NEPC'S ELECTION PERSPECTIVE: THE RACE TO THE BOTTOM

NEPC Research

On November 8, the United States of America will elect its 45th President. But oftentimes, October is when electoral decisions are made amid the rising crescendo of campaign commercials and rancorous presidential debates. While political campaigns are invariably messy and antagonistic, the current presidential race between Donald Trump and Hillary Clinton is unprecedented. Ask political commentator John Oliver. "Just do me a favor: look up into the sky right now. Higher. No, higher still," Oliver said in a recent episode of his TV show, *Last Week Tonight*. "Do you see that? Way up there? Way up above the clouds? That's rock bottom. And we are currently way down here."

With less than a month to go before election day, Americans' dislike for the two major party candidates is tracking above 50%. While polls are clearly tilted in Clinton's favor, a word of caution: As we learned from the outcome of the Brexit vote earlier this year, unhappy voters can be volatile and results can be unpredictable.

At these times, it is reasonable for investors to wonder how the outcome of the elections will influence their portfolio. The answer: history tells us that the results are likely to have little impact on investments. Over the last 100 years, domestic stocks have outperformed by around 3% annually under a Democratic presidency compared to a Republican one. However, there is only a marginal difference in returns with either party in the Oval Office after adjusting for volatility and economic downturns.

Still, stock movements do provide some insight into presidential elections. Since 1928, the S&P 500 has been negative on eight occasions in the 90 days preceding the presidential elections (Exhibit 1a). Of the eight times, the incumbent political party holding the presidency lost the election on seven occasions (the sole exception: the 1956 re-election of a very popular Dwight Eisenhower). Of the remaining 14 presidential races, the incumbent party won 12 with the S&P 500 positive in the 90 days before the elections (the exceptions: the elections of Richard Nixon and

Exhibit 1a: Periods of Negative Returns for the S&P 500 (3 Months Before Election Date)

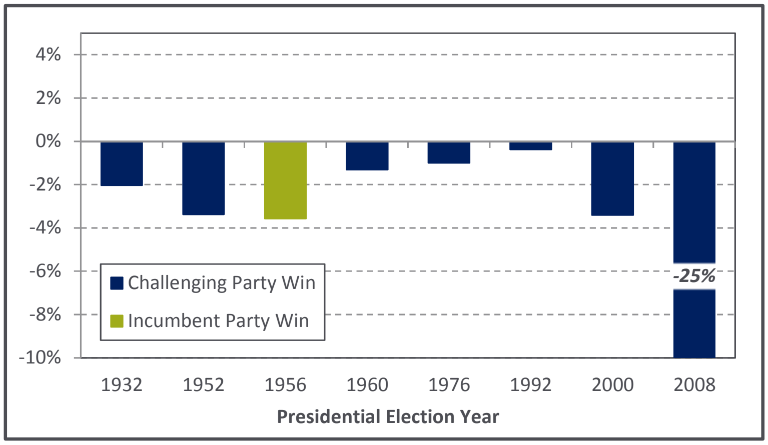
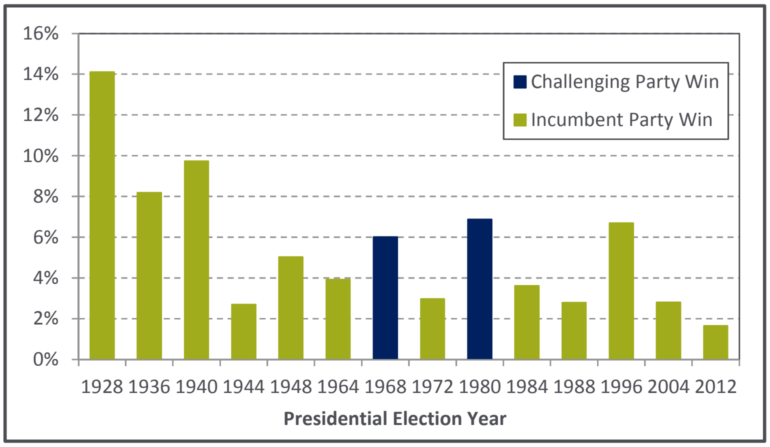


Exhibit 1b: Periods of Positive Returns for the S&P 500 (3 Months Before election Date)



Source: Bloomberg, NEPC

Ronald Reagan, in 1968 and 1980, respectively) (Exhibit 1b).

So, where do we stand today? The closing index price of the S&P 500 was 2,181 on August 8, three months ahead of election day. The market is currently range bound in this level. If past patterns hold and irrespective of current polling, a modest equity rally in October foreshadows a win for Clinton and a moderate decline favors Trump.

While the US presidential race dominates headlines, control of the Senate and House of Representatives can be as, if not more, influential for the economy and markets. With our constitutional system of checks and balances, domestic economic and taxation policies flow through Congress. Currently, Republicans lead the House of Representatives and the Senate. If the same party controls Congress with its nominee occupying the Oval Office, the President's ability to push through legislation will greatly increase, likely resulting in meaningful policy shifts with implications for the economy and financial markets.

Though we cannot discount the possibility of sweeping changes that result in Republicans losing majority in the House, displacing them will be a tough slog for Democrats who would essentially need to win all the tightly contested races, requiring a net 29 new representatives to establish majority, according to data from RealClearPolitics. In the Senate too, Democrats need to win at least three of the four races in Missouri, Nevada, North Carolina and New Hampshire to have a shot at leadership, according to RealClearPolitics. To this end, the GOP retaining control of the Senate is a fair assumption but low Republican voter turnout could alter this dynamic.

Who gains control of Congress can provide insight into the ability of Trump or Clinton to implement key initiatives. Two election scenarios are most likely: Clinton wins the presidency with the GOP retaining control of at least the House of Representatives or Trump wins the election with the GOP maintaining a majority in the Senate and the House. These two scenarios will result in vastly different policy proposals, influencing the economy and financial markets. As such, the likelihood of a divided government could stymie Clinton's major policy initiatives. Conversely, a Trump victory is likely to include stronger Congressional support for his proposals—including his controversial immigration plans—due to Republican majority.

That said, it is important to remind investors that while political events can fuel short-term market volatility, it is market fundamentals that ultimately shape investment returns. We encourage investors to look past the political uncertainty and objectively assess the valuation opportunities offered by the market. On that note, putting aside talk of investments, we would first and foremost encourage all voters to exercise their voice as November 8 approaches.

Disclaimers and Disclosures

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