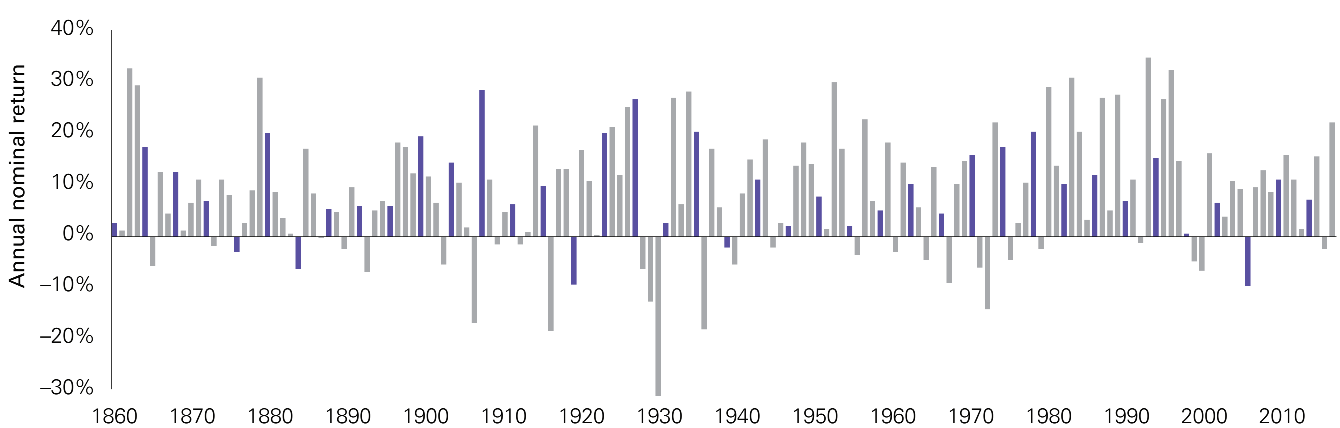
Vanguard

Elections matter, but not so much to your clients' investments

In any presidential election year, many of your clients may no doubt have heightened concerns about what political uncertainty can mean for their portfolios. This year, those concerns are likely amplified as the health and economic impacts of the COVID-19 pandemic continue to weigh on the public.

You can help to ease clients' worries about their investments during this election cycle by showing them the facts about past elections' effect on market returns. Decades of research demonstrate that election years have no statistically significant impact on market returns or, for that matter, volatility.

Comparing election years versus nonelection years: 60% stock/40% bond portfolio returns show no statistical difference



8.9% | Average return during election years (40 periods)

8.1% | Average return during nonelection years (120 periods)

Source: Vanguard calculations based on data from Global Financial Data as of December 31, 2019. The 60% GFD US-100 Index and 40% GFD US Bond Index, as calculated by historical data provider Global Financial Data. The GFD US-100 Index includes the top 25 companies from 1825 to 1850, the top 50 companies from 1850 to 1900, and the top 100 companies by capitalization from 1900 to the present. In January of each year, the largest companies in the United States are ranked by capitalization, and the largest companies are chosen to be part of the index for that year. The next year, a new list is created and it is chain-linked to the previous year's index. The index is capitalization-weighted, and both price and return indices are calculated. The GFD US Bond Index uses the U.S. government bond closest to a 10-year maturity without exceeding 10 years from 1786 until 1941 and the Federal Reserve's 10-year constant maturity yield beginning in 1941. Each month, changes in the price of the underlying bond are calculated to determine any capital gain or loss. The index assumes a laddered portfolio that pays interest on a monthly basis.

Note: *Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.*

Clients worried about politics and their portfolios?

Adopting a proactive approach with clients can go a long way toward alleviating their worries and averting emotionally driven investing decisions on their part. Vanguard advocates a “three A’s” behavioral coaching approach:

Assess the situation—check in with clients about how they are feeling during the run-up to the election. Are they worried about a significant market drop or a perceived risk that their long-term goals are in jeopardy?

Address the situation—be empathetic. You can explain that such worries are common and share with them resources that speak to their concerns. It may be helpful to have them focus on their long-term goals, reminding them how fleeting, frequent, and minimally impactful election cycles have been in the overall scheme of their financial objectives. Additionally, you can remind them that two major elements of wise investing are knowing what they can and can’t control and why they should keep their emotions and investment decisions separate.

