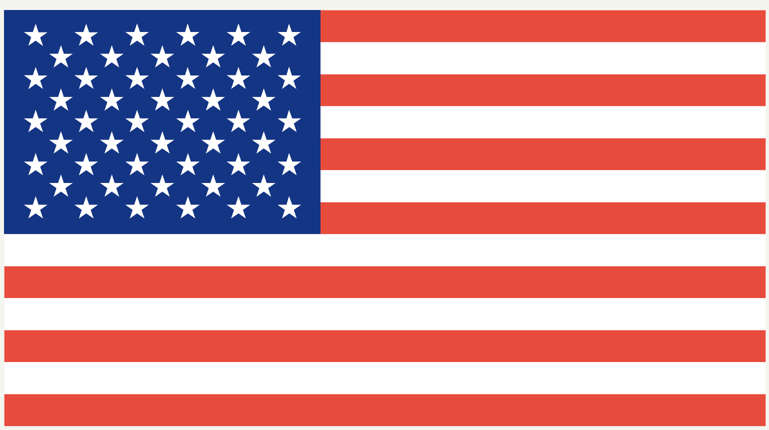
How to Prepare Your Portfolio

for the Upcoming Election



Written by:

YOUR FIRST BANKERS TRUST TEAM

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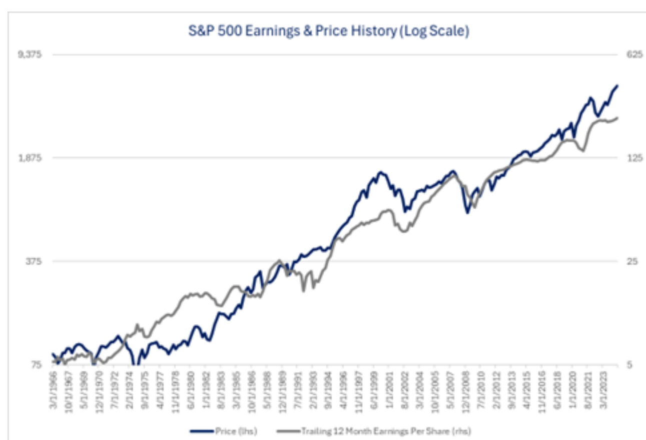
Don't.

It is tempting to end the newsletter there, but we will elaborate on why clients should not fret too much about this election, or elections in general.

Fundamentals Drive the Market

We have said it many times before, and we will say it many more times: fundamentals drive the market over the long-term. Sure, technical factors and emotions certainly help the market overshoot and undershoot reality but the market ultimately follows one thing over the long-term: the earnings of its constituents. The charts below showcase the market's ability to overshoot and undershoot. For time periods longer than five years, we prefer to use logarithmic scaling to better digest the incredible effects of compounding. With the benefit of a log scale on the right, one can see the history of the market veering away from corporate earnings at times. Undershooting in the late 1970's, overshooting during the tech bubble in the late 1990's… you can venture a guess where the market might be now. No matter who the next president is, the market will have to overcome the significant headwind of lofty valuations.

