Market Volatility that Accompanies a Contentious Election

August 2020

DeMarche

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The first quarter of 2020 was a roller coaster ride, in which we saw both an all-time high in the U.S. market as well as the second largest one-day decline in the Dow Jones Industrial Average on record. The DJIA fell 12.9%, the largest decline since Black Monday on October 19, 1987 when it fell 22.6%. We also saw the DJIA's fourth largest daily gain of 11.4% on March 24, as lawmakers were finalizing a deal to deploy a historic stimulus package to ease the economic fallout from the coronavirus pandemic. Since the March 23 bottom large cap stocks (as represented by the DJIA and the S&P 500) have calmed down in terms of volatility. The same is true for developed markets abroad as March 23 was also the bottom for MSCI EAFE Index.

This paper will focus on market volatility that tends to occur near contentious presidential elections. Based on the apparent polarity among U.S. voters, we feel the upcoming election will be both contentious and slow-moving, given the health and logistics issues voters face due to Covid-19. We will compare today's environment with another contentious timeframe that many younger investors may not remember with clarity: The "Hanging Chad" election of 2000. In the 2000 U.S. Presidential election (Bush vs. Gore), Votomatic-style punched card ballots were used in many parts of Florida. Chad is the part of the ballot that is punched out. These type of ballots often punched holes incompletely, which resulted in partially punched chads: either a "hanging chad," where one or more corners were still attached, or a "fat chad" or "pregnant chad," where all corners were still attached, but an indentation appears to have been made. These votes were not counted by the tabulating machines.[1] The aftermath of the controversy caused the development of new technology for ballots in the United States.

The 2000 election, due to the voter count controversy, resulted in great volatility in the U.S. stock market from Election Day, November 8, through December 12 when the U.S. Supreme Court overturned the Florida Supreme Court, ruling 5-4 that there may be no further counting of Florida's disputed presidential votes. On December 13, Al Gore conceded, and George W. Bush became president-elect.

While there have been many landslide elections over the years, there have also been many elections in US history similar to the 2000 election, where a decision was made with very small margins. Prior to 2000, the most notable was in 1960 when Kennedy defeated Nixon by 84 Electoral votes, and only 0.2 percent of the popular vote. It's regarded as one of the most famous elections in our history. The 1960 election gave John F. Kennedy an early lead as polls in the earlier time zones closed, but as the west began to close, Richard Nixon gained.

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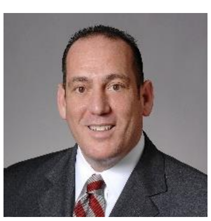

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Nixon did not concede the election until the following afternoon. Kennedy carried 11 states by three percentage points or less, and Nixon carried 5 states by the same margin.[2]

Will we see an election similar to 1876, where Rutherford Hayes beat Samuel Tilden by 1 Electoral vote? The 1876 election was one of the most disputed in American history. Will 2020 be its rival in the history books?

24 Days of Uncertainty

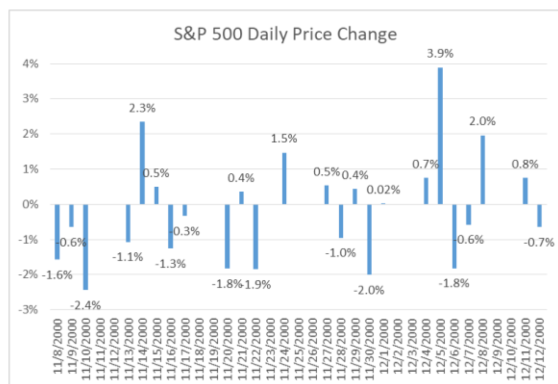
We will start by focusing on the 24 trading days during the 2000 election and highlight the headlines and events coinciding with various days where returns or volatility were excessive.

First, as a backdrop, a historical account of the year 2000 may be helpful. The year's most memorable event was the "Dot-Com" or "Tech Bubble." Between 1995 and its peak in March 2000, the NASDAQ stock market index rose 400%, only to fall 78% from its peak by October 2002, giving up all its gains during the bubble.[3] The bubble burst on March 11, following the NASDAQ Composite index's peak of 5,048.62 the day before. Also noteworthy are the monumental regulatory changes introduced that year with the entrance of Regulation FD (Fair Disclosure). The new regulation prohibited a company from intentionally disclosing information to select persons, such as securities firms and institutional investors, without disclosing that information to the public at large. The brokerage market was disrupted as online trading began to emerge with larger numbers of retail investors executing trades with discount brokerages from personal computers. Online trading also gave rise to day trading. How many of you remember "trading in eighths?" 2000 was the year that the New York Stock Exchange moved to the use of decimal price increments, rather than fractions, which narrowed spreads and lowered trading costs for small investors. Finally NASDAQ became a private company, independent of the NASD.

