FROM THE INVESTMENT MANAGEMENT GROUP

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Behavior finance shows us that investors are always worried about something. The election gives those investors new reason to do so.

Our Election Investment Handbook

EXECUTIVE SUMMARY

1. Turbulent trifecta of pandemic, social unrest and economic suppression brings election into focus.
2. Contrary to popular beliefs, markets have historically marched higher regardless of the party occupying the executive branch.
3. There are likely more important drivers for market returns than the presidential election outcome – namely:
   a. Continued progress against COVID-19 with therapeutics and vaccinations,
   b. Continued monetary policy support and,
   c. Who controls the Senate, post-election.
4. The unprecedented amount of global stimulus is very supportive for economic growth and should continue regardless of political parties in office.
5. Equities should continue to be a favored asset class. Government policies may create new winners and losers within specific companies and industries but, they are likely to wash-out at the broader index level. And, as the economy continues to recover, it is likely that market participation will broaden out. Monetary policies under either outcome should keep short-term interest rates lower for longer. This should also have a favorable impact on equities and ramifications for fixed income investors.

Behavioral finance shows us that investors are always worried about something. The election gives those investors a new reason to do so. While politics has become more tribal than perhaps ever before, the intent of this report is exclusively on the investment aspect of this election cycle. Many have strong views of how the world should be. We focus on the reality of what is and possible outcomes. To borrow from a famous Greek philosopher, Epictetus: "The chief task in life is simply this: to identify and separate matters so that I can clearly say to myself which are externals not under my control, and which have to do with the choices I actually control." – *The Discourses, Book 2, Chapter 5.*

This report is broken down into four sections. First, we take an historical view of markets, dispel some myths and provide constructive context to what could be. Second, we examine the role of uncertainty as a driving force of short-term market performance around elections. We then describe the high-level difference in various policies and election outcomes and review what's most important and likely. Lastly, we highlight some portfolio implications.