Source: Bloomberg, FBT Research



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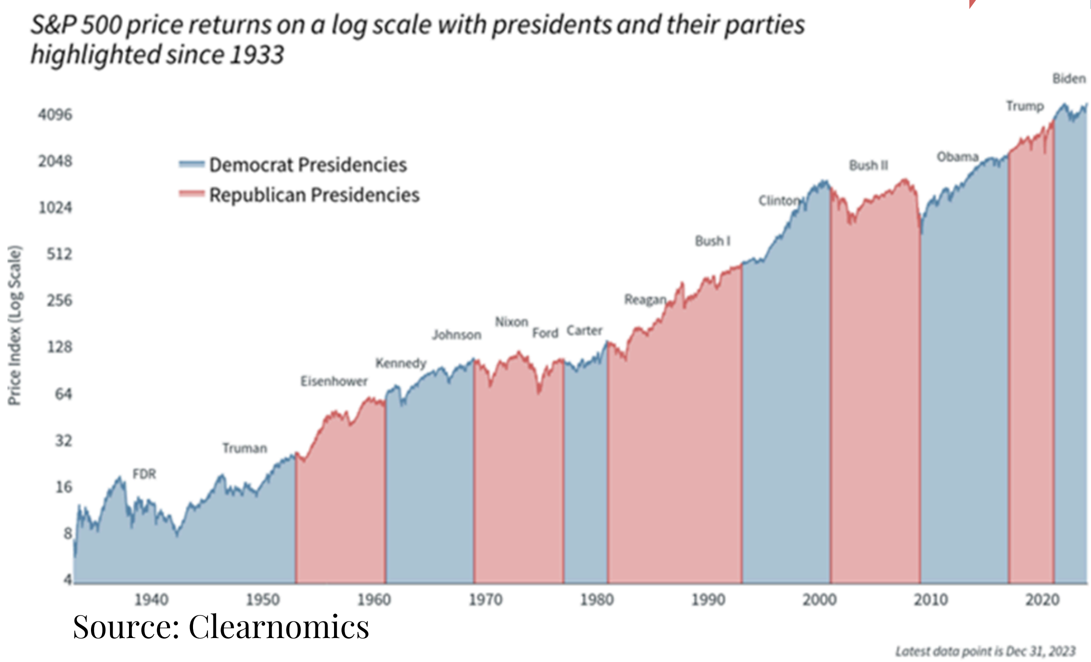
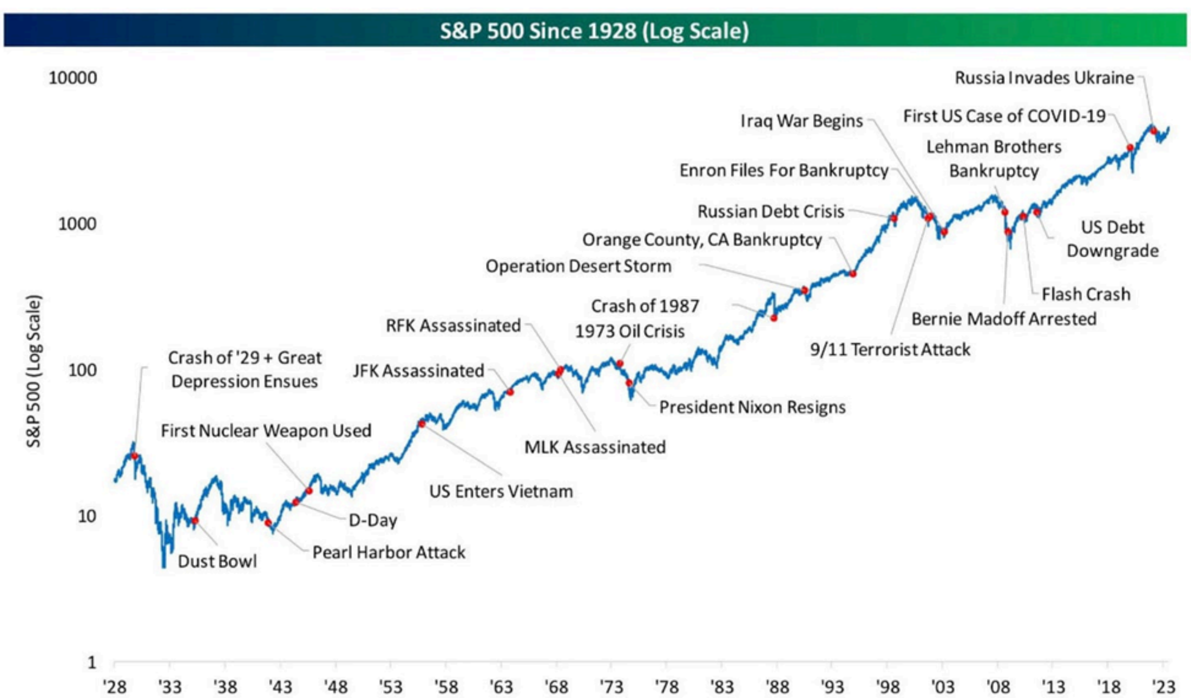


Source: Clearnomics

Do you notice any correlation between the earnings chart and the color of the party holding presidency? Neither do we. The incredible engine that is American innovation powers through any political noise, fears, and even tragedy.



