THE TRUTH ABOUT INVESTING & POLITICS

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It was November of 2016 and I could hear distress in the sound of her voice over the phone.

"*I think our new President, Mr. Trump, is going to be bad for the country, and the stock market is going to crash! How are we invested to handle that*?"

It wasn't the only call like that I took around then. They reminded me of several discussions, eight years prior, that sounded something like this:

"*I think our new President, Mr. Obama, is going to be bad for the country, and the stock market is going to crash! How are we invested to handle that*?"

As it happened, stocks did well under both Presidents Obama and Trump, but it's no surprise that I'm starting to take more than a few calls about the new Commander-in-Chief.

Over my 33-year investing career I don't recall these suggestions <u>not</u> coming up when the White House changed hands or power shifted between the parties in Congress. This begs the question as to how important Federal politicians are in shaping investment returns. The answer may surprise you.

The fact is that politics has almost no discernable effect on the markets. Full stop.

In fact, I would cite this concern as among the most widely held, but false, assumptions among investors. At best, news of material changes in Federal policy, directly targeted at businesses or tax rates, have a marginal impact on stock prices, and those reactions tend to be very short lived.

Investors have been tilting at this windmill going back to the dawn of stock trading in the United States. The truth is that stock prices are driven by the future direction of earnings, which are powered by the economic cycle, independent of who is running the country.

Now, this is not to say that Fiscal and Monetary policy exist in a vacuum and don't impact the economy. They do—but you cannot associate those changes with any one party or mix of elected representatives.

Some will claim that one political party is "better" for the economy or markets than the other. Often, they cite the average-stock-returns-by-administration as support for this argument. But I was one of those weird kids that loved statistics in school, and I can flatly state that we don't have enough data points to arrive an empirical conclusion as it relates to party vs. market return. 46 presidents do not a valid-sample-set make.

What about taxes?

Here's something that will blow your socks off. Did you know that we have had seven periods of material tax rate increases since the Great Depression, and they corresponded with great returns for stocks? It's true. The average annual stock market return during these tax hike regimes was 18.9%--nearly twice the long-term average return of stock of 10%.

I won't go so far as suggesting that higher taxes lifted stock prices, nor will I equivocate that stocks will do great during future period of tax hikes. Making those cases fly in the face of my prior point about deriving conclusions from sample sets that are statistically insignificant. But I think you can safely say from the data that rising taxes do not hurt stocks.

So, if politics has little to do with stock returns, why do so many people assume the opposite? I think it has everything to do with conflating the idea our preferred candidate will be good for the nation and that will be borne out in the market. Conversely, we assume our rival candidate will be bad--bad for the nation, bad for investors.

As you might imagine, clients who thought President Obama would cause stocks to crash did not vote for him, and the ones fretting about President Trump were not his supporters.

Our biases shape our logic and create a false sense of connectivity between cause and effect as highlighted by the passion behind our views during this period of increasing polarization.

There is plenty to be concerned about as to the future direction of stocks this year, from pockets of frothy valuations, to what the post-COVID world looks like, to the impact on the extraordinary money creation over the last year. That's where my focus will be—not on what's happening in Washington DC.

Bill Valentine has worked in the investment business for over 30 years. Bill joined ASI as the founder of Valentine Ventures, a Wealth Management firm that merged with ASI in January of 2021. He serves as co-chair of ASI Investment Committee.