Does Wall Street Care About the Election?

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At the height of the Cold War in 1968, the British singer Lulu scored a minor U.S. hit with her cover of Canadian folksinger Bonnie Dobson’s “Morning Dew.” Its bleak vision of a post-nuclear world was staged as a dialogue between the last two humans on Earth:

\[
\text{Take me for a walk in the morning dew, my honey}
\]

\[
\text{You can’t go walking in the morning dew today}
\]

\[
\text{But I know I hear my baby crying, “Mama!”}
\]

\[
\text{You’ll never hear your baby cry again}
\]

\[
\text{Oh, where have all the people gone?}
\]

\[
\text{Don’t you worry about the people any more}
\]

\[
\text{You can’t go walking in the morning dew today.}\]

I’m reminded of that song whenever I tune into social media lately. Half of America seems convinced that apocalypse will be upon us if President Trump is re-elected, and the other half seems equally convinced that the country is doomed if a Democrat wins (or if the President is impeached and removed from office). Apparently equanimity and perspective are in short supply among the American polity today.

It’s not for me to comment on the social or political implications of next November’s election, but I do think often about the interplay between politics and economics: How will American securities markets respond to various possible election outcomes? What are markets currently expecting? What will happen to the American economy? Is financial apocalypse indeed nigh?

With the S&P 500 index touching all-time highs and corporate bond prices reflecting little probability of defaults, the markets seem to be telling us that the American economy is on a strong footing and that Election Day 2020 won’t have any deleterious impact. In this respect, the markets and the humans who constitute them seem to be fundamentally at odds: Can you fear apocalypse on social media while ignoring it in your 401(k) plan?

One explanation for this apparent contradiction is that as voters we consider our overall well-being and that of the nation; but as investors we consider only our wallets. Wall Street does care who wins the Presidency and which party will control Congress, but only insofar as the winners would affect the fortunes of companies whose securities it trades. To assess the odds, markets rightly ignore national polls; Hillary Clinton or Al Gore can explain why. So far, the collective judgment seems to be that the economy will be fine regardless of who wins in November.

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1 These are excerpts from the original lyrics, as performed by Ms. Dobson in 1962. Tim Rose adapted them slightly (receiving a partial songwriting credit for his minimal effort), and it is his version that Lulu sang on her top 40 cover. More on this later.
Yet elections do have consequences, as President Obama famously said early in his first term. In the current political climate, however, the economic consequences of the current campaign may not be particularly severe. The reason is that the American system of checks and balances largely works; or, to put it another way, we aren’t engaged in a single national election so much as a dozen or so important state elections – a few state contests for the Presidency, and a few closely-fought Senate races.

It’s theoretically possible that President Trump will win re-election and the Republicans will sweep to reclaim the House of Representatives and claim a 60-vote supermajority in the Senate; it’s also theoretically possible that a Democratic standard-bearer will similarly lead a blue tidal wave. The probability of either outcome is vanishingly small, however, and markets reflect probabilities rather than possibilities.

Looking at the Senate races that are competitive, it’s almost certain that neither party will capture a filibuster-proof majority in the upper chamber. That may not matter with respect to confirming judicial appointments and overseeing regulatory agencies, but it does mean that the minority party will have some influence on any major legislative actions, such as changes to the tax law or a rewrite of the Affordable Care Act.

Markets are justifiably grateful that this minority protection exists: Split control of the federal government turns out to be a good thing for the economy and the markets, as it tends to prevent either party from enacting the excesses promoted by its most partisan activists. This is most evident in the debates playing out over the nation’s health care system and tax laws.

You may love or loathe the idea of Medicare for All, or any of the other proposals that several candidates are promoting – but it’s highly unlikely that a dramatic change would actually be enacted: Senate Republicans can dilute or quash Medicare for All, and the Democrats can prevent the outright repeal of Obamacare. Whoever is elected President, and whichever party controls either chamber of Congress, the result is most likely to be another muddled incremental change to the current system.

The health insurance companies don’t really face an existential threat; a prospective President Sanders or President Warren won’t be able to abolish private insurance. At the margin, though, a progressive Democrat could still use the regulatory process to expand care, reduce prices, and bite into insurers’ profit margins. It’s this calculus that underlies the stock market performance of health care stocks this year: They haven’t suffered catastrophic losses as might be expected if their continued existence were at stake, but they have still been among the worst performers.

The same is true for tax law. One reason that Medicare for All won’t be enacted is that Congress will not authorize the changes in tax law it would require – regardless of which party has the gavel in each chamber, the minority has some power. It’s likewise doubtful that the 2017 Tax Cuts and Jobs Act would be rolled back, or that any other meaningful change to the current regime could gather a filibuster-proof (and veto-proof) majority. Stock prices of companies that benefited most from the TCJA have not suffered this year, because investors know that the companies won’t suddenly be paying higher taxes in 2021.
There are, of course, economic issues over which Congress has little sway, and it is in those areas where the Presidential election can have the most significant consequences. The two most relevant to investors are the regulatory arena and foreign trade. On the former, the pendulum has swung for decades between deregulation and re-regulation with each change in party control of the White House; President Trump successfully reversed many of President Obama’s policies, just as Mr. Obama had reversed many of President George W. Bush’s deregulatory moves.