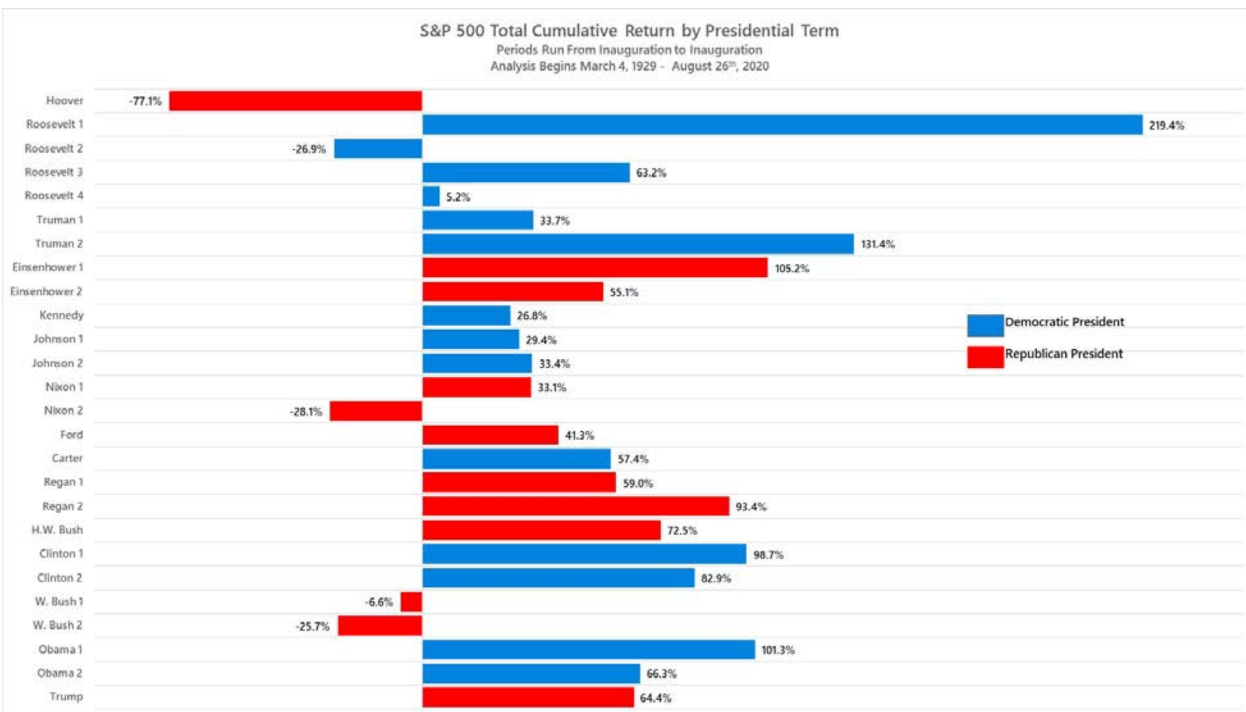
I. HISTORY LESSONS

Let's start with a few common questions, perceptions and historical tendencies.

How do markets perform under various political outcomes?

While there are certainly policy differences and opinions on which policies are better for the economy and markets – not always the same – a simple review of market (S&P 500) performance during various presidencies may be surprising. Exhibit 1 shows returns by President (blue = Democrats; red = Republicans) since 1929. Investors enjoyed a positive return 64% (7 of 11; not including current 4-year term) of the time during Republican presidencies and 93% (13 of 14) of the time during a Democratic presidency. (When combining Presidencies for a party 4-year calculation (e.g. Roosevelt/Truman in 1945), then investors enjoyed a positive return 80% with Republicans and 92% with Democrats. Exhibit 2 highlights that the market has average annual returns of 13.9% during the term (inauguration to inauguration) for Democrat presidencies compared to 7.9% for Republican presidencies.