So, 2000 was quite a year already, regardless of the "hanging chad" controversy. But the uncertainty over these 24 trading days brought on remarkable volatility in equity prices and trading volume.

Price Change Volatility

Daily price change volatility over this 24-trading day period (11/8/00 through 12/12/00) was even higher than the two months (42 trading days) after the March 11 crash, in terms of days with greater than 100 basis point price change; during these 24 days, 47.6% of the time vs. 45.2% for post-crash period. More notable is that over the prior 10 years, going back to 1/2/91, days where price change was more than 1% was only 20.7%; days where price change was more than 2% was only 4.3% of the time. For the 24 trading days referenced, that number is 14.3%.[4]



And then there's the VIX

Created by the Chicago Board Options Exchange (CBOE), the Volatility Index, or VIX, is a real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of S&P 500 index options, it provides a measure of market risk and investors' sentiments. It is also known by other names like the "Fear Gauge" or "Fear Index." Investors, research analysts and portfolio managers view VIX values as a way to measure market risk, fear and stress before they make investment decisions.[6] It is worth noting that while this is a measure of forward-looking perceived risk, we also found a relatively strong correlation between VIX and standard deviation of the absolute value of daily price change over the past 90 days (63 trading days). In other words, today's perception of risk is somewhat built on the risk perception developed over the past three months. Since 1/2/91, we found a positive slope relationship of these two variables, with a correlation coefficient of 0.83.

During the 24-trading day period referenced, the correlation was 0.66, which means the aforementioned relationship was not as strong.

When using VIX as an indicator of fear during this time of uncertainty, we note that 91.7% (23 out of 25) of the days experienced a VIX intraday-high greater than 25. As a point of reference, from 1/2/91 to 11/8/00, the number of VIX>25 days was 15.5%. On 11/30/00, the day after Gore appealed to the Florida Supreme Court, the VIX was at its highest during this period, at 31.1.

December 2000

So November came to an end with Al Gore's appeal, and the S&P 500 riding a choppy decline from 1,409 to 1,315 (a 6.7% drop), and still no decision. And now for the rest of the story— Here are some key dates[2] that led up to the December 12 final Supreme Court decision:

On December 1, U.S. Supreme Court hears arguments on Bush's appeal, which argues that the Florida Supreme Court improperly extended the Nov. 14th deadline for certification. Local Democrats file suit accusing Martin County canvassing board of mishandling absentee ballot applications. This was the least volatile day of the period. S&P 500 was flat. On Sunday, December 3, Dick Cheney, in televised interviews, urges Gore to concede. Gore says he has given little thought to concession. On Monday December 4, U.S. Supreme Court orders Florida Supreme Court to clarify its ruling on the extended certification date. Florida Circuit Judge N. Sanders Sauls rejects Gore's plea for a Florida recount. The following day, the S&P jumps nearly 4%. On December 6, Gore appeals Sauls' ruling to Florida Supreme Court and on the 7th, The Florida Supreme Court hears arguments on Gore's contest. The following day, The Florida justices, on a 4-3 vote, order immediate manual recount of all ballots in the state where no vote for president was machine-recorded. This could take some time (approximately 45,000 ballots). On December 9, on Bush's appeal, the U.S. Supreme Court halts the manual count, pending a hearing, and on December 10, lawyers file briefs with the U.S. Supreme Court. The Bush team says the manual vote recount violated the U.S. Constitution's guarantee of equal protection, and the Gore team says the issue is the importance of counting every vote.

Finally, on December 11, the U.S. Supreme Court hears arguments, and on December 12, the Florida House of Representatives votes to appoint electors for Bush. The U.S. Supreme Court overturns the Florida Supreme Court, ruling 5-4 that there may be no further counting of Florida's disputed presidential votes. And so it came to an end. On December 13, Al Gore concedes and George W. Bush becomes president-elect. For the decade following, 2001-2010, while average volatility was not as high as during this 24-trading day period (10.3% of the time greater than a 2% daily move versus 14.3% over the referenced time frame), note that the decade's market volatility was significantly higher than that of the 1990s (only 4.3% of the time, the S&P 500 made daily moves of more than 2%). So, if increased volatility is a trend, then watch out as we move toward November 3, 2020!

