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The US election rematch: only short-lived volatility predicted

Matthew Cady

Preparing for a Joe Biden vs Donald Trump rematch: Matthew Cady, Investment Strategist, explains the likely impact of this year's US presidential election on markets.

The United States is gearing up for another presidential election on Tuesday, 5 November. With the political stage set, we have a rematch between two people who have been president once before: current president Joe Biden (Democrat) and former president Donald Trump (Republican).

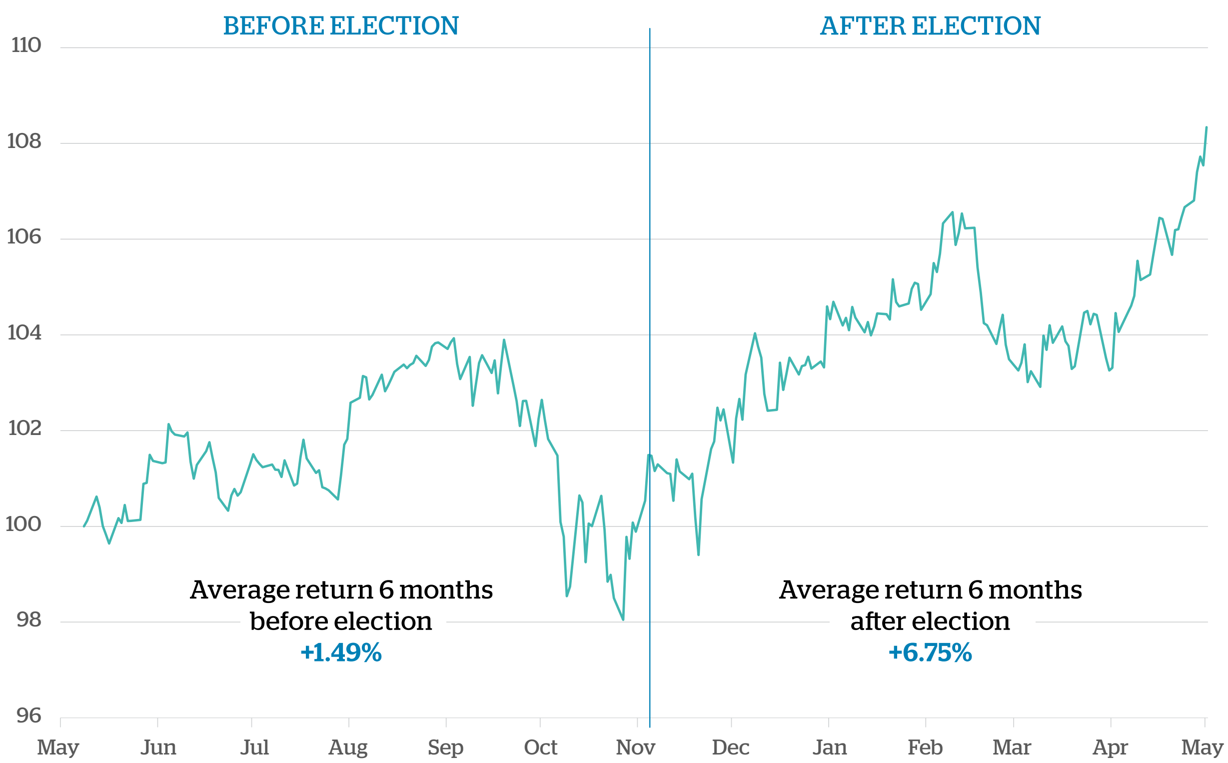
The latest polls are churning out mixed signals, leaving the outcome shrouded in uncertainty. The campaign engines are running at full throttle, and news outlets are abuzz with election talk. Amid these noises, it is easy to get sidetracked when making sound investment decisions. However, drawing from history we can distil two important lessons from past elections that can guide our investment thinking and provide a sense of reassurance.

Lesson 1: Markets often rally once political uncertainty goes away

Investment markets are no stranger to volatility, and election years are no exception. As the countdown to the polls begin, markets often exhibit heightened sensitivity, particularly when the race is neck and neck. This uncertainty can increase market fluctuations, prompting some investors to scale back their risk exposure. However, these same investors typically re-enter the market once the election outcome is clear.

In the past, the resolution of electoral uncertainty has frequently been followed by a market rally. The chart below shows that the average US equity market return six months before an election was +1.49%, whereas the average return six months after the election was +6.75%. This pattern underscores the market's preference for stability and predictability over the unknown. It is also an important reminder that a key determinant of longer-term investment returns is staying invested during periods of market volatility. At the end of the day, it is 'time in the market', not 'timing the market' that counts more.

Chart: Average US equity market performance across the last eight US presidential elections



Source: Bloomberg, MSCI, MSCI USA (Price return USD dollars) is used as a proxy for equity return. Past performance is not an indicator of future returns.

Lesson 2: Markets care more about the economy and less about politics

Contrary to popular belief, markets are often indifferent to which political candidate emerges victorious in an election. As shown in the table below, equity market returns were largely independent of the political outcome over the past eight US elections. While some fear that markets might take a hit if a certain candidate or party wins, the prevailing economic conditions typically have a more substantial impact on market performance.

For instance, in 2020, the market was more heavily influenced by the pandemic lockdowns and the subsequent economic reopening than by the political ideologies of the candidates. Similarly, in 2008, the defining moment for the market was the global financial crisis, not the presidential candidates' positions on issues like the Iraq War or US healthcare reform.

Table: Historical election outcome and equity market return

US Election Year	Winning Party	Equity return 6 months before election date	Equity return 6 months after election date
1992	Democrats	0.8%	5.2%
1996	Democrats	11.4%	16.8%
2000	Republicans	-0.3%	-12.3%
2004	Republicans	1.4%	3.2%
2008	Democrats	-28.4%	-9.2%
2012	Democrats	5.0%	13.4%
2016	Republicans	3.8%	12.1%
2020	Democrats	18.3%	24.7%

Source: Bloomberg, MSCI. MSCI USA (price return US dollars) is used as a proxy for equity return. Past performance is not an indicator of future returns.

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Looking beyond the political horizon

Political events can undoubtedly evoke strong emotions, but it is vital to keep an eye on the long-term investment horizon. We believe that core economic fundamentals will continue to be the main driver of market trends. However, we are mindful that risks such as inflation and geopolitical tensions could pose challenges to the investment landscape. Despite the political uncertainty, the investment outlook is generally positive as we head into US elections later this year.

On balance, we see steady economic growth, supportive fiscal policy and easing inflationary pressures allowing central banks to lower interest rates. Collectively, this should all continue to sustain corporate and consumer outlooks. As such, we believe there are plentiful opportunities for multi-asset investors, and crucially, this holds true regardless of who sits in the Oval Office.

While the presidential election is a significant political event, investors should arguably focus more on the broader economic landscape and maintain a long-term perspective. This approach can help to navigate the markets as effectively as possible, providing peace of mind by reducing worries about short-term market fluctuations.

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