Morningstar Investment Management Insights

How to Deal with the New President as an Investor (Or Any Political Leader)

November 2020
Estimated Read Time: 4 Minutes

For Financial Advisers and Their Clients

Key Takeaways

- Our answer to political instability is often simple … manage risks, stay informed and—if in doubt—stay the course.
- That doesn't mean that offering a steady hand is simple, but we strive to stick to our principled approach to disciplined buying and selling.
- We should not discount the risk of further market turbulence. If this happens, it may create buying opportunities that could add meaningfully to returns in the future.

Political Events and Investing

It should not be controversial to say that this election cycle was unusual. Here are just a few unique factors: COVID-19, economic loss, polarizing political views/policies, related health concerns, and now legal battles. As a result, investors have been quick to link the election result with investment failure or success. That is, we believe in the power of a leader, including their ability to impact business. But the link is not always so straight forward, as we're about to find out.

Chief among the many problems related to political forecasting is the temptation to react too quickly or with too much confidence at the time of major trigger points. Whether that be the COVID-19 pathway or trade talks with China, it is important to identify the difference between political developments and investment impact.

To do this, we can be grounded by two key questions:

- Are long-term asset class returns likely to be much different given the unique nature of the election?
- Should we behave differently, as investors in this environment, to deal with any future uncertainty?

In our mind, the answer is that we are unusual times, where there are a wide range of outcomes; potentially wider than in the past. This is motivating for our team, as we understand our clients need a steady hand.

The Problem Most Investors Face

Perhaps the biggest challenge for those making investment decisions post-election is that you must get two things right: 1) you must guess the outcome of the next political developments, and 2) you must guess the market participant reaction to that outcome. We'd caution that this is extremely difficult way to obtain returns. To illustrate this point, consider expert insights on what markets would do following two recent political events, the election of Donald Trump in 2016 and the approval of the Brexit referendum.

U.S. Election Predictions (U.S. stocks rallied 2.22% on the day after the election and around 9% in the three months following)

We would expect a small global stock market rally if Clinton wins (about 2%) and a large decline if Trump wins (about 10%) —Eric Zitzewitz, professor of economics at Dartmouth College[1]

The S&P 500 will fall by 3% to 5% immediately if Trump is elected —Tobias Levkovich, Citigroup's chief U.S. equity analyst[2]

If investors are wrong and Trump wins, we should expect a big markdown in expected future earnings for a wide range of stocks—and a likely crash in the broader market —Simon Johnson, professor at MIT Sloan School of Management and former chief economist of the International Monetary Fund[3]

Brexit Referendum Predictions (U.K. stocks fell 3.15% the day after the referendum but gained around 13% in the six months following. Economic growth also continued to rise, albeit slowly, until COVID-19).

A vote to leave would tip our economy into a yearlong recession with at least 500,000 U.K. jobs lost —George Osborne, former chancellor of the exchequer under Prime Minister David Cameron[4]

Leaving Europe would tip the country into recession —David Cameron, former prime minister[5]

Brexit would trigger recession —IMF forecasts for Q3 2016 that predicted -0.3% GDP growth[6]

Keep in mind these errant predictions were made from intelligent, determined and informed individuals. They aren't the first to get short-term predictions wrong and certainly won't be the last. If nothing else, this help us to remember that political uncertainty is nothing new. As always, we must choose research over reaction and urge individuals to stick to their financial plans made at calmer times.

Political biases aside, it is always easy to build an ugly bear case for the election implications—no matter which scenario you look at—and therefore it is important to balance longer term sources of return that derive primarily from the pessimism of investors with the realization that in the short term, pessimism may increase leading to lower asset prices and consequently better investment opportunities.

It is for this reason that we take a diversified approach when managing money for clients. We don't go "all in" on a given outcome, because we can mitigate the risks by spreading an investor's eggs across multiple baskets representing our expectation of superior returns in a variety of outcomes. While some of these scenarios may be directly impacted by the outcome of the election, such as US government bonds, the returns of others will be determined by entirely separate factors, such as Korean equities and European financial companies.