Exhibit 1: Domestic Equity Performance by Presidency

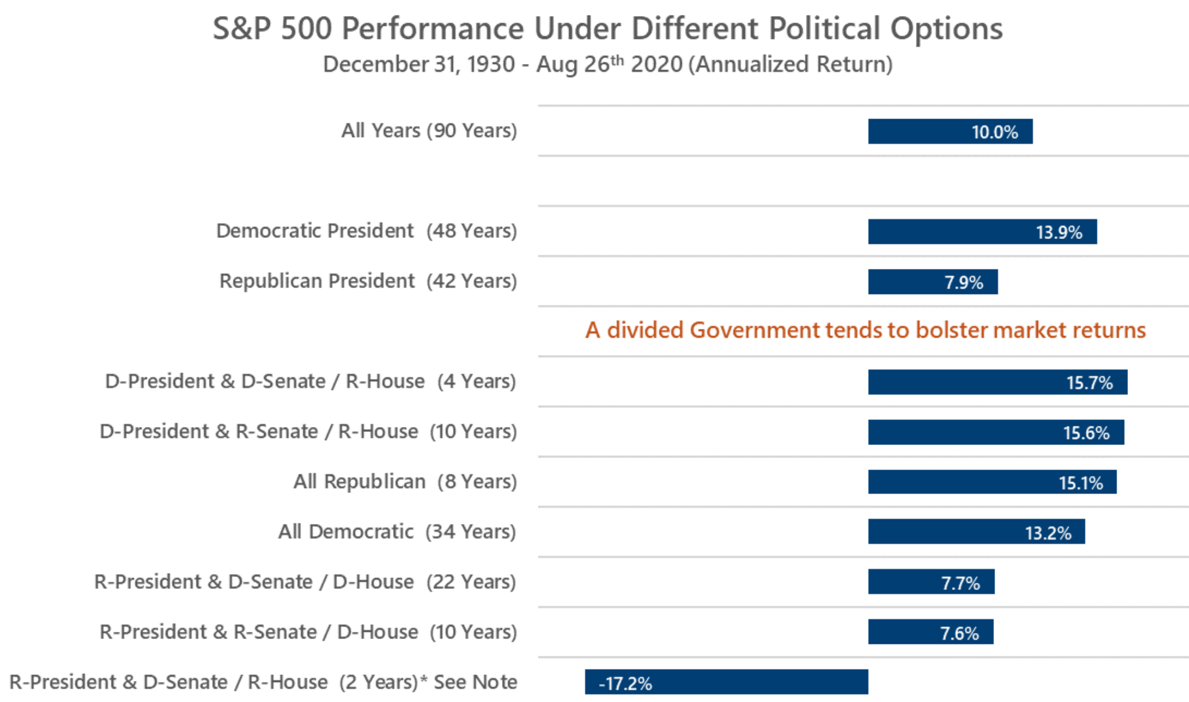


Source: Bloomberg, Past Performance is no guarantee of future results. As of 8/26/2020. Data is represented by the S&P 500 Index with data going back to the last 1920s. The S&P 500 is considered generally representative of U.S. equity market performance. Hoover: Measured from 3/4/1929 to 3/4/1933. Roosevelt 1: Measured from 3/4/1933 to 1/20/1937. Roosevelt 2: Measured from 1/20/1937 to 1/20/1941. Roosevelt 3: Measured from 1/20/1941 to 1/20/1945. Roosevelt 4: Measured from 1/20/1945 to 4/12/1945. Truman 1: Measured from 4/12/1945 to 1/20/1949. Truman 2: Measured from 1/20/1949 to 1/20/1953. Eisenhower 1: Measured from 1/20/1953 to 1/20/1957. Eisenhower 2: Measured from 1/20/1957 to 1/20/61. Kennedy: Measured from 1/20/1961 to 11/22/1963. Johnson 1: Measured from 11/22/1963 to 1/20/1965. Johnson 2: Measured from 1/20/1965 to 1/20/1969. Nixon 1: Measured from 1/20/1969 to 1/20/1973, Nixon 2: Measured from 1/20/1973 to 8/9/1974, Ford: Measured from 8/9/1974 to 1/20/1977, Carter: Measured from 1/20/1977 to 1/20/1981 , Regan 1: Measured from 1/20/1981 to 1/20/1985 , Regan 2: Measured from 1/20/1985 to 1/20/1989 , H.W. Bush: Measured from 1/20/1989 to 1/20/1993 , Clinton 1: Measured from 1/20/1993 to 1/20/1997 , Clinton 2: Measured from 1/20/1997 to 1/20/2001, W. Bush 1: Measured from 1/20/2001 to 1/20/2005, W. Bush 2: Measured from 1/20/2005 to 1/20/2009, Obama 1: Measured from 1/20/2009 to 1/20/2013, Obama 2: Measured from 1/20/2013 to 1/20/2017, Trump: Measured from 1/20/2017 to 8/25/2020.

Senate and House Outcomes Are Important

Being that market returns can be influenced by government policies, it is important to note what is likely to be legislated through Congress. After all, our government consists of three equal branches. According to the analysis highlighted in Exhibit 2, market returns vary further when considering how the Senate and House of Representatives is populated during Presidencies. Under these considerations, the best market performance has occurred when government is divided with checks and balances among its parties.

Exhibit 2: Market Returns Under Various Congressional and Presidential Occupancies



Source: Bloomberg, Past Performance is no guarantee of future results. As of 8/26/2020. Data is represented by the S&P 500 Index. The S&P 500 is considered generally representative of U.S. equity market performance. The United States has not had a Democratic President, Republican Senate and Democratic House since 1889 and therefore is out of the date range for this analysis.

Note: The 2000 election resulted in a 50–50 tie in the Senate, and the Constitution gives tie-breaking power to the vice president. The vice president was Democrat Al Gore from January 3, 2001 until the inauguration of Republican Richard Cheney on January 20. Then on May 24, Republican Senator Jim Jeffords of Vermont left the Republican Party to caucus with the Democrats as an independent, resulting in another shift of control. This period was treated as a Republican President, Democratic Senate and Republican House.

