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Could Biden Tank The Market?

Politics ignite powerful emotions, and since emotions dominate the short-term direction of asset prices, politics can impact the stock market. But how much influence do Presidents really have over the long run?

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Marshalling Hatreds

Try not to act too surprise, but articles about the impact of presidential elections on the stock market typically get a lot of attention during election years. Here's an excerpt from one this week[1]:

> *"Many Wall Street analysts are warning their clients that a Biden presidency will not be good for the stock market. The former Vice President and presumptive Democratic nominee has pledged to roll back President Donald Trump's signature tax cut legislation, which has boosted corporate profits, and if there is a blue wave in November, Democrats will be able to enact major economic changes that may further affect the market in a negative way, investors fear."*

Politics ignite powerful emotions, and since emotions dominate the short-term direction of asset prices, politics can have a profound effect on the stock market over the course of a few days, weeks, or months.

This was the case after Barack Obama won his re-election in 2012 (similar articles to the one above made their way through financial news outlets leading into the election[2]). The very next day, the market began a steep decline that sent the index down over 5.5% in a single week[3].

The market reaction seemed justified to those who disagreed with his politics. This cohort prophesized that Obama's policies towards big business and his party's scheme to fix healthcare were going to bankrupt America. Hence, a drop in an index that depends on the future health of the American economy made a lot of sense.

However, the S&P 500 recovered within a month. It was as if all the harm that Obama could do magically disappeared. In fact, the market rose over 50% through 2015, and more than tripled during his presidency[3].

The same goes for Republicans. Back in 2002, President Bush enacted a myriad of controversial policy decisions including cutting taxes and expanding the deficit. He fought an unpopular war and was vilified for acting as the world's police at the expense of taxpayers. However, the S&P 500 did not seem to notice for too long. The market almost doubled through the end of 2007[3].

Two parties with opposing views, yet both times the stock market surged. How can that be? Were the Republicans wrong to think Obama was bad for business? Did the Democrats make false assumptions about the impact of Bush's foreign policy on the domestic economy?

Headwinds vs. Tailwinds

The answer to these questions lies in the fact that while the President may be the most powerful person in the world, (s)he is not strong enough to direct the entire economy. An administration can certainly promote or kill sectors within it, but the overall beast is just too big and complex.

Consider where nearly all of the world's innovation and entrepreneurship is being born. Self-driving cars that run on batteries, breakthroughs in cancer treatments, taxis on demand, 3D printing, cell phones that act as credit cards, virtual reality, fracking, and so many other world-changing ideas were conceived and commercialized here under both Democrat and Republican leadership.

Simply put, presidential policies can be good or bad for stocks, but there are thousands of drivers of stocks. It's a stretch to assume that one input like a Biden win in November is going to somehow suppress the collective power of the economic tailwinds already in place.

Politics vs. Policy

It's also important to differentiate between *politics* and *policy*. By analyzing the characteristics of the two, we can better understand how each can impact financial markets and the broader economy. Five in particular are worth noting:

1. **Substance:** Politics allow a candidate to make claims that have no basis or support of any kind. Policy is an actual plan comprised of several moving parts that are vetted through committees to ensure thoroughness.
2. **Commitment:** Politics allow a candidate to make promises they don't intend to keep. Policy requires enforcing what is passed into law, which often restricts the ability to roll back legislation once it has been implemented.
3. **Speed:** Politics move at warp speed because promises are just words. Policy moves at a snail's pace due to endless amounts of red tape and the checks and balances of the government.
4. **Accountability:** Politicians will say anything on the campaign trail with little fear of expectation to deliver. Those who create policy are held accountable for their actions and are expected to deliver.
5. **Flexibility:** A politician can promise one thing to an audience today and the exact opposite to a different audience tomorrow. Once policy is executed, making changes can often be more difficult than the initial implementation.

Add it all up and the goal of politics is to win votes (short-term), whereas policy governs and enacts change (long-term). These contrasting features of politics and policy make their impact on the economy and financial markets noticeably different.

That's why we tend to see big reactions in the stock market after an election. Politics (emotions) fuel markets briefly, however emotions usually don't last long enough to alter our $21 trillion economy.

Policy is what matters because it is the process that converts talk into action. But this process is also designed to kill most ideas and only implement those that have passed a series of reviews from key stakeholders. Even after policy is passed, the effects can often take years to be felt.

The complexity of passing policy in this country makes it very difficult for any administration to enact too much change too quickly. Therefore, a candidate may conjure up some powerful emotions on the campaign trail, but their direct influence on the broader economy is quite limited.

For example, go back to 2009, when the Obama administration was in the White House and Democrats controlled Congress. Despite what appeared to be a clear path to healthcare policy, it still took over six years for plans to be made available to Americans. Trump campaigned on tax reform and a wall on our southern border. These policies were not implemented overnight either.

The Bottom Line

Emotions are what distinguish us from machines. They are why we can love, laugh, and smile, and they also keep us safe from harm (a scary noise in a dark alley causes the body's senses to heighten for survival).

As important as it is to embrace these powerful forces, emotions also wreak havoc on our decisions. Recall the last time your emotions got the best of you and resulted in a decision void of all logic and reasoning. Was the outcome favorable?

A few months ago, I woke up in a hotel room and stubbed my toe on a poorly placed coffee table. I got so mad at this inanimate object that I slammed my fist down upon it to teach it a lesson. Had I only stopped for a moment to assess the situation, I would have realized that this

	Politics	Policy
Substance	Flimsy	Vetted
Commitment	Weak	Firm
Speed	Lightning	Glacial
Accountability	None	Significant
Flexibility	Significant	Little
Timeframe	Short-Term	Long-Term
Driver	Emotions	Fundamentals
Goal	**Win Votes**	**Enact Change**

coffee table was probably not going to learn the error of its ways, and my wrist could have been spared weeks of avoidable pain.

Few emotions are stronger and impact decisions more than political ones, and the examples above show how politics can create unnecessary risk. For example, had an investor who feared for the future of America sold into the panic after Obama won his reelection, think about the gains this investor would have missed (the same goes for Trump's victory in 2016).

That's not to say investors should ignore politics. Active management of any portfolio must pay close attention to D.C. at all times because they set the rules. The key to success is to assess all possible outcomes from an election or policy change, determine the impact of each (without injecting one's political beliefs), and then formulate a plan that attempts to profit in each outcome. That way, an investor can prepare for most scenarios and mitigate the risk of an emotionally fueled decision.

The bottom line is that the real risk to investors is not who wins in November but how one reacts to the outcome. The election does matter, but it's only one input. There are several others that have little to do with politics, and these probably won't change much after the election.

Sincerely,

Mike Sorrentino, CFA

Chief Investment Officer

Sources

1 https://www.cnbc.com/amp/2020/06/24/bidens-big-lead-in-the-polls-could-be-partly-behind-markets-drop-and-may-lead-to-more-weakness.html

2 https://www.bloomberg.com/news/articles/2012-09-06/obama-is-bad-or-good-for-markets-in-poll-showing-global-division

3 Bloomberg

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