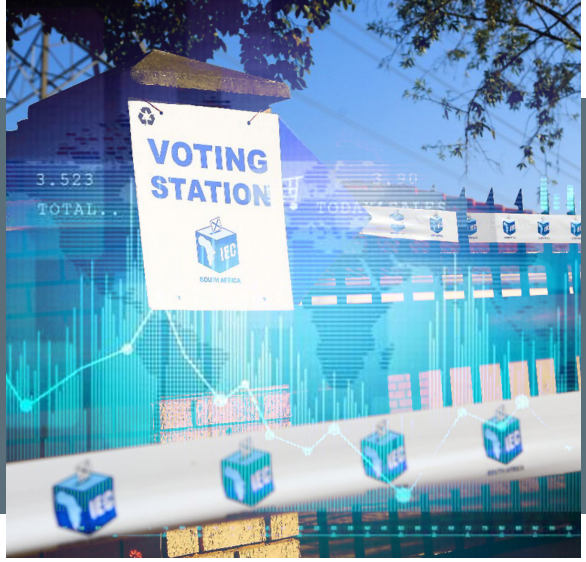
Elections and their effects on the markets

Umthombo's exploration on the topic



UMTHOMBO WEALTH

This year is set to be a landmark for democracy, with more than 50 countries globally, including the European Union, heading to the polls. More voters than ever before will participate, with around 46% of the global population eligible to cast a ballot.

Of high significance are this year's US election (regardless of any seemingly inspiring outcomes) and, of course, our own local general election scheduled for the end of May. The 2024 elections are thought to be a landmark event, as it seems for the first time since 1994 the ANC may lose its outright majority, ushering in a new era of coalitions. Given these facts, it seems as good a time as any to explore the relationship between elections and market returns.

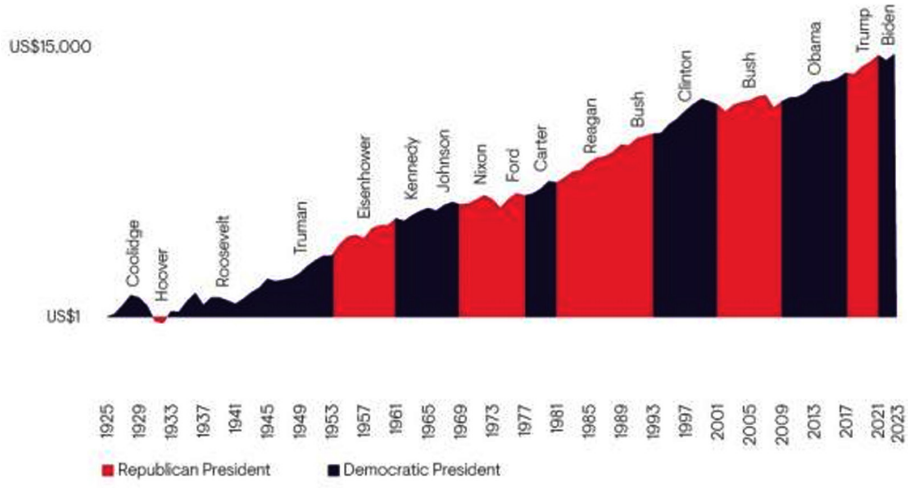
What can be expected in America?

Naturally, given the size of the American markets and established academic tradition, there are numerous studies on the matter. However, inherent to academia, these studies often yield conflicting results.

We find the following narrative most compelling: historical data suggests minimal medium- to long-term impact on financial markets based on election outcomes. Investors tend to focus on party platforms for potential market implications, rather than just the winner of the election. Interestingly, divided government scenarios historically show positive market returns, regardless of which party controls which branch.

This is interesting because it goes against the idea that political gridlock would harm the economy. The positive returns in divided government scenarios could be explained by American investors' desire for stability. The idea is that divided government prevents any one party from making drastic changes. This is encapsulated in the US investors' mantra "never change anything ever" . A stark contrast to local investors.