What indicators may suggest the Presidential outcome?

A political strategist famously stated, "it's the economy stupid". There are a couple of ways to evaluate this.

Recession or Market Drop Indicator

Since 1952 no party has retained the White House when there was either a 20% market decline (DJIA) or a recession during the year. Both have taken place in 2020. The market has now recovered into positive territory and it is our belief that we should exit the recession in the third quarter. Moreover, because the catalyst of the 2020 recession was an exogenous shock, one of the biggest questions heading into the fall is whether this cycle will be different.

DO YOU KNOW? TEST YOUR ELECTION AND PRESIDENTIAL KNOWLEDGE

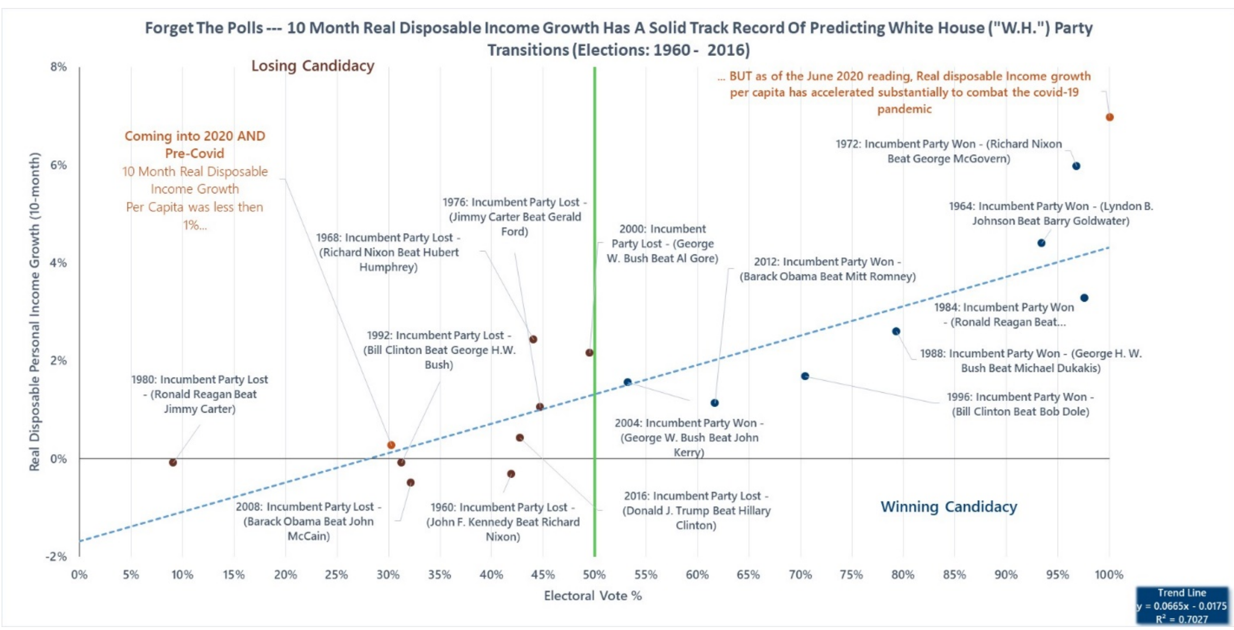
Q1: When was the first known election?

See page 10 for answer

Income Growth Indicator

While a recession is bad, it is a somewhat arbitrary definition that may not necessarily fully reflect the economic state of voters, particularly as recessions are defined in arrears by economists. When evaluating consumers real disposable income growth, Exhibit 3 shows incumbent "parties" have lost the presidential election 64% (7 of 11) of the time when disposable income growth was below 2.2%. This year may be particularly odd as income growth prior to COVID-19 was tepid but has since actually accelerated due to government transfer payments (i.e., stimulus checks) and despite high levels of unemployment.

