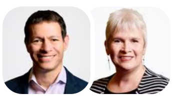
How to Position Your Investment Portfolio Before the 2024 Election

Lessons learned from a deep dive into market behavior following the 2016 and 2020 elections.



Dan Lefkovitz and Susan Dziubinski • Apr 17, 2024

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Editor's note: This video was filmed when Joe Biden was the presumptive Democratic nominee for president. See the latest here.

Susan Dziubinski: Hi, I'm Susan Dziubinski with Morningstar. Here in the US, we'll be heading to the polls in November to elect our next president. And for now, it looks like we'll be choosing between current President Joe Biden and former President Donald Trump. Here with me to discuss what investors might learn from how the market performed during the prior administrations is Dan Lefkovitz. Dan is a strategist with Morningstar Indexes and the co-host of *The Long View* podcast.

Hi, Dan. Thanks for being here today.

Dan Lefkovitz: Always great to be with you, Susan.

Dziubinski: All right. So, you did a real data deep dive into the performance of various asset classes during actually the last four administrations, and viewers can access your research in a link beneath this video. Talk in very broad strokes about how stocks and bonds performed during these various administrations.

Lefkovitz: We looked at annualized returns for the Morningstar US Market Index, which is our broad gauge of equities, as well as the Morningstar US Core Bond Index during the last four administrations. We found stocks performed best under Trump. They also did very well under Obama, solid returns under Biden, and they performed worst under the George W. Bush administration. Bonds did best under Bush and worst under Biden. Now it goes without saying, but I'll say it anyway: There was a lot going on, a lot of different variables, and context is really critical to understand.

Dziubinski: Got it. Now, given that this year's presidential candidates have both held office before, pretty recently, let's delve a bit more into market performance before and during the Trump and Biden administrations, specifically. Now, you often hear heading up to elections and in election years, "Oh, expect more market volatility." Did we see more volatility than usual, say, in 2016 and in 2020, which were our last two election years?

Lefkovitz: We presumed that there would be more volatility in election years, but it turned out not necessarily to be the case. So, 2016 was actually less volatile than 2015. There was some volatility in the runup to the November 2016 election, but the biggest market move of 2016 was actually in June, and it was in response to Brexit. It was a decline when the United Kingdom voted to leave the European Union. It surprised and unsettled markets, and there was a decline even in the US market. But even that move wasn't as big as the August 2015 flash crash, which I'm sure you remember, Susan. I didn't actually. But it's amazing how these events, which seem so important at the time, sort of get lost. But 2020 was a very volatile year, but it was more because of the pandemic than because of the election. We saw the big pandemic panic in March of 2020 when the lockdowns first started, and there were pandemic-related market-moving events in September, October, and November of 2020 as well.

Dziubinski: Let's talk a little bit now about market dynamics during the Trump and the Biden administration, starting with the Trump administration and his surprise win in 2016. How did the US stock and bond markets initially respond after his win?

Lefkovitz: There was a big rally in November of 2016. It was referred to at the time as the "Trump Bump." And when we delved down, it was really the small-cap value section of the US equity market that was leading the charge after the election. Companies that were economically sensitive, rate-sensitive, domestically oriented were the biggest perceived beneficiaries of the Trump platform, which was turbocharged economic growth, tax cuts, regulatory rollbacks, infrastructure spending. Now, Big Tech, Trump was perceived not to be a friend to Big Tech, and technology stocks actually lagged the market in November of 2016, as did the bond market. The bond market sank on expectations that there'd be a lot of stimulus and inflation and rate hikes.

Dziubinski: And what about international markets? How did international markets respond initially?

Lefkovitz: Russia up, Mexico down. So back when the Russian equity market was investable, the Russian equities did well after the election. Trump was perceived to be a friend to Russia. And Mexico, if you remember, the big campaign slogan was "build the wall," the Mexican equity market as well as the Mexican peso really sank after the Trump election.

