Worried About the Market During This Election?

Humpty might fall, but he most likely won't crack.

By: Sharon Bloodworth, President

We can always tell the temperature of the voting public by the incoming questions and comments from clients. "Should I hold off investing this month?" "Should I move to cash?" "I'm moving to Canada if "so and so" gets elected. " The temperature seems to be rising faster this past week in tandem with the increased pace and severity of the news stories plaguing the election. With such little time for candidates to defend themselves against significant moral and ethical allegations, the public seems more and more unsettled.

Do you feel that the markets are as fragile as an egg perched on a table ready to drop?

We are emotionally designed to live in the present. We forget the pain of childbirth and of war – and gladly (sometimes a little more cautiously) repeat our paths. Our brains behave the same in the markets. I experienced this just a few months ago when I went out to watch "The Big Short", which told the story of the terrible 2008 market crash. Most patrons in the movie theater laughed during the movie. I couldn't bring myself to laugh. The same can be applied to elections and election years. We forget that US elections have happened during WWI, WWII and the great depression. But somehow THIS election makes people want to run into the hills with their cash. I might be wrong but I imagine an election, during a time when the entire world is ALREADY at war, might be worse and with much graver ramifications.

So lets remove ourselves from the emotion and look at the numbers:

When you look at real returns (inflation adjusted returns) in the Dow Jones from 1915 to 2015 what does a normal November look like? Out of the 101 Novembers, 71 experienced positive returns and 30 experienced negative returns. When you look at the Novembers with elections in them - see table 1– out of the 25 election Novembers between 1915 and 2015 14 were positive and 11 were negative.

Table 1: November performance during an election year:

series_id	date	real return	Up	Down	President	Percentage of vote received
DJIA	12/1/1916	1941.9		1	Wilson	52.17%
DJIA	12/1/1920	879.37		1	Harding	76.08%
DJIA	12/1/1924	1651.71	1		Coolidge	71.94%
DJIA	12/1/1928	4159.8	1		Hoover	83.61%
DJIA	12/1/1932	1084.73	1		Roosevelt	88.89%
DJIA	12/1/1936	3046.97		1	Roosevelt	98.49%
DJIA	12/1/1940	2205.08		1	Roosevelt	84.56%
DJIA	12/1/1944	2029.05	1		Roosevelt/Truman	81.36%
DJIA	12/1/1948	1744.45	1		Truman	57.06%
DJIA	12/1/1952	2592.36	1		Eisenhower	83.24%
DJIA	12/1/1956	4290.95	1		Eisenhower	86.06%
DJIA	12/1/1960	4900.64	1		Kennedy/Johnson	56.42%
DJIA	12/1/1964	6643.39		1	Johnson	90.33%
DJIA	12/1/1968	6303.31		1	Nixon	55.94%
DJIA	12/1/1972	5690.69		1	Nixon/Ford	96.65%
DJIA	12/1/1976	4092.94	1		Carter	55.20%
DJIA	12/1/1980	2649.04		1	Reagan	90.89%
DJIA	12/1/1984	2728.46	1		Reagan	97.58%
DJIA	12/1/1988	4267.75	1		GHW Bush	79.18%
DJIA	12/1/1992	5516.15		1	Clinton	68.77%
DJIA	12/1/1996	9640.16		1	Clinton	70.45%
DJIA	12/1/2000	14704.03	1		GW Bush	50.37%
DJIA	12/1/2004	13435.63	1		GW Bush	53.15%
DJIA	12/1/2008	9899.77	1		Obama	67.84%
DJIA	12/1/2012	13536.58		1	Obama	61.71%
		Nov 1915-2016	14	11	25	

Highlighted in yellow above shows the elections since 2000, which are during a time of increased information and liquidity in the market. During those November elections, 75% of the time the month was up. When we look at the same data one year out from the election (instead of one month) the numbers are actually identical 14 to 11 with a 75% positive skew