Exhibit 3: Real Disposable Income Growth Is Supportive to Incumbents

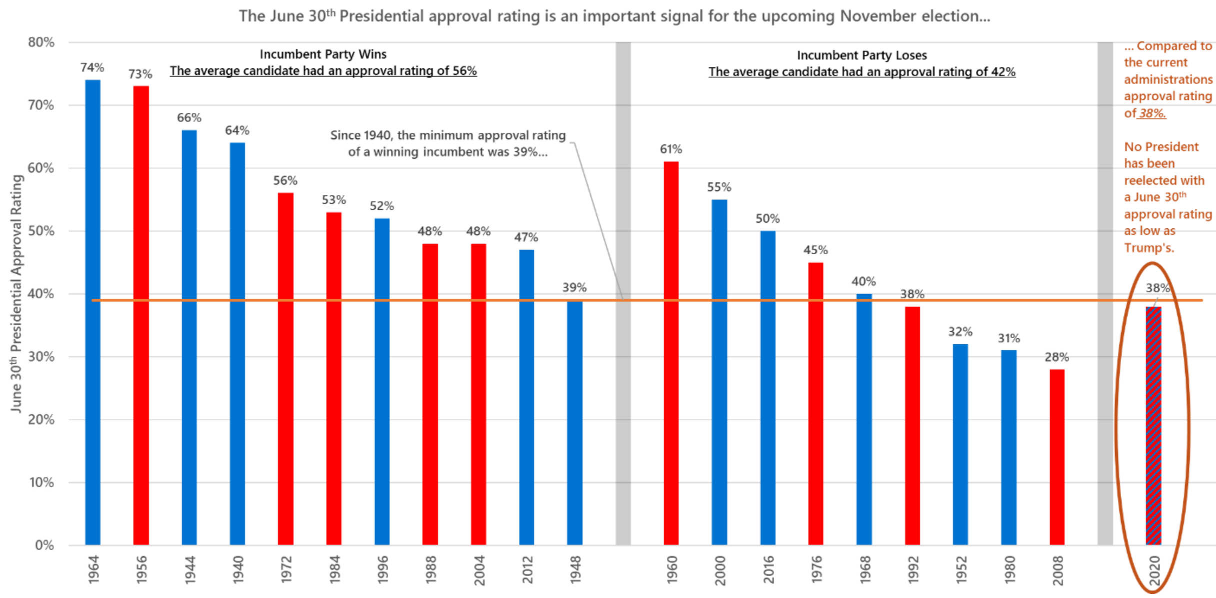


Source: St. Louis Federal Reserve, Encyclopedia Britannica. Real Disposable Income Growth is measured by the % growth from the January reading relative to the October reading. The June 2020 datapoint was measured by the % growth from the September 2019 reading relative to the June 2020 reading.

Approval Ratings Indicator

Approval ratings have proven to be an important indicator of outcomes. Approval ratings also have a longer life than "political polls". According to Ned Davis Research, an independent investment-research firm, no president has ever been re-elected with an approval rating lower than 38% at the June 30th marker during an election year. President Truman was the closest in 1948 with an approval rating of 39. Truman won in a shocking upset as the newspapers went to press on election night stating "Dewey Defeats Truman."

Exhibit 4: Approval Ratings Are Important



Source: Gallop Poll (www.gallup.com), Ned Davis Research.

DO YOU KNOW? TEST YOUR ELECTION AND PRESIDENTIAL KNOWLEDGE
Q2: Why are U.S. elections held in November and on a Tuesday? *See page 10 for answer*

S&P Returns, 3-months Prior to Election Indicator

The S&P 500 is considered a leading economic indicator. Using the returns of the S&P 500 prior to an election outcome is a good indicator of who wins or loses. As Exhibit 5 shows, when the performance of the S&P 500 is positive in the three months prior to the election the incumbent "party" has won the election 83% (19 of 23) of the time.

