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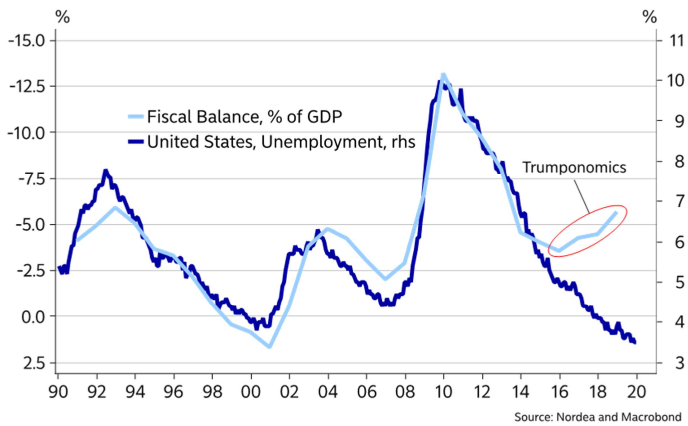
November 3, 2020: The upcoming U.S. presidential election

This election will be different and unchartered territory, but isn't that what people say before every election? Is this time really going to be different, or will it follow the same the presidential election theories?

To start, Donald Trump's time as the head of U.S. government has shown a notable exception to the first-year stock slump that the popular presidential election cycle theory predicts. The S&P saw a 19.4% rise, supported by Trump's pursuit of individual and business income tax breaks passed in late 2017. During the second year in office, we saw the index take a 6.2% dive, but as theory would suggest, we once again experienced an especially strong third year for equities, as the S&P surged 28.9%. *https://www.investopedia.com/terms/p/presidentialelectioncycle.asp*

Despite some alignment with the presidential election cycle theory, we cannot ignore the significant uniqueness to President Trump's approach. For example, he "frontloaded his fiscal easing in 2018 and 2019 – the second and third year of his presidency – via both tax cuts and increased government spending. These measures, which likely added a 0.5% to 1% point to GDP growth each year, came at a time when the US economy was already growing above expectations. Hence, the policies contradicted the usual counter-cyclical nature of the fiscal balance (see chart B)."

Chart B: Fiscal balance vs. unemployment
Normally, fiscal policy is counter-cyclical, but not in Trumponomics



Furthermore, many analysists suggest that elections drive leadership decisions that impact economic environments. Especially when a leader is up for re-election, the belief is that leadership will push through positive social and economic initiatives to prop up the economy and the leader's image prior to re-election. To support these initiatives, it is also suggested that

government financial stimulus is on average more accommodative in the lead up to an election. However, fiscal stimulus may be more difficult to achieve during this election. "Congress is currently divided … we therefore find it unlikely that the Democratic House majority would support another round of significant fiscal stimulus" – especially given financial support already given due to covid-19. https://insights.nordea.com/en/insights/us-election-economy/
By Nordea Analyst Morten Lund and Chief Analyst Anders Svendsen

The potential lack of financial stimulus available, as well as economic hardship from covid-19, is not doing any favours for the incumbent president. Again, statistics suggest an incumbent president is more likely to be re-elected when the economy is strong and voters are happy. Thus, a recession, rising unemployment, and turbulent markets would be a big risk for Trump's re-election chances. In addition, a more left leaning democratic opponent, opposed to a more moderate individual, will possibly add to market uncertainly and volatility. If elections create uncertainty and market volatility, then the 2020 US election likely will not be an exception.

As we near November, when votes will be cast, we will be keeping a close eye on both the strength in markets and popularity of the candidates. If volatility increases, we may see a flow of funds towards investments considered to be more defensive, as investors ride out the storm.

Knowing that there is no definitive answer or system of rules that we can reliably follow, we must learn to be comfortable with the unknown. The outcome of elections and the impact of elections cannot be consistently predicted. As such, it is important to understand your risk tolerance and time horizon, to remove the emotion from investing, to have a disciplined investment approach, and to stick to those rules.