Investors need to invest with their heads, not their hearts

By: Edward J. Perkin, CFA | September 28, 2020

Boston - While COVID-19 continues to be the dominant driver of markets, investors have begun to focus more and more on the November 3 elections. Nate Silver — considered the guru of political forecast modeling, with an impressive track record —sees Biden as the favorite, at a 77% chance of winning based on his latest simulations.[1]

Biden may not be a foregone conclusion

Polling tends to tighten as Election Day approaches, especially with three debates still to come amid the uncertainty of the pandemic and the state of the US economy — and the potential for better news on both those fronts. I am inclined to believe that although Biden is the clear favorite, the consensus could be overconfident in his chances.

Sectors are more likely to feel election impacts than the broad markets

For those willing to lean in, industry groups generally presumed to be hurt by a Biden victory have reached levels that may offer attractive risk/reward opportunities. These include banks, managed care, defense and utilities.

Senate control deserves far more attention than the Presidential race

Under the scenario where consensus thinking turns out to be correct, and we get a so-called Blue Wave with Democrats sweeping the Presidency, Senate and House of Representatives, market participants and company managements are likely to take ***two actions*** in the final 58 days 2020. (If the election is close and counting mail-in ballots delays the final tally, that window of time would be even more compressed.)

1. I anticipate that investors may flip from their usual end-of-year tax *loss* harvesting to tax *gain* harvesting. That way, they could book gains under what we can presume to be a more favorable tax regime.
2. I expect corporate management teams to pay special dividends in December, pulling forward anticipated future dividend payments to the current regime. Under a different administration, dividends may be taxed at a higher rate, and payouts may also be limited by regulation —such as capping dividend payments at trailing twelve month earnings levels, which we have already seen with the banks.

Possibility of post-Election Day volatility is real

Not that long ago, investors complained about the lack of volatility and catalysts for market action. No more. In these strange times of global pandemic, recession, looming election and high-frequency traders playing with the Fed's easy liquidity, I suspect the roller coaster ride is likely to continue.

Bottom line: In my experience, successful investing is not about predicting the future with pinpoint accuracy. Rather, I believe we should aim to contemplate a range of scenarios and their likelihood, then compare those probabilities to market prices to infer what is priced in. The intensity of political polarization means that many have strong emotional stakes in the election outcome, but markets may have a different interpretation of the results. So I think we should try to avoid letting our political preferences overwhelm prudent investing decisions.

[1] FiveThirtyEight, "Biden is favored to win the election" as of September 25, 2020. https://projects.fivethirtyeight.com/2020-election-forecast/

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Edward J. Perkin, CFA
Chief Investment Officer
Equity
Eaton Vance Management

"Consensus calls for a Biden win and a Blue Wave in Congress, but what if that confidence is misplaced?"

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