Figure 1: Growth of a dollar invested in the S&P 500, January 1926 – December 2023



Source: Daily Maverick , Ninety One

This doesn't mean that there aren't short-term reactions. The U.S. markets reacted distinctly to the election days of Biden, Trump, and Obama. After Joe Biden's 2020 election, markets surged with the Dow Jones up 2.4%, S&P 500 up 3%, and Nasdaq up 4.1%, driven by the decreased likelihood of a 'blue wave' and subsequent regulatory and tax changes. When Donald Trump was elected in 2016, initial volatility gave way to gains, with the Dow closing up 1.4%, reflecting optimism about his pro-business policies. Conversely, Barack Obama's 2008 election saw the Dow drop 5.1%, largely due to the prevailing financial crisis rather than his victory.

India is another major country in the process of an election. India's stock market had an impressive performance in 2023, with key indexes gaining around 20% thanks to strong domestic growth and foreign investment. The current PM of India, Narendra Modi, was quoted saying in a TV interview: "You will see that within one week after June 4, the day election results are to be declared, market participants will get tired." This was at a time when the NSE Nifty 50 (Indian stock market index) was less than 300 points away from touching a fresh record high. However, in spite of Modi's optimism, the elections triggered a period of heightened volatility in the Nifty.

So, out of interest, how do the Indian markets perform after an election? Findings by researchers Nguyen & Nguyen reveal that the impact on the market is not the same between any two elections, even when the same party comes to power for the second time. However, stocks have been found to become more volatile under the party that supports social equality and egalitarianism, especially when the market expects that party to win elections. Second, the expectations of inflation are low with a party who supports social or economic conservatism, which increases demand for stocks and stimulates higher trading volume. This also leads to higher stock price volatility and higher mean.

Much like India, South Africa's impending election has also impacted the markets, unfortunately not in a positive manner as echoed by the local bond markets. During the first three months of the year, longer-duration bonds had seen a sell-off (predominantly by foreigners), with bond prices only now seeing some reprieve. These yield curve actions can be explained by the negative sentiment relating to the outcome of the election, where the market seems to be pricing in the worst-case scenarios.

At Umthombo, we are circumspect about trusting pollsters and fear stirring narratives weaved by the media, even though we don't claim to know May's election outcomes nor do we attempt to make predictions. Nonetheless, we do believe that the market is being overly punitive on South African assets with it appearing that "worse case" election outcomes are priced in.

In South Africa's last 2019 general election, we witnessed the transfer of power from former President Jacob Zuma to the current President, Cyril Ramaphosa. This transition was expected to bring about much-needed reforms and efforts to combat corruption in the country. The phenomenon dubbed 'Ramaphoria' had a positive impact on the markets, with the rand strengthening in the short term and the stock market experiencing upward trends. Sectors closely tied to political and economic policies, such as banking, saw improvements after the election. However, five years later, South Africans are still waiting for comprehensive reforms. As the graph below illustrates, the show must go on, and so do the markets. Ultimately, the impact of elections on financial returns tends to be transient; what truly shapes the economic landscape are the policies implemented by elected officials.

Table 1: More often than not, election years have been good for SA markets

Election year	ALSI calendar year return	ALBI calendar year return
1966	20.7%	0.5%
1970	**-26.4%**	**-6.3%**
1974	14.8%	**-5.3%**
1977	31.1%	14.2%
1981	0.8%	2.2%
1984	9.4%	1.8%
1987	**-4.8%**	14.8%
1989	55.5%	21.8%
1994	22.7%	**-9.1%**
1999	70.8%	29.9%
2004	25.4%	15.3%
2009	32.1%	**-1.0%**
2014	10.9%	10.2%
2019	12.0%	10.3%

Source: Daily Maverick , Ninety One

So what's the point?

The point is that as investors, we must resist getting swept up in short-term frenzies and instead focus on the long-term prevailing narrative and market fundamentals. While it's easy to get caught up in the hopeful or fearful rhetoric that political changes bring, examining examples of both perceived negative and positive election outcomes reveals that economic and political forces persist regardless of the initial outlooks.

As we approach the upcoming election, we don't believe in the worst-case scenario where the ANC affiliates with an 'unholy' alliance. However, we also don't anticipate an election result that will trigger the much-needed restructuring South Africa require.