Exhibit 5: Election Outcome by S&P 3-Month Performance

S&P 500 Performance 3 Months Prior to Presidential Election							
Year	S&P 500 Total Return	Incumbent Party (Won / Loss)	Market Likes Consistancy	Year	S&P 500 Total Return	Incumbent Party (Won / Loss)	Market Likes Consistancy
1928	14.9%	Won	✓	1976	0.9%	Lost	✓
1932	-2.6%	Lost	✓	1980	8.0%	Lost	X
1936	9.6%	Won	✓	1984	6.0%	Won	✓
1940	10.0%	Won	✓	1988	2.9%	Won	✓
1944	3.3%	Won	✓	1992	-0.4%	Lost	✓
1948	6.7%	Won	✓	1996	8.8%	Won	✓
1952	-2.0%	Lost	✓	2000	-2.9%	Lost	✓
1956	-1.7%	Won	X	2004	2.6%	Won	✓
1960	0.1%	Lost	X	2008	-19.0%	Lost	✓
1964	3.3%	Won	✓	2012	3.0%	Won	✓
1968	7.2%	Lost	X	2016	-1.3%	Lost	✓
1972	3.8%	Won	✓	2020	??	??	??

Source: Bloomberg, Past Performance is no guarantee of future results. Data is represented by the S&P 500 Index. The S&P 500 is considered generally representative of U.S. equity market performance. 1928: Election was on 11/6/1928. 1932: Election was on 11/8/1932. 1936: Election was on 11/3/1936. 1940: Election was on 11/5/1940. 1944: Election was on 11/7/1944. 1948: Election was on 11/2/1948. 1952: Election was on 11/4/1952. 1956: Election was on 11/6/1956. 1960: Election was on 11/8/1960. 1964: Election was on 11/3/1964. 1968: Election was on 11/5/1968. 1972: Election was on 11/7/1972. 1976: Election was on 11/2/1976. 1980: Election was on 11/4/1980. 1984: Election was on 11/6/1984. 1988: Election was on 11/8/1988. 1992: Election was on 11/3/1992. 1996: Election was on 11/5/1996. 2000: Election was on 11/7/2000. 2004: Election was on 11/2/2004. 2008: Election was on 11/4/2008. 2012: Election was on 11/6/2012. 2016: Election was on 11/8/2016.

II. THE ROLE OF UNCERTAINTY

Borrowing from human psychology and market history, we know that uncertainty drives higher levels of volatility and can cause selloffs or softening markets while investors "cash out" until certainty prevails. We don't have to look any further than our last presidential election to see this.

DO YOU KNOW? TEST YOUR ELECTION AND PRESIDENTIAL KNOWLEDGE

Q3: How many Presidents won the popular vote, but lost the election?

See page 10 for answer

2016 Election – Revisiting Expectations

Going into the election on November 8, 2016, Hillary Clinton enjoyed a lead in various polls. (As it turns out, the national polls were accurate relative to the popular vote, but polling in key states was less accurate and created an eventual surprise.) However, prior to the election markets tended to slip whenever negative news came out on Hillary Clinton (e.g., FBI public commentaries). In fact, the night of the election as it appeared that then-candidate Donald Trump was going to win, equity market futures sold off massively to the point that circuit breakers kicked in to halt the sell-off at the maximum allowed negative 5%. In the days that followed, as uncertainty gave way to pro-growth policies, such as tax cuts and deregulations, investors drove the equity market higher.

Incumbent Party Outcomes May Be More Important than Which Party Wins

As a reflection of this uncertainty, we note that equity markets tend to do worse in the year of an election when an incumbent party loses, but markets have fared better in the post-election year. This is magnified significantly when an incumbent Republican president loses. Exhibit 6 shows that the Dow Jones Industrial Average (DJIA) has fallen on average the most in "election" years when the incumbent Republican has lost. However, this reverses in "post-election" years, with the strongest average gain following incumbent Republican losses. As this table shows, returns are mixed, and market returns around the elections may be driven more by sentiment than actual fundamentals.