Audit the engagements—measure your effectiveness, evaluate clients’ behaviors. Do they understand the importance of planning for the long term? Do they opt to stay the course, maintaining their desired asset allocations instead of converting a large portion of their portfolios to cash?

Elections matter, just not how you might think

Elections hold great importance in upholding the U.S. tradition of democratic, representative government. However, their impact on financial markets has historically proved to be negligible.

Analysts in Vanguard Investment Strategy Group analyzed more than 150 years of asset returns to see whether a relationship between the returns and electoral events existed. The research examined whether election-year uncertainty exposed markets to lower returns or higher volatility, among other things.

The research found a modest return differential existed between presidential election years and nonelection years. The return differential of 0.8%—8.9% during election years and 8.1% in nonelection years—was statistically insignificant and likely attributable to randomness, or noise.

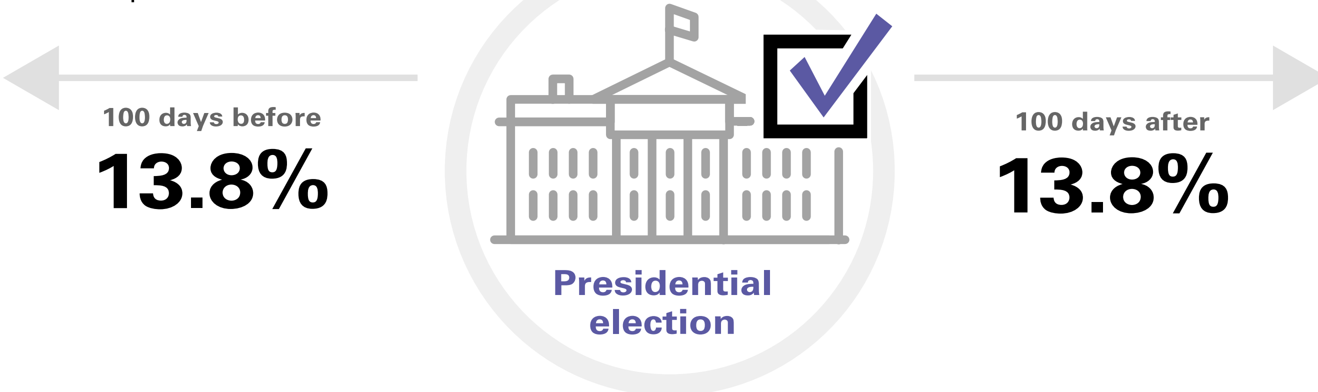
Similarly, Vanguard’s analysis of monthly returns in election years failed to detect any performance pattern. Several different months were as likely to be ranked 1st as 2nd, 5th, or 12th. The number of unique months in any performance rank in the last dozen presidential election years averaged 7.2. For comparison, a completely random data set averaged 7.8 unique months in each performance rank. In short, monthly returns during election years are very close to random.

Given the horse race nature of political campaigns, you may think that in the months closest to an election, there is a noticeable uptick in volatility. Think again. In actuality, the opposite has been true. From January 1, 1964, to December 31, 2019, the Standard & Poor's 500 Index's annualized volatility was 13.8% in the 100 days both before and after a presidential election, which was lower than the 15.7% annualized volatility for the full time period.

Volatility and the vote: Markets tend to ignore elections

S&P 500 Index annualized volatility

Full time period: **15.7%**



Source: Vanguard calculations of S&P 500 Index daily return volatility from January 1, 1964, through December 31, 2019, based on data from Thomson Reuters.
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Elections and the events surrounding them can breed an atmosphere of anxiety and uncertainty. The 2020 election cycle is no exception, since it comes with the additional burdens of global health and economic crises. At the same time, such uncertainty presents an opportunity to demonstrate your value by addressing clients' potential worries head-on and providing needed behavioral coaching.

Times like now—when clients' urges to flee the markets may be strongest (and potentially quite costly)—are when your guidance can have the greatest positive impact. By putting these principles of Vanguard Advisor's Alpha® into practice, you can deepen your relationships with clients and help them stay on course toward achieving their financial goals.

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