Politics and the Market

The most asked question among investors when it comes to election is, "How much will the outcome affect my portfolio?"

In a few short weeks voters will cast their ballots for the 44th President and the 111th Congress. You too might be wondering what a Barack Obama or John McCain presidency would mean for financial markets.

- How would different administrations respond to the economic landscape?
- How would potential tax changes impact investors' portfolios?
- Would there be different investment options and opportunities under different administrations?

It is important to remember that any campaign promises cannot be kept without Congressional support. Therefore, Congressional elections play as large a role as Presidential elections in determining how markets react.

Let us take a look at the Senate. Currently there are 49 Democrats, 2 Independents (who caucus with Democrats) and 49 Republicans. Most political pundits expect the Democrats to increase their margins in the Senate. If this happens, the Democrat Obama will likely have an easier time getting his legislation passed than Republican McCain. Nevertheless, unless the Democrats pick up enough seats (60) then Senate Republicans will continue to exert influence.

In the House, Democrats hold a 55% to 45% advantage. Again, if pundits are correct, Democrats will pick up additional seats, but Republicans will still impact legislation.

Elections are just part of the long list of variables that affect financial markets. Historically, markets are driven by the economy, tax policies and trade issues much more than by Presidential elections.

Someone once said, "It's the economy, stupid!" In this election, the economy remains a hot issue. Economic growth is slowing, inflation is increasing, unemployment is rising and consumer confidence is falling. Although McCain and Obama have different prescriptions to cure our economic ills, no matter who is elected, the US economy will take time to get better.

Promises made in an election year do not always equate to promises kept. Simply put, there is not enough money to enact every campaign promise. Both candidates offer ambitious health care platforms and both would require significant tax incentives and/or spending increases. Federal budget realities will force the new administration to scale back some of its plans thus reducing the impact on "the market".

One economic issue that likely will impact the market concerns housing. The new president will work with Congress on tax incentives and business stimulus packages that go beyond rebate checks.

Fannie and Freddie: Less than six months ago, the federal government got involved to prevent the collapse of Bear Stearns, the fifth largest investment bank in America. Last week, the government seized control of the country's two largest mortgage facilitators. What's next?

As this drama continues to unfold, it is important to realize that most of the losses taken by financial firms (brokerages, banks, hedge funds) are NOT the result of a recession, subprime crisis, or other serious economic downturn. Instead, they are the result of truly dumb lending standards and an excessive use of leverage encouraged by a Federal reserve policy of extremely low interest rates. And greed.

Backstopping Fannie Mae and Freddie Mac with public funds (translation: taxpayer money) temporarily mitigates a great uncertainty hanging over the mortgage market. It will be interesting to see how the candidates in this election (Presidential and Congressional) address this challenge.

The economic issue of primary concern to most investors remains taxes. Conventional wisdom suggests that Republicans lower taxes and Democrats raise them. Reality remains more complicated. Because the U.S. economy is still in a period of economic weakness, politicians are not likely to dramatically raise taxes.

The proposed tax policies of the two candidates are quite different and are likely to have distinct implications for different people. Nevertheless, it is safe to assume that the tax landscape will look different in the next 24 months.

What should you do? Stay informed and review your financial plan. It is premature to make fundamental changes to your portfolio based on guesswork. History has shown that election years influence news coverage and water cooler conversations more than they do the economy.

A solid financial plan is non-partisan. Your best course of action to make a difference remains the same. Vote.

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