Exhibit 6: Incumbent Outcomes Most Important

Market performance in anticipation of winner often reverses after election

	Presidential Election Cycle by Party Dow Jones Industrial Average (Mean) % Total Return since 1900		
Political Party	**# Cases**	**Election Year**	**Post Election Year**
Incumbent Republican Wins	10	21.6%	10.0%
Incumbent Democrat Wins	8	9.5%	8.7%
Incumbent Republican Loses	6	-4.3%	14.8%
Incumbent Democrat Loses	6	2.9%	1.2%

Source: Bloomberg, Past Performance is no guarantee of future results. Data is represented by the Dow Jones Industrial Index. The Dow Jones Industrial Average (DJIA) is an index that tracks 30 large, publicly-owned companies trading on the New York Stock Exchange (NYSE) and the NASDAQ. The Dow Jones is named after Charles Dow, who created it in 1896, and his business partner, Edward Jones.

III. WHAT'S IMPORTANT? POLICIES

While fiscal policies are important, they tend to wash out at the broader market level. Clearly, various tax and regulatory policies can help or hinder certain companies and industries. However, this is a year in which both parties are incented to continue with strong fiscal policy support. And, the Federal Reserve is intent on sustaining very accommodative monetary policies.

DO YOU KNOW? TEST YOUR ELECTION AND PRESIDENTIAL

Q4: Why is the oval office oval?

See page 10 for answer

The following table provides a high-level overview of various policies under different government regimes (President/Senate/House) and is not intended to be all-encompassing. The information that follows has been gathered from a variety of resources, including market and political strategists, and is believed to be reliable. Each item is subject to change and any final implementation is clearly conjecture at this point.

Exhibit 7: Potential Policies & Outcomes

Topic	Outcome — Majority Party (President/Senate/House): DDD	DRD	RRD (Status Quo)	RRR
Taxes	Personal taxes likely go up on high income earners and down on middle and low-income payers. Capital gains and dividends proposed as ordinary income for earnings over $1 million, but not likely, particularly before next mid-terms. Corporate taxes go up from 21% to 28%. They were at 35% prior to the Tax Cuts and Jobs Act (TCJA) of 2017.	Tax increases likely hard to pass before mid-terms. Economy may dictate tax policy at that point.	Possible extension of current tax cuts (Tax Cuts and Jobs Act (TCJA)). Possibly more tax reductions including capital gains.	Possibly more tax cuts, as well as extensions.
Regulation	More regulations particularly within certain sectors, such as financial and energy.	More regulations particularly within certain sectors, such as financial and energy.	Continued or sustained cuts in regulations.	Continued or sustained cuts in regulations.
Trade Policy	Tough on trading partners, but less use of trade as a geopolitical tool, less uncertainty and less potential tariff damage.	Tough on trading partners, but less uncertainty and potential tariff damage.	More uncertainty and potential tariff damage.	More uncertainty and potential tariff damage.
Fiscal Spending	Substantial fiscal spending (stimulus, healthcare, climate), which may offset headwinds of tax increases and regulations. Infrastructure spending most likely.	Less fiscal spending as financial prudence returns as a higher priority of Republicans. More spending likely if economy still attempting a recovery. Infrastructure spending most likely.	Moderating fiscal spending from previous pace. Infrastructure spending most likely.	Moderating fiscal spending from previous pace. Infrastructure spending most likely.

Based on the current odds of a Democratic Presidency, a primary question appears to be around who will control the Senate. A divided government would serve to temper some of the fiscal spending, tax cuts and regulatory plans currently suggested by Vice President Biden. Under a Democratic sweep, the question would then be whether fiscal stimulus and subsequent economic growth would offset potentially lower corporate profitability and earnings. Some current estimates are for higher corporate tax rates to reduce corporate earnings by approximately 4% to 5%. It is also important to note that if the economy isn't hitting on all cylinders, tax increases are less likely. Sentiment appears to be changing that a Biden presidency would be okay for the market. A Republican win in the presidential election would be considered a status quo. There would be continued and possibly more tax cuts and deregulation. Markets would most likely prefer this outcome.

