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Volatility, the Vote and Taking the Long View

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MARKET MINUTE FROM BLACKROCK FUNDAMENTAL EQUITIES

Volatility, the vote and taking the long view

Oct 12, 2020 | Tony DeSpirito

Elections have historically brought heightened volatility, but little long-term impact on stock performance. More important than investing for an election outcome is investing for the long haul, says CIO of U.S. Fundamental Equities Tony DeSpirito.

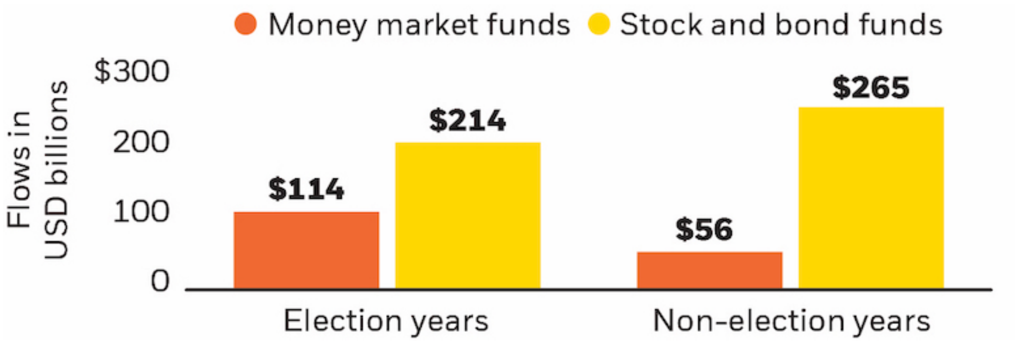
Elections are notoriously peppered with angst, anticipation and speculation. And **this one is seen as particularly consequential**. As investors, however, we believe elections also should be approached with humility — and a grain of salt.

As discussed in our **Q4 market outlook**, promises and proposals made on the campaign trail offer an indication of a candidate's intentions, but bureaucracy, compromise, lobbying and politics help shape the reality once in office. At the same time, markets don't always behave as conventionally expected. We saw that when defense and many so-called "sin stocks," deemed to be losing propositions under an Obama presidency, outpaced the S&P 500 Index from 2008 to 2016.

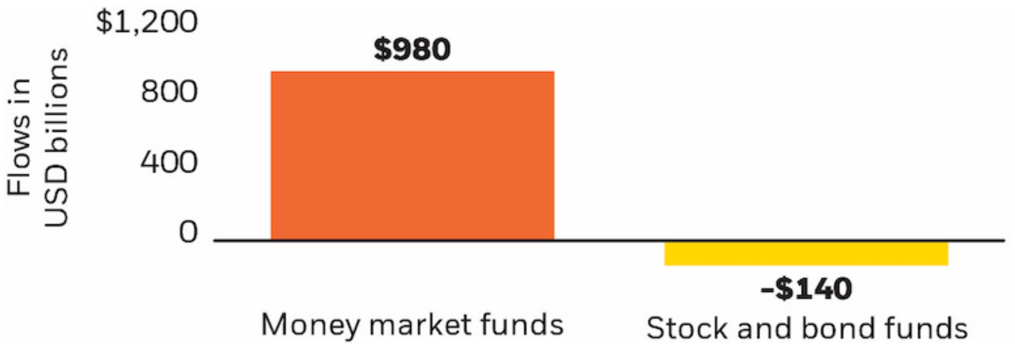
Investing for a particular outcome can be a fool's errand. We prefer to let bottom-up company fundamentals inform our investment decision-making. Ultimately, the stock market has advanced regardless of the party in the White House: A hypothetical $1,000 investment in U.S. equities in 1926 would have grown to nearly $9 million as of June 30, 2020, according to data from Morningstar.* The key takeaway: It's important to stay invested.

That said, the uncertainty of election years causes many investors to retreat to cash while waiting out the volatility. COVID-19 has exponentially increased uncertainty, and cash balances, in 2020. This is illustrated in the charts below.

Investors build up cash in election years
Election-year fund flows, 1993-2020



2020 cash hoarding has been extreme
Year-to-date fund flows, through June 30



Source: BlackRock, with data from Morningstar as of June 30, 2020. Money market funds, stock funds and bond funds are represented by their respective U.S. fund categories as defined by Morningstar.

We believe increased cash on the sidelines could make a return to stocks as election and coronavirus-related uncertainty abates – and particularly as stock valuations appear attractive versus bonds. With interest rates at historic lows, and poised to stay there for some time, equities are a relative bargain and can be a compelling option for growth, value and **income seekers**. This underscores our vote for equities.

Three potential outcomes

But what of the potential outcome of the Nov. 3 vote? We see three possibilities: a Biden win and Democrat majority in Congress (Dem sweep), a Biden win but split Congress, or a Trump victory with split Congress.

A Dem sweep raises the likelihood of corporate and individual tax increases, with Biden having signaled a hike in the corporate tax rate from 21% to 28%. This scenario could also mean greater investment in clean energy, a potential infrastructure spending bill, and higher chances for healthcare reform.

Under a Biden victory and split Congress, tax law changes or significant healthcare reform seem unlikely, but we'd still expect the Biden administration to focus on green