Source: Bespoke Investment Group

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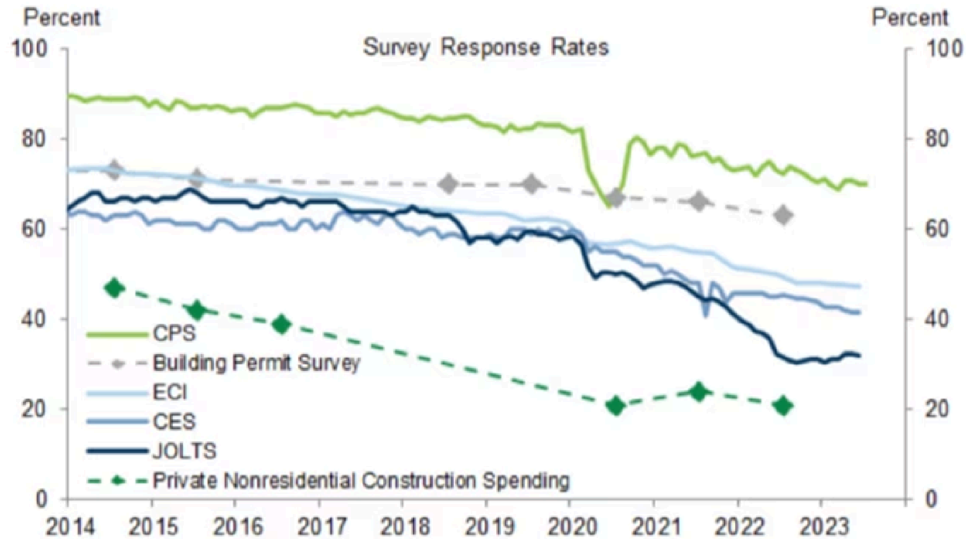
Elections Themselves Are Unpredictable

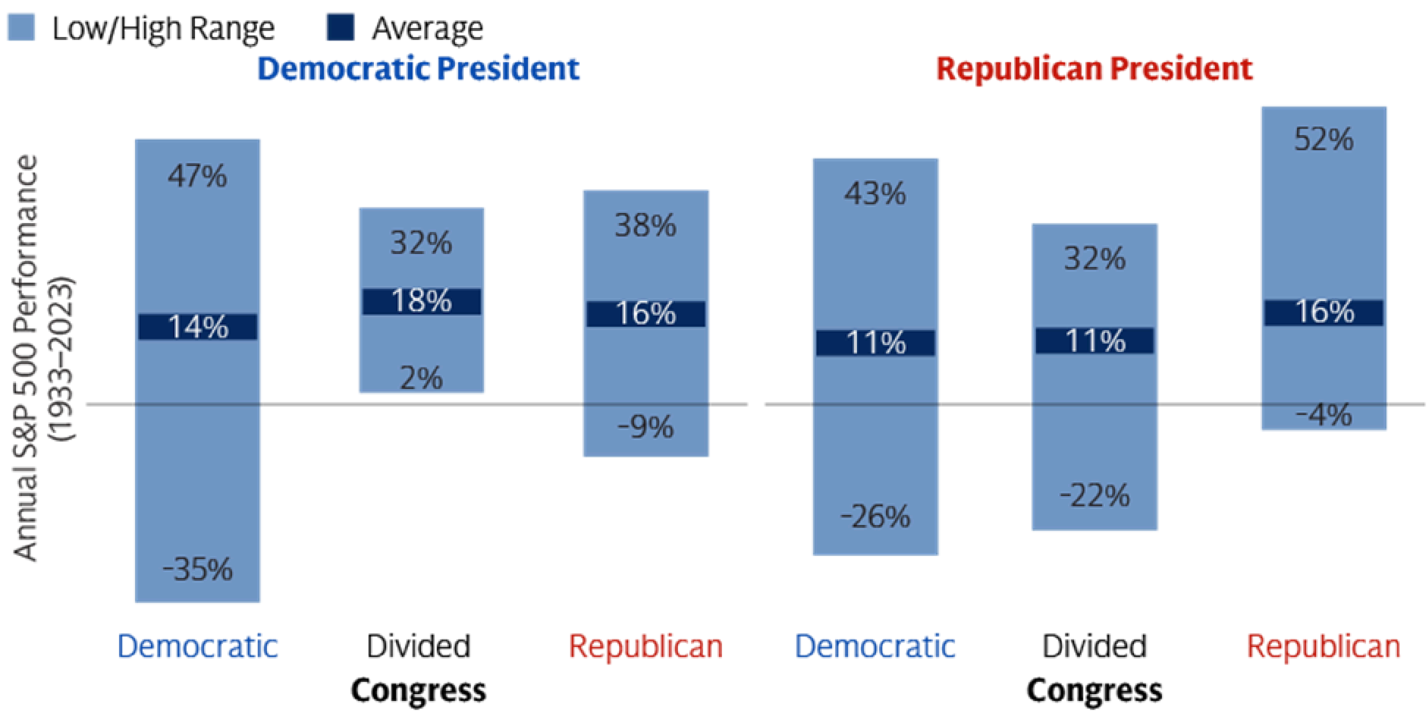
If you're still not convinced that the market does not care about political emotions, another reason to avoid portfolio changes is how unpredictable elections are in general. Hillary Clinton was believed to have a huge lead (and betting markets agreed!) in 2016 yet lost. Anyone basing investment decisions on a Hillary victory was likely disappointed with their portfolio outcome. Furthermore, the post-Covid survey landscape is abysmal. Even critical business surveys have dismal response rates. Anyone confident in the election outcome based on surveys and polls is asking for a large helping of humble pie



Source: Goldman Sachs Investment Research

Market Reactions Are Complex

Still think you should base investment decisions on elections? Let's explore a few more reasons to do the opposite. First of all, it is easy to lose track in this day and age of emotionally charged elections that the president is not the only one in charge of policy. At the time of this writing, the market appears to be pricing in a Trump victory. However, even if Harris surprises the markets with a victory, the stock market's reaction may shift to Congressional outcomes. A divided government might provide gridlock that the market has historically enjoyed.



Source: Goldman Sachs Investment Research

Secondly, stocks are not the only game in town. A red or blue wave may not be well received by the bond market at a time of fiscal recklessness. A spike in long-term interest rates could be the final straw for a softening housing market.

Finally, politicians themselves can be unpredictable. Let's pretend you knew a red wave was imminent. Do you know which tariffs will actually be enacted rather than used as a bargaining chip?

The hypotheticals go on and on. Nobody knows the outcome, the short-term market reaction, or even what policies will pass. Thus, don't invest based on an election.

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What Does this Mean for Portfolios?

Stay the course! We don't mean to play down the importance of elections. Policies matter for economic growth and thus corporate earnings. But some policy mistakes are a slow burn. It's fair to argue housing subsidies and bank policies passed during the Clinton administration were key culprits to the Great Financial Crisis – almost 10 years later! Had you known those policies would create an economic disaster and removed yourself from the market, you would have missed opportunities to buy incredible technology companies like Apple after the tech bubble bust at prices that haven't been available since (even at the lows of the Great Financial Crisis!)

We will continue to focus on the fundamentals for client portfolios. The economy is doing fine, and corporate earnings are accelerating. Could this be derailed by policy changes in the short-term? Anything is possible, especially if our political leaders ever get serious about our federal debt and deficit situation. But we don't believe we have any insight into whether that will be addressed now or ten years from now. What we do believe is that the price the market is paying for a dollar of corporate earnings is getting excessive and that will be a hindrance to long-term returns. We will continue to navigate this tricky environment of robust corporate earnings, uncomfortably high valuations, and fiscal profligacy to help clients reach their goals.

Sincerely,

Your First Bankers Trust Team

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