Dziubinski: Now let's look at the whole term, the whole Trump administration. What happened in the market during that time and by the end of the term? Did those initial expectations or behaviors in the market hold?

Lefkovitz: No, they did not persist. In fact, in 2017, small-cap value, which had been the biggest beneficiary of the Trump election, was the worst-performing corner of the style box measured by our indexes. Large-cap growth was on top in 2017. What happened was a lot of key planks of the campaign agenda like infrastructure spending failed to advance, and expectations really reset. So, what we saw through the remainder of the Trump presidency was that technology was the best-performing equity sector, which was certainly not the expectation after the election. If you remember, we talked about the FANG stocks in those days. That acronym was coined in 2013: Facebook and Amazon, Netflix and Google. Those were the market leaders before the election, and that acronym only evolved and grew throughout the Trump presidency.

Dziubinski: Let's fast-forward a little bit and talk about the Joe Biden's win in 2020. And again, same questions here. How did the markets respond initially, both here and abroad, to that win?

Lefkovitz: Well, interestingly, there was also a small-cap value rally after the Biden victory in November 2020. But it's very hard to separate the election results from the effects of the announcements of the covid vaccines. So, the covid vaccines came out in November 2020, right after the election. And stocks that, again, were economically sensitive and that had been suffering during the pandemic and as a result of the lockdowns, they rallied. We used to talk in 2020 about the BEACH stocks: booking and entertainment and airlines and cruises and hotels. Those were the biggest losers of the pandemic, and they rallied really strongly after the vaccine announcements in November 2020. So small-cap value rallies after both Trump and Biden.

Dziubinski: Dan, now that we're further along in Joe Biden's term, how have those initial expectations panned out? Have they sort of stuck?

Lefkovitz: The story is a little bit complicated. So small-cap value did do very well in 2021. It was the best-performing part of the market. 2021 was really a good year across the board for both growth and value. In 2022, we had the big crash. Now, energy held up very well in 2022. Technology led the market down. And then we had the artificial intelligence enthusiasm that began at the end of 2022 and carried on through 2023. And so far, this year, we've been talking about the "Magnificent Seven," large-cap growth technology leadership. But energy has actually been the best-performing sector of the US equity market under Biden, which is surprising given his focus on renewables, and the energy sector in the equity market is more traditional oil and gas. But technology has done very well under Biden as well.

Dziubinski: Dan, given what we've seen in the past, is there one candidate that would be better or worse for the markets?

Lefkovitz: My honest answer, Susan, is "Who knows?" It's really hard to know how politics are going to affect markets. And I'd say that politics and elections present a lot of behavioral pitfalls for investors. There are a lot of emotions involved. It's also really hard to predict the results of an election, what sort of policies are going to be enacted, what the market reaction is going to be. So, I don't know.

Dziubinski: After digging through all of this data across four administrations, what would you say are some key takeaways for investors in this election year of 2024?

Lefkovitz: Number one, I'd say that elections don't take place in a vacuum. Elections are just one of many variables that are constantly interacting to influence markets. Two, I'd say that the initial reaction doesn't always persist. In the long term, markets are going to be driven by earnings and cash flows of companies, not so much by policy and administration effects. And three, I'd say that in 2024, we can't just assume that the market will react the same if Trump wins as it did in 2016 or the same if Biden wins as it did in 2020 because markets are always learning and adapting. And that's why the past isn't always predictive.

Dziubinski: And that's why I guess no matter what season we're in or what year we're in, a diversified portfolio is probably the best way to go for most people.

Lefkovitz: That's right. I think there's that old expression: Don't predict, prepare. I think there's a lot of wisdom in that.

Dziubinski: Good advice, Dan. Thanks for being here today.

Lefkovitz: Thank you, Susan.

Dziubinski: I'm Susan Dziubinski with Morningstar. Thanks for tuning in.

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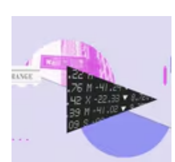

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