The 2020 Election

The 2020 Election has started to look potentially contentious due to the increased need for mail-in voting as a result of safety concerns during the recent coronavirus pandemic. Only five states currently utilize mail as their main option for voting in a primary election. These five states include Washington, Oregon, Hawaii, Colorado and Utah. These states highly praise mail-in voting because of their increased voter turnout. An additional 29 states offer mail-in voting with what is called no excuses. Any registered voter can request to vote by mail with no excuse needed. The remaining 16 states allow mail-in voting but only with an acceptable excuse, which includes having a disability or proof of being out of the country during the election. Due to concerns with voters potentially spreading the coronavirus, five additional states including California, Nevada, New Jersey, Vermont and the District of Columbia, have pledged to mail ballots to all registered voters for the November election.[9] Many states are currently attempting to expand their ability to offer mail-in voting as the primary option during the upcoming election, including New York, Maryland and Georgia. Some lawmakers are arguing the case that mail-in voting should be an option for every registered voter due to the pandemic.

One of the main problems by allowing all states to utilize mail-in voting is their ability to successfully process the increased amount of mail within a short period of time. As a result, the Natural Disaster Emergency Ballot Act of 2020 has been introduced. This bill will allow all registered voters the ability to vote by absentee ballots on-line and the option to vote by mail. Unfortunately, time is running out and not all states have the funding to put the necessary equipment and people in place before the election in November. It has been estimated that an additional $2 billion would be needed to ensure all states have the adequate staff, high speed election scanners, specialized envelopes, postage and election drop boxes put in place in time for the election. Congress is currently reviewing options to increase funding for each state as needed, but many issues are slowing their ability to come to an agreement. Some states would require a change to their constitution to allow mail-in voting. Other states have requested the ability for absentee ballots. As long as the ballot is mailed by the Election Day, absentee ballots would allow for the ballots to be received as much as three days after the election because of potential postal delays.

This begs the question can the Postal Service handle an additional influx of mail? The Postal Service states they have the ability to deliver more than 470 million pieces of mail on average, including 181.9 million pieces of first-class mail.[9] The Postal Service's ability to deliver the potential increase of mail has yet to be tested. During the 2016 election, only 24% of the 140 million Americans that voted did so by using a mail-in ballot.[7] Compounding the problem is the breadth of difficulties the Postal Service is already facing with stressed finances from years of declining demand for first-class mail, to the recent massive increase of online retail and shipping, and numerous complaints from Americans across the nation about not receiving their mail. Even so, the Postal Service states they have a 92% on time delivery record for first-class mail within a two day window and a 81% record for three to five day performance.[8] On August 18, "Postmaster General Louis DeJoy said the U.S. Postal Service is suspending operational changes, such as removal of mail processing equipment and collection boxes, until after the November election, as the agency tries to reassure Americans that it can handle the anticipated surge in mail-in voting."[9] As a result of these difficulties within the Postal Service, many suggest that mail-in ballots will need to be mailed well in advance of their due date.

Another option that would side-step the Postal Service and still allow mail-in ballots is the use of secured election drop boxes. The concerns regarding the use of drop boxes include who would be allowed to collect the ballots, and can the drop boxes be secured enough to disable them from being stolen. States that have already utilized drop boxes have had success by appointing a bipartisan team to collect the ballots. Even so, the ballots still have to go through additional care to ensure that they have not been fraudulently received by authenticating each voter's signature.

Meanwhile, President Trump has not been a fan of mail-in voting and continues to tweet his concerns regarding the potential for mail fraud that could corrupt the election results. As President Trump tweets his concerns about the idea of using mail-in ballots during this election, the stock market has reacted rather indifferently. The S&P 500 Index actually increased 0.7% on July 27th after President Trump tweeted, "The 2020 Election will be totally rigged if Mail-In Voting is allowed to take place, & everyone knows it. So much time is taken talking about foreign influence, but the same people won't even discuss Mail-In election corruption. Look at Patterson, N.J. 20% of vote was corrupted!" As compared to the decline of 0.4% in the S&P 500 Index on July 30th after President Trump tweeted, "With Universal Mail-In Voting (not Absentee Voting, which is good), 2020 will be the most INACCURATE & FRAUDULENT Election in history. It will be a great embarrassment to the USA."[10] It appears the market has become immune to President Trumps barrage of tweets, at least when it comes to the election. Thankfully we don't have to worry about his tweets creating large market swings as it did in his earlier years.

Hopefully America won't experience another contentious and volatile 24 days after the election this November. Only time will tell if we can overcome the difficulties faced by the Postal Service and local election staff in accurately processing the huge influx of mail-in voter ballots. Let's hope the coronavirus cases drop off significantly so everyone is able to vote using the voting option that best suits their individual preferences.

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