence investment strategy may have hindered each from capitalizing on the double digit stock market returns enjoyed under each administration. Indeed, remaining invested for 30 years ending 9/30/20 resulted in a 10.6% annual return. The message is to remain invested regardless of the outcome of this year's elections, as there is money to be made independent of the party in power.



Source: Pew Research Center, JP Morgan Asset Mgmt., WestStar Wealth Management

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