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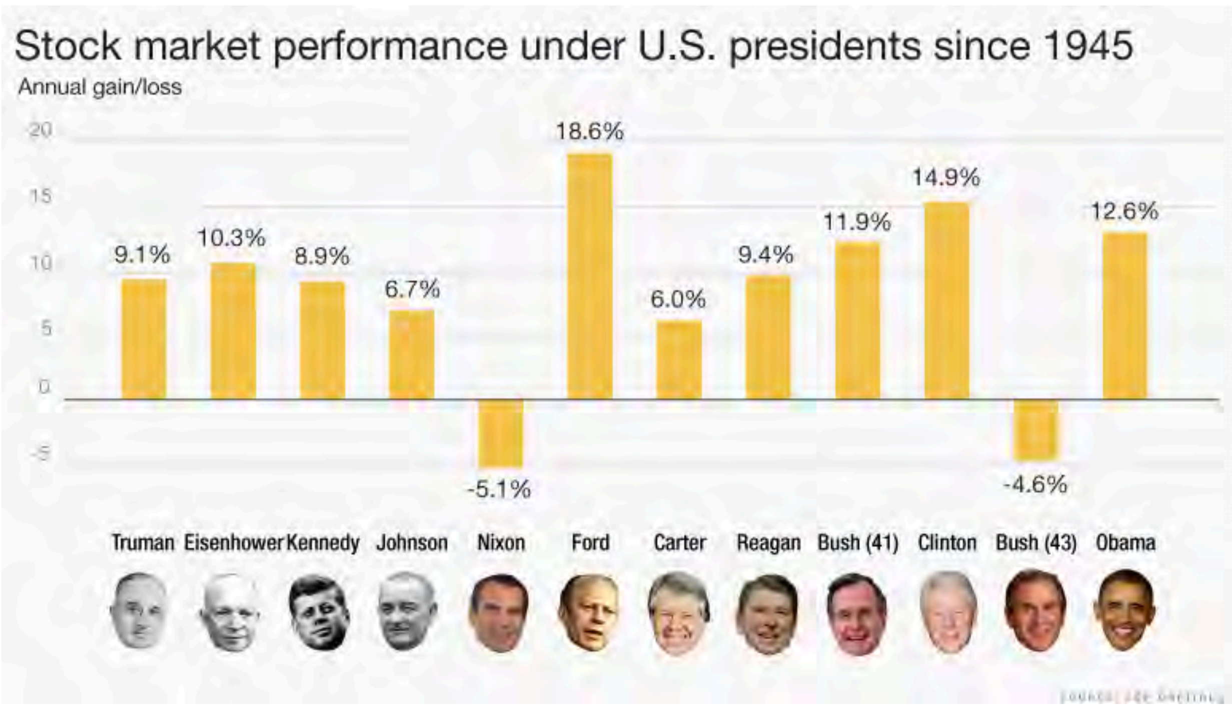
since 2000. In addition there appears to be no correlation between a hotly contested election and a market drop in the same month. Many of the lowest winning votes elections have happened in the last 15 years. So what does that mean? Historically election months were less fruitful in the market, but the trend hasn't proven out in the last 15 years.

So now to shift to the longer term - the chart below shows since 1945 through third quarter 2015 there has been positive performance under almost every president.

Chart 1:



So at what point between the first month and the subsequent four or eight years will you feel comfortable investing? According to recent history the market has not dropped post election in most of the last elections. So we are stuck back at the FOMO (fear of missing out) paradigm. Am I fearful of losing upside and/or downside?

Good investing in its simplest form is buying something at a reduced price and holding it as it appreciates. The US markets as a whole are expensive relative to historic norms, although well below the late 1990s levels. (See chart 2). Illustrated however on Chart 3 is the fact that since 1925, within the US, value stocks and particularly small value stocks, are at some of the cheapest levels in US history.

