Regional view - United States

Keep your politics out of your portfolio

Justin Waring
Investment Strategist Americas

Brian Rose
Senior Economist Americas

Americans increasingly see the economy through "political shades." We tend to view the other party's ideas as much more dangerous and damaging, potentially dangerously skewing our investment behavior.

This year's State of the Union was a crystal clear demonstration of how significantly politics can impact our perspectives.

President Trump's speech focused heavily on the US economy, citing many statistics to demonstrate its health. He listed jobs created, record-low poverty and unemployment rates, and rising household net worth figures. Republicans gave a standing ovation to each new figure, and President Trump concluded that his "pro-growth economic policies" were responsible for building "the greatest economy that we've had in our history."

On the other side of the Capitol dome, Democrats sat and shook their heads. Following the speech, the Democrats' perspective was given a voice when Michigan Governor Gretchen Whitmer delivered the party's response. Governor Whitmer strongly disagreed with President Trump's upbeat assessment. She highlighted income inequality, downplayed the import of the stock market for working-class Americans' financial well-being, and argued that "the American economy needs to be a different kind of strong."

There are many ways to measure the economy's health, and there are strong arguments for each of these perspectives. Fact-checking any political speech clearly demonstrates how individual statistics can be true, while also being spun into a favorable context to enhance their political value.

This is nothing new. Incumbent politicians have a self-interest in focusing on the strengths of the economy; the opposition party is shrewd to highlight its shortcomings and argue for change. Those incentives are even stronger in an election year.

If this is where the contrasting perceptions ended, all of the above would be a wholly worthless observation. Politics as usual, nothing to see here.

Unfortunately, there is mounting evidence that this effect has spread much further than Capitol Hill.

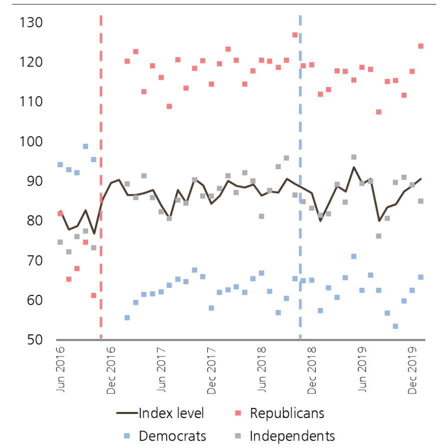
Political pessimism

Looking at Americans' views of the economy—in particular, their optimism or pessimism about the future—it's clear that we are letting political preferences skew our perception of reality.

For example, here is a chart of the University of Michigan Index of Consumer Expectations. In addition to providing a high-level view of how Americans feel about the outlook for the economy and their personal finances over the next 12 months, the survey also breaks down the information by the respondents' political affiliation.

Two Americas

University of Michigan Consumer Expectations Index, with indications for the 2016 and 2018 elections



Source: Bloomberg, UBS, as of 3 January 2020. Responses to "A year from now, do you expect that in the country ... will be better or worse than they are at present, or just about the same?"

This picture is truly worth 1,000 words.

Looking before the 2016 election, you can see that Republicans had very little faith in the economic expansion. By contrast, Democrats had a far higher opinion of the economic outlook. Just a few months later, after President Trump took office, the relationship reversed entirely. Democrats' index of expectations tumbled from 95 to 55 (–40), while Republicans' index skyrocketed from 61 to 120 (+61).

Today, the perception gap is near record levels, just like the partisan divide.

The cost of the partisan divide

We've established that Americans are increasingly viewing the economy and markets through "political shades," allowing their political disappointment to dim their view of the economy when their political party is out of favor.

So what? How much is this partisan divide really costing us?

A just-released Gallup poll might tell us the answer. In the annual Mood of the Nation survey, 59% of Americans said that they are better off financially than a year ago, and 74% expected to be better off next year.

These overall averages are both record, or near-record, readings—but the underlying data show a huge disparity by political ideology: 32% of Democrats reported feeling worse off than a year ago, and 23% expect to be worse off next year, versus 9% and 6%, respectively, for Republicans.

Another part of the survey showed that only 56% of Democrats feel "very satisfied" with their life, versus 80% for Republicans. The data are also broken down by income level, which allows us to see that this satisfaction gap mirrors the difference between making less than USD 40,000 a year (54% are very satisfied) and more than USD 100,000 a year (76% satisfied).

In other words, it seems that having your party in the White House is worth more than **USD 60,000** a year of income-equivalent happiness.

Implications for investors

As we said before, it's natural for politicians to emphasize these clashing narratives to earn your vote. However, taking these narratives to heart can be very costly to your investment portfolio—especially in an election year.

To see how costly, we can look at the last two elections that resulted in a change in control of the White House.

As we showed earlier, Democrats became more pessimistic and Republicans more optimistic after the 2016 election. A subsequent study of investors showed that they chose to express this in their portfolios, with Republicans adding more to their equities than Democrats following President Trump's surprise victory.

We don't have data on how that affected performance in the years since then, but global stocks rallied about 26% in the year following Election Day 2016, so it may have cost Democrats some foregone gains.

A similar trend happened following the 2008 election. Republican hedge fund managers were found to have underperformed their Democratic peers by a significant margin—7.5%—during the first 10 months of the Obama administration.

Political loss aversion

These examples are consistent with the political theory of "negative partisanship," which describes US politics as increasingly partisan (no surprise), but also observes that Americans tend to feel more negatively about the other party than they feel positive about their own.

This seems similar to the behavioral bias known as "loss aversion," where investors feel about twice as much pain from losses as they feel pleasure from gains. Instead of investment gains and losses, we tend to view the other political party's ideas as much more dangerous and damaging, and so tend to overreact, especially in response to political disappointment.

In a politically charged election year, this tendency may threaten to override our objective assessment of risk and reward, potentially dangerously skewing our investment behavior.

Don't invest too much in politics

Political drama can be entertaining, but investing is a very expensive form of entertainment. If you can find a way to think like an independent—keeping political exuberance and disappointment from coloring your view of the world—you might be able to buy yourself thousands of dollars of happiness.

When you hear political rhetoric that really grinds your gears or makes you worried about the future of the country, it's important to remember that geopolitical events—even those that have changed the world—are rarely as impactful on markets or the economy as we think they will be. If you don't believe us, check out our "Political flux" simulator to test your intuition of markets' reaction to some of history's most monumental turning points.

In addition, the US political system has many flaws, but a tendency to change quickly overnight is **not** one of them. The 2020 election will not be inconsequential, but there are far more policies being proposed than will ever become law, and gridlock will slow the pace of change, especially in this hugely partisan environment.

To separate political rhetoric from governing reality, and put policies into the context of your portfolio, make sure to follow our *ElectionWatch* 2020 series at ubs.com/electionwatch, and speak with your financial advisor about how you can position yourself to reduce the impact of politics and policies on your financial goals. In the end, your personal happiness and your financial well-being might be more at risk from paying too much attention to the election, rather than from specific policies.

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