Capital moves faster than regulation or statute, and investors have already begun to think about how a Democratic administration might differ from the current regime. Some of the profit gains in the industrial economy over the past three years can be attributed to a looser regulatory regime, especially in manufacturing; perhaps in a Democratic regime some of these gains might be lost. Yet it would be incorrect to overstate this point, because some of the most aggressive deregulatory moves have been in the energy sector, where lower prices have had a much bigger contrary impact on profitability.

Still, it’s reasonable to assume that a Democratic regime would impose harsher regulatory scrutiny on oil and gas companies, automobile manufacturers, health care and pharmaceutical firms, and financial institutions. As Democratic hopes of winning the presidency have risen, health care and energy stocks have lagged far behind the rest of the U.S. stock market.

Some Democrats advocate using Justice Department antitrust enforcement powers to break up the “big tech” companies like Amazon.com, Facebook, and Alphabet (Google). Actually doing so would likely be monumentally difficult, and wouldn’t necessarily impair the aggregate value of these companies anyway. Even so, a victory by one of the “progressive” Democrats probably would push their stock prices down while the process plays itself out.

In the foreign trade arena, the traditional orthodoxies have been upended. Republicans have historically favored free trade and eschewed tariffs, while Democrats have been protectionist. Today, most of the Democrats seem to be embracing a more globalist approach, supporting lower tariffs to encourage world trade while at the same time pursuing more equitable rules to protect American intellectual property and promote the free flow of capital across borders.

Wall Street has consistently voted with its dollars, bidding up the prices of multinational companies whenever a trade deal looks more likely and punishing the same companies when snags arise. Whether President Trump’s tariff bludgeon ultimately brings about a trade deal with China remains to be seen; it’s likewise treacherous for investors to assume they can forecast how a Democratic administration would deal with China. With so much uncertainty on this topic, I suspect that most investors simply are ignoring the potential trade impacts of a change of residents at the White House.

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2 This is a theme I will continue addressing over the course of the coming year, as Election Day nears and people – not just investors, but voters, entrepreneurs, savers, and everyone else – think about how their individual situations may be affected by who wins or loses. Stay tuned.

Stepping back to review the bigger picture, the 2020 election may have historical importance and may affect millions of us profoundly – some for better, some for worse. But for financial markets and investors, the implications are likely to be far more limited. Neil Shearing, chief economist at Capital Economics, recently published a paper examining the impact of elections on markets and economies. He found that despite campaigning on far-left or far-right platforms, most politicians ultimately have adopted more centrist policies once elected – “sometimes because an adverse market reaction has triggered a policy rethink … or because coalition partners have forced leaders to drop some of the more radical aspects of their agenda.” Consequently, he found that “economic growth is shaped more by a complex set of issues around institutions and technology rather than by the relatively narrow one of tax and government spending. The feedback loops to the real economy are smaller than is often assumed.” I think he’s right.

Ultimately, elections still do have consequences, of course, and it’s quite likely that U.S. markets may react badly to some potential outcomes. Yet after sifting through the possible ramifications of probable election scenarios, I find myself returning to “Morning Dew” – not to the Bonnie Dobson or Lulu versions, but instead to the Grateful Dead’s cover with its added and more comforting coda. After an instrumental interlude that nearly approximates what a nuclear war might feel like, a sudden calm descends on the music, and Jerry Garcia plaintively sings,

\[ \text{Walk me out in the morning dew today} \\
\text{I’ll walk you out in the morning dew, my honey} \\
\text{I guess it doesn’t matter anyway.} \]

To say “it doesn’t matter” who wins the election is an overstatement, even in the limited sphere of our financial lives; but even so, we are blessed to live in a resilient and self-reliant economy. Regardless of who wins the Presidency or the Senate, the U.S. will likely remain healthy and growing. Although financial markets may react in response to political developments, in the fullness of time they will likewise prove resilient and rewarding for investors.

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5 While Dobson’s and Lulu’s versions are hauntingly beautiful, it was the Grateful Dead’s searing 1972 live version that first captured the lyric’s apocalyptic vision in its musical arrangement. Compare for yourself:

- Bonnie Dobson: [https://www.youtube.com/watch?v=aawu-kPl5p8&list=RDaawu-kPl5p8&start_radio=1](https://www.youtube.com/watch?v=aawu-kPl5p8&list=RDaawu-kPl5p8&start_radio=1)
- Lulu: [https://www.youtube.com/watch?v=bPcGUzPiFuw&list=RDbPcGUzPiFuw&start_radio=1](https://www.youtube.com/watch?v=bPcGUzPiFuw&list=RDbPcGUzPiFuw&start_radio=1)
- Grateful Dead: [https://www.youtube.com/watch?v=NDuZdf4hFQ](https://www.youtube.com/watch?v=NDuZdf4hFQ)