THE Wealth REPORT

THE PROBLEM WITH PARTISANSHIP

Overview

As we approach the upcoming presidential election, voters may wish to examine the compatibility of their political beliefs with their personal financial goals. Since 2018, when the Democrats regained control of the House of Representatives and Republicans kept their majority in the Senate, very little meaningful legislation has been passed. Therefore, it is worth considering how a divided government impacts our lives.

From an investment perspective, there are advantages. After all, the markets do not like uncertainty. When there is legislative stagnancy, the stock market appears to benefit from the knowledge that no big changes are on the horizon.

In fact, the economy tends to keep rolling along independent of which party holds the most power. Fiscal, monetary and legislative policies can effect change over time — often beyond the term of the party in power — but the economy and the stock market are largely cyclical. This enables investment portfolios to thrive regardless of political turmoil.

The gulf between political parties has grown wider over time. While fiscal policies and legislation can have a long-term impact, the economy and markets are cyclical — rising and falling based on factors over which politicians have little control.

The bad news, however, is that partisanship typically means little is done to resolve difficult problems the United States faces — such as the growing cost of health care, the federal budget deficit and differences over immigration policy. These larger issues have little chance of reconciliation when the government is divided among political parties. This is one of the biggest drawbacks of partisanship.

Perception vs. Reality

The term “fake news” has been bandied about so much that it is difficult to gauge what is real and what is influenced by media bias. However, recognize that those types of issues are borne out of today’s amplified partisanship. On the other hand, economic indicators and stock market reports are largely independent of the political realm. Information can be “spun” as good or bad, but the veracity of the data itself — as reported by the U.S. Bureau of Labor Statistics and Wall Street analysts — is generally undisputed.

This year has seen the economy rapidly deteriorate due to the worldwide pandemic. The U.S. has sunk into a recession, with gross domestic product (GDP) falling in the second quarter by an annual rate of 31.7%, a slight improvement over initial estimates. Consumer spending has slipped by more than a third (34.1%), with the biggest drops in services, gasoline and clothing.[1] Projections have the third-quarter GDP, scheduled to be released just days before the election, growing by approximately 20% on an annualized basis. However, that’s not likely to make up much ground given that the 2020 recession erased the last five years' worth of economic growth.[2]

After an initial spike in unemployment, from 3.8% in February to 14.4% in April,[3] the rate dropped to 8.4% in August.[4] However, with schools reopening and the flu season approaching, economists anticipate increases in COVID-19 cases that may well boost unemployment again. Also, given the depths from which the employment rate needs to climb, the job market is nowhere near its pre-coronavirus level.[5] Some economists are predicting the economy will not fully recover to pre-pandemic levels until 2022.[6]

The Economy's Impact

Historically, an incumbent president riding the wave of a strong economy has generally been the frontrunner for re-election, and, conversely, a faltering economy is seen as hurting a sitting president's chances. But this year could put a wrench in that theory, with voters focusing on more than economic issues when they choose the next president.[7]

For starters, a recent poll revealed that the COVID-19 pandemic and public health are the foremost political concerns among voters ahead of the November election. The economy was the No. 2 concern, followed by race relations/racism. However, the poll reveals deep divisions among Republicans and Democrats on those issues, with the pandemic the top political concern of 52% of Democrats but only 19% of Republicans, and the economy the top concern of 41% of GOP voters but just 10% of Democrats.[8]

A partisan belief that could affect voters' choices is that the stock market outperforms when a Republican is president. However, since 1947, the S&P 500 has had a 10.8% average annual total return under a Democratic president, versus a 5.6% return for a Republican president.[9]

This is an important point because investors should construct their portfolios based on long-term goals rather than political trends. While a president may shape the direction of legislative policies during that term, remember that stock market prices are largely driven by external forces. Examples include inflation, interest rates, weather-related crises, sector trends and innovation, and global events that affect things like the price of oil and trade agreements.

"A very weak economy come November might not eat away much at Trump's base of support — but an improving economy also might not benefit him as much as it might another president."[10]

The Wealth Report

Policy Differentiation

Despite issues related to partisanship, investors can evaluate investment opportunities based on the preferred policies of the president and the party in power. For example, President Donald Trump advocates expanded coal production, oil exploration and fracking, while former Vice President Joe Biden looks to increase investment in the renewable energy industry.

Taxes will be a difficult issue no matter which political party is in power over the next four years. Between the loss of revenues stemming from the Tax Cuts and Jobs Act of 2017 and the enormous government spending bills necessitated by the pandemic, it's hard to see even Republicans justifying additional tax breaks going forward. Both parties will likely want to address the substantial increase in the U.S. annual deficit and its ongoing contribution to the national debt.

Perhaps the most prominent issue in this year's presidential election is the tremendous partisan divide. Analysis by the University of Michigan showed the partisan gap between how Republicans and Democrats view the state of the economy at 55.4%. That is two times higher than during the Bush and Obama administrations and three times more than during the Reagan era.[11]

Final Thoughts

Something to keep in mind when creating your investment strategy: It can take years for fiscal policies and federal legislation to have a direct impact on Americans' lives and well-being. Therefore, the more prudent approach for investors is to build a portfolio aligned with their financial — rather than political — objectives.

In fact, in light of the uncertainty facing Americans with regard to the future political landscape and direction of the pandemic, now may be a good time to get back to basics. Establish an asset allocation strategy designed for long-term personal goals, maintain at least a 10-year outlook on stocks and actively practice diversification — including periodic rebalancing to retain your portfolio's investment mix.

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