How to Prepare Your Finances for an Election Year

Election years create a certain level of uncertainty regarding your finances and investments. During continued market volatility, an imminent election can make investors tense. But don’t get too caught up in everything you read and hear without doing your own research. When it comes to elections and investing, surprisingly, there isn’t much of correlation. All followers of political parties believe their party plays a crucial role in the nation's economic health. But is that really accurate? Is panicking unfounded and potentially financially damaging to an investor's financial goals? Here are a few things to keep in mind to help you preserve your financial interests as an election approaches.

Fluctuation in the Market is Normal

Historically elections have had less of an impact on markets than voters might expect. According to Fidelity, since 1950, during election years, US stocks have returned on average 9.1%, and despite popular myths that suggest one party is better than the other for market returns, historical data busts these myths. Historically the S&P 500 has had positive returns under nearly all partisan combinations.

If you invest long enough, you will experience fluctuations in the stock market. This is normal and should be expected. Over the past 127 years, the market has experienced four bear and five bull markets. Over time, the stock market sees significant stretches of high returns (bull) and periods of low returns (bear). These cycles are known as secular trends. For people with diverse investment portfolios, the fluctuations in the equity markets have the potential to balance out, especially over long periods of time.

Rising Interest Rates During Election Time

Generally, elections are poor at predicting any pattern when it comes to the movement of the interest rate. Reuters has shown that policy rates held steady for six to 12 months before the 2000, 2012, 2016, and 2020 presidential elections, then, they were cut heavily in 2000 and raised significantly after the 2016 vote.

As of 2024, the Fed has held interest rates steady going back to mid-summer 2023, the highest in over 20 years. Prospective homebuyers have been waiting for a more optimistic market, but they may continue waiting. However, it isn’t all that concerning if you are a value investor.

An environment with higher interest rates can be a strain on the economy. This, in turn, tends to inhibit business activity. Incidentally, corporations see lower revenue streams and lower earnings, which could potentially cause the stock price to drop. For value investors, though, this actually is a positive. It allows them to buy cheap for the purpose of holding. Bull and bear markets will then come and go over the decades that follow, but may not particularly impact the value investor on a day-to-day basis.

Don’t Get too Excited by Media and Bias

As elections near, chatter on the media and heavily slanted economic and policy issue stories are regularly popping up in your social media feeds; it is front page news, and ever-present on the television broadcasts. According to U.S. Bank, there are situations where elections could influence the market in the short term. However, market returns are typically more impacted by economic and inflation trends rather than election results.

Popular belief is often debated that one party or another will be the reason the market will improve or struggle, though historically, there has not been a particularly significant relationship regarding control of government seats by any one party and the performance of the market. This information is critical, mainly if you are prone to panic selling. Research finds that panic selling occurs at a higher rate for men over age 45 or who are married with children. This strategy has proven to be impractical as panic selling may cause a loss to their investments.

You Can't Predict the Market

Many blogs, analysts, and talking heads on TV speak as if they have some inside scoop on how the market will behave at any given time. As we have learned, this is a tactic to get ratings, and it is, in fact, impossible to predict how the market will fluctuate. It is also impossible to see the future of what might cause the market to go haywire, for example, a pandemic like COVID-19, the attack on the World Trade Center, or some other event. Keeping this in mind and instead managing your money based on your own risk tolerance and research may help you move through the natural market ups and downs regardless of what it is "predicted" to do.

Adopting a Value-Investing Stance

Because it is impossible to predict how the market will move, even during an election, taking a more risk-averse approach like value-investing instead of trading could be more beneficial in the long term. In a report published by MoneyShow, as many as 90% of traders are estimated to lose money in the markets. Elections are another event that has the potential to make the market jump and sink, though historically, according to Investopedia.com, since 1957, the stock market has generated annualized average returns of around 10.20%.

Consulting a Financial Professional

For many Americans, an election might be a reason for them to make rash financial decisions as people get extremely excited about politics and harbor strong opinions. These financial decisions very well could impact their short- and long-term goals without them realizing to what extent. They are making these decisions emotionally and may not be as pragmatic in their thinking and reasoning based on research and risk tolerance. Consider consulting a financial professional to determine the course of action you may want to take if you think the election may affect the market. A third party working with you can view your financial situation and can motivate you to want to make more cautious and risk averse decisions without the emotional factor clouding your judgement.

Sources:
Panic sellers during stock market dips are often married men with kids (cnbc.com)
Dow Jones Historical Trends | Guggenheim Investments
S&P 500 Average Return and Historical Performance (investopedia.com)
5 reasons why most people lose money in the stock market? (linkedin.com)