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# Election-Year Politics and Stock Market Forecasts

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Over the past several weeks, many commentators have opined on how the stock market would react to Donald Trump winning the general election and becoming president of the United States. The latest notable prediction came from Dallas Mavericks owner and TV personality Mark Cuban, who said that "there is a really good chance we could see a huge, huge correction" in the event of a Trump victory in November. But before investors make changes to their portfolio as a result of these predictions, they should consider the following three points:

1. Markets have already priced in the possibility of a Trump presidency.
2. Two-step forecasting is difficult.
3. Your political beliefs can lead to investing mistakes.

*Markets Have Already Priced in the Possibility of a Trump Presidency*

Right now, if you look at the odds on betting markets, the consensus estimate is that Trump has about a 30 percent chance of winning the general election (Clinton's prospects are around 65 percent with the remaining 5 percent allocated to various candidates and non-candidates). What will wind up moving markets is if conditions change such that the odds of Trump becoming president significantly increase or decrease.

You may or may not remember that the market declined significantly the day after President Obama won re-election in 2012, even though bettors gave Obama a 67 percent chance of victory the day before the election. One way to interpret this is that the market had already priced in a 67 percent chance that Obama would win the race, and then after he won the market declined because that probability moved from 67 percent to 100 percent.

*Two-Step Forecasting Is Difficult*

Two-step forecasting is when someone says, "I forecast X, and as a result Y will happen." Let's say you're 60 percent sure Trump is going to win (which is much higher than the consensus estimate). Let's also assume that you are 60 percent sure that a Trump victory means stocks will decline in value. Then assume that if you're wrong and Clinton wins (a 40 percent chance) there's another 30 percent possibility that stocks will decline for other reasons.

Keep in mind that going back to 1926, the S&P 500 has had negative returns in 27 percent of calendar years, so these assumptions are essentially saying that a Trump presidency is more than twice as likely to cause a stock market decline as has happened historically, while a Clinton presidency means that the chances are roughly the same as history.

Using the above assumptions, the math works out on this so that there is a 36 percent probability (60% x 60%) that you're right about Trump winning and then also right about the market declining as a result, plus another 12 percent probability (40% x 30%) that you're wrong about Trump winning but accidentally right about the market decline anyway. This totals out to a 48 percent chance of getting your two-step forecast correct, or essentially a coin-flip.

Of course, so far I haven't even mentioned how difficult it is to get the *first* prediction correct, much less getting both predictions right. Philip Tetlock, who teaches psychology, business and political science at the University of California, Berkeley is the author of "Expert Political Judgment: How Good Is It? How Can We Know?" The book, which was published in 2006, discusses the findings of his 20-year study, the first scientific study on the ability of experts from various fields to predict the future. Tetlock found that so-called experts who make predictions their business are no better than random luck. Mark Cuban should have learned this lesson, as back in December he appears to have incorrectly predicted that Trump wouldn't win the Republican nomination.

*Your Political Views Can Lead to Investing Mistakes*

There's actually evidence that election results have the power to affect how investors handle their portfolios. The 2010 study "Political Climate, Optimism, and Investment Decisions" examined the link between investors' political affiliations and their investment choices. Simply put, when your political party is in power, you feel much more confident about the economy and the markets, and vice versa. For more information on this, I'd suggest this article by BAM ALLIANCE Director of Research Larry Swedroe.

Being aware of your biases can help you make better investment decisions. Trying to time the market due to concerns about the upcoming election is not likely to be a winning strategy. The reason is that you have to be right not once, but twice. In order for market timing to work, you need to know when to get out and when to get back in. Suppose you get out now. Do you get back in if Clinton wins? Or, if Trump wins, do you stay out of the market for four full years waiting for the 2020 election? The bottom line is that you shouldn't let the latest economic or political news cause you to abandon your well-developed plan.

## About Kevin Grogan, Director of Investment Strategy, The BAM ALLIANCE

Kevin Grogan is director of investment Strategy for the BAM ALLIANCE.

In addition to his advising duties, Kevin conducts investment research and writes articles on a wide range of topics, including retirement planning and investment policy. Kevin co-authored The Only Guide You'll Ever Need for the Right Financial Plan with Larry Swedroe and Tiya Lim. This step-by-step handbook focuses on the art of investing by providing investors with information they can use to build a tailor-made investment strategy. He also co-authored the article "The Maturity of Fixed-Income Assets and Portfolio Risk" with Larry Swedroe, which appeared in the Winter 2009 issue of The Journal of Investing. Kevin holds an MBA from Saint Louis University and a bachelor's of science in finance from Missouri State University in Springfield.