While many of these policy differences can have a meaningful impact, they may be less important than the continued progress with COVID-19 and monetary policies here and abroad. This leads us to our portfolio implications.

IV. POTENTIAL INVESTMENT OUTCOMES

Elections can elevate emotions and our tribal tendencies. Being part of a tribe, whether it be your favorite baseball team or a social club, can be socially connective. However, political tribes can become a bit more adversarial and campaign rhetoric tends to amplify these issues. This election is unprecedented in modern times with the trifecta of a pandemic, social unrest and economic suppression. De-risking or "cashing out" is an understandable, albeit ill-informed, approach for anxious investors. History has shown us that a retreat to cash is often a mistake. What matters most is staying invested.

The base case is that any potential government policy changes under a new government regime would most likely be reflected by winners and losers (relatively) at the individual company and specific industry level and wash out at the broader sector and market level. Active management is key in understanding and benefitting from such potential rotations. In fact, many managers have already or are prepared to adjust their strategies.

From an asset class perspective, equities continue to look more attractive than bonds, particularly on an equity risk premium basis (see our *July 2020 Market Commentary – Disruptions, Courage & Innovation*). Would you rather invest in equities for the long-run or be in fixed income with historically low yields? Naturally, the answer comes down to the percentage weightings of each, but equities should continue to be favored post-election assuming continued progress with COVID-19 and an economic rebound. Continued fiscal and monetary policies also suggest a stronger case for international equities. We believe that owning great companies despite their domestic origins is a winning long-term proposition.

Fixed income will continue to present challenges for fixed income investors with such low historical interest rates and a Federal Reserve (Fed) that is not likely to increase short-term rates until at least 2022. While the Fed is expected to let inflation run hotter than it has historically, this bodes well for economic growth and equities and credit-oriented bonds. However, it could translate into an increase in longer-term interest rates. An increase in personal taxes could make an already attractive muni market more so. Whatever the case, fixed income still serves an important role within balanced portfolios and the right mix should be based on client goals.

We continue to believe that convertibles are attractive and should be utilized within client portfolios for their asymmetrical risk and return profile. Similarly, lower-risk alternative investments that are designed to not correlate with either equities or bonds should continue to serve well during bouts of volatility.

We will continue to monitor geopolitical events as they unfold and provide updates as newsworthy events unfold. In the meantime, stay calm and invest on.

NOW YOU KNOW . . .

YOUR ELECTION AND PRESIDENTAL QUESTIONS, ANSWERED

Q1: When was the first known election?

Elections are believed to have been used in ancient Greece and Rome. The first recorded popular elections for public office date back to Ephors in Sparta in 754 B.C. All citizens were eligible to vote and hold office. Source: Wikipedia.

Q2: Why are U.S. elections held in November and on a Tuesday?

Election dates were originally set when agriculture was more prevalent in society. The first Tuesday in November was chosen because it was after the harvest season and it allowed for citizens to travel the day after Sunday Sabbath to polling locations. Today, this is considered more problematic for many citizens as it is harder for some to leave work in order to vote.

Q3: How many Presidents won the popular vote, but lost the election?

5! A candidate has won the popular vote but lost the presidential election on five occasions in U.S. history. Most are familiar with the two most recent examples of Al Gore losing to George Bush in 2000 and Hillary Clinton to Donald Trump. However, we have to go back to the 1800s for the other three occurrences. Andrew Jackson lost to John Quincy Adams in 1824. Samuel Tilden lost to Rutherford B. Hayes 1876. Grover Cleveland lost to Benjamin Harrison in 1888.

Q4: Why is the oval office oval?

The Oval Office has roots back to George Washington. President Washington wanted to dramatize the office of the Presidency for social greetings. The office was expanded and completed in 1909 under a competition spawned by President Taft. The winning architect expanded the office and was inspired by the White House's original oval-shaped Blue Room.

Definitions & Disclosures:

S&P 500, is represented by the S&P 500 Index, which measures the market performance of 500 large companies on the stock exchanges of the US.

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