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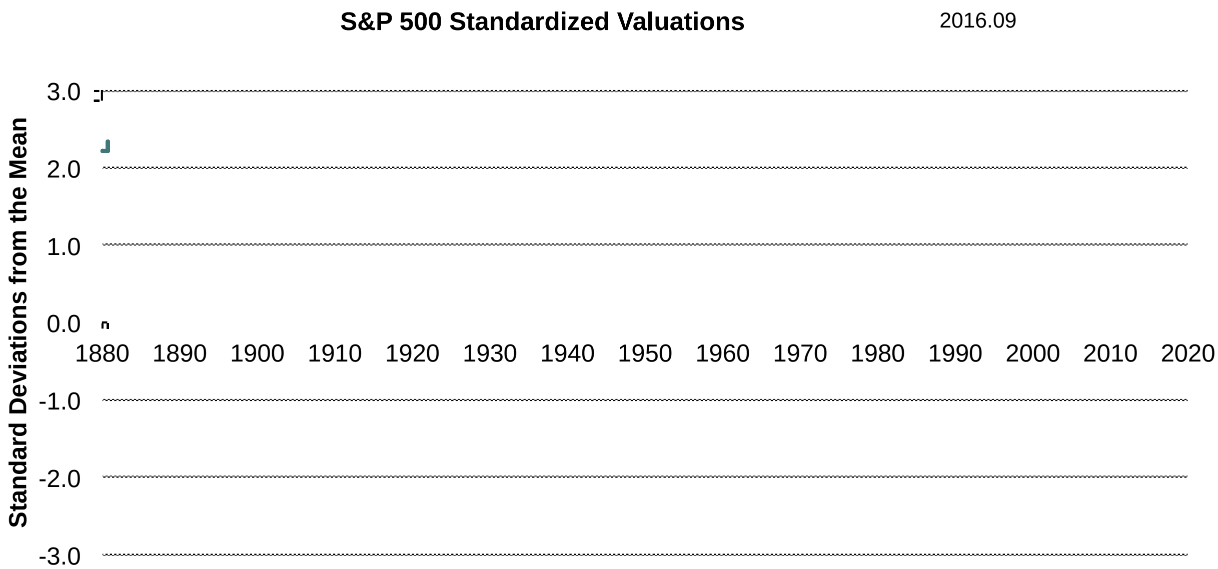
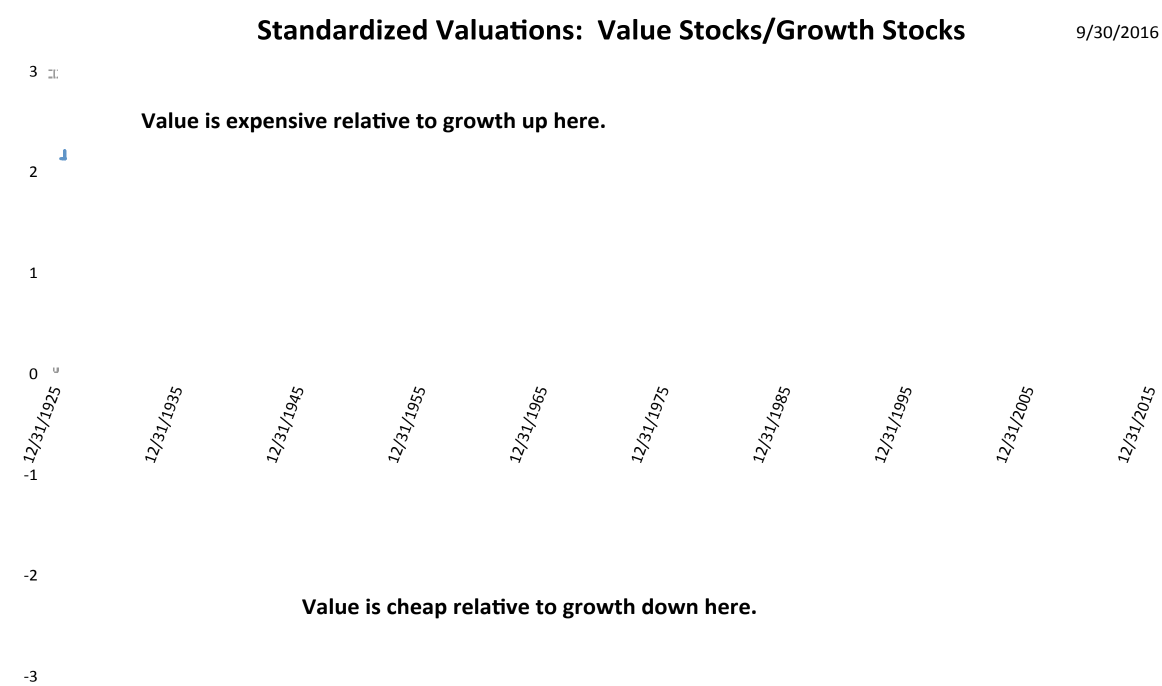
Chart 2:



Data Sources: Robert Shiller, Standard & Poor's, Yahoo Finance, and Morningstar
LN (S&P 500 TR) is regressed on time variable to form a log-linear trend line that is considered fair value. Valuations are expressed in terms of standard deviations from the mean.

Chart 3:



Data Source: Eugene Fama and Kenneth French

The Hi 30 Index (value stocks) is the 30% of US stocks in the database that have the highest book equity to market equity ratios. The Lo 30 Index (growth stocks) is the 30% of US stocks in the database that have the lowest book equity to market equity ratios. The relative TR index represents the total return index of the Hi 30 divided by the total return index of the Lo 30. The valuation shown is the relative valuation between Hi 30 and Lo 30 and is expressed in terms of standard deviations from the mean. A total return index divided by its log-linear trend line is used as the valuation methodology. The trend line is calculated by regressing LN (Hi 30/Lo 30) on time.

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To explain the value concept more easily I often describe it related to personal residential real estate. Say you are buying a house and on the block there are two identical houses and one is priced cheaper than the other. In addition to jumping up and down for joy at getting a good price, if you buy the cheaper one, when the housing market goes up, your house appreciates more than the more expensive one. If the housing market drops then your house drops but not as far as the overpriced house. So why overpay for the same thing?

Conclusion

It is a better approach to invest based on value principles than be whipsawed by the emotion of an election. History has proven out that election months (and the subsequent first 12 months) are not necessarily negatively impacted and that most 4 and 8-year periods in the market are positive. So, humpty might fall in the short term – but he is unlikely to crack beyond repair.

About the Author

Sharon Bloodworth, CFP® is Partner and President of White Oaks Wealth Advisors, Inc. and has been with the company since February 2001. Her experience in the financial services industry dates back to 1993, and includes positions at American Express Financial Advisors as a Financial Advisor, and the investment management firm, Lord, Abbett & Co. in New York City, as Client Liaison.

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