[1] https://www.pbs.org/newshour/economy/column-stock-market-doesnt-like-idea-trump-presidency

[2] https://fortune.com/2016/11/05/stock-market-prediction-donald-trump/

[3] https://www.marketwatch.com/story/the-stock-market-could-crash-if-donald-trump-is-elected-2016-10-31

[4] https://www.gov.uk/government/news/britain-to-enter-recession-with-500000-uk-jobs-lost-if-it-left-eu-new-treasury-analysis-shows

[5] https://www.bbc.co.uk/news/uk-politics-eu-referendum-36355564

[6] https://www.theguardian.com/business/2016/jun/18/imf-says-brexit-would-trigger-uk-recession-eu-referendum

Last, we leave you with a few key points.

- Remember, the answer to political instability is often simple… manage risks, stay informed and—if in doubt—stay the course.
- Any turbulence in markets may create great opportunities to purchase assets that will add meaningfully to returns in the future. We are not there yet, but we should look at this opportunistically.
- We appreciate that the current period is very unsettling and may even cause debate among your families. We will do our utmost to support you during this time.

Since its original publication, this piece may have been edited to reflect the regulatory requirements of regions outside of the country it was originally published in.

About Morningstar, Inc.

Morningstar, Inc. is a leading provider of independent investment research in North America, Europe, Australia, and Asia. The company offers an extensive line of products and services for individual investors, financial advisors, asset managers, retirement plan providers and sponsors, and institutional investors in the private capital markets. Morningstar provides data and research insights on a wide range of investment offerings, including managed investment products, publicly listed companies, private capital markets, and real-time global market data. The company has operations in 27 countries.

About the Morningstar Investment Management Group

Morningstar's Investment Management group, through its investment advisory units, creates investment solutions that combine award-winning research and global resources with proprietary Morningstar data. Morningstar's Investment Management group provides comprehensive retirement, investment advisory, and portfolio management services for financial institutions, plan sponsors, and advisors around the world.

Morningstar's Investment Management group comprises Morningstar Inc.'s registered entities worldwide including: Morningstar Investment Management LLC; Morningstar Investment Management Europe Limited; Morningstar Investment Management South Africa (Pty) Ltd; Morningstar Investment Consulting France; Ibbotson Associates Japan, Inc; Morningstar Investment Adviser India Private Limited; Morningstar Investment Management Asia Ltd; Morningstar Investment Services LLC; Morningstar Associates, Inc.; and Morningstar Investment Management Australia Ltd.

Important Information

The opinions, information, data, and analyses presented herein do not constitute investment advice; are provided as of the date written; and are subject to change without notice. Every effort has been made to ensure the accuracy of the information provided, but Morningstar makes no warranty, express or implied regarding such information. The information presented herein will be deemed to be superseded by any subsequent versions of this document. Except as otherwise required by law, Morningstar, Inc or its subsidiaries shall not be responsible for any trading decisions, damages or losses resulting from, or related to, the information, data, analyses or opinions or their use. Past performance is not a guide to future returns. The value of investments may go down as well as up and an investor may not get back the amount invested. Reference to any specific security is not a recommendation to buy or sell that security. There is no guarantee that a diversified portfolio will enhance overall returns or will outperform a non-diversified portfolio. Neither diversification nor asset allocation ensure a profit or guarantee against loss. It is important to note that investments in securities involve risk, including as a result of market and general economic conditions, and will not always be profitable. Indexes are unmanaged and not available for direct investment.

This commentary may contain certain forward-looking statements. We use words such as "expects", "anticipates", "believes", "estimates", "forecasts", and similar expressions to identify forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results to differ materially and/or substantially from any future results, performance or achievements expressed or implied by those projected in the forward-looking statements for any reason.

The Report and its contents are not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Morningstar or its subsidiaries or affiliates to any registration or licensing requirements in such jurisdiction.

For Recipients in Dubai: The Report is distributed by Morningstar Investment Management Europe Limited Dubai Representative Office which is regulated by the DFSA as a Representative Office.

For Recipients in Europe: The Report is distributed by Morningstar Investment Management Europe Limited, which is authorised and regulated by the Financial Conduct Authority to provide services to Professional clients. Registered Address: 1 Oliver's Yard, 55-71 City Road, London, EC1Y 1HQ

For Recipients in South Africa: The Report is distributed by Morningstar Investment Management South Africa (Pty) Limited, which is an authorized financial services provider (FSP 45679), regulated by the Financial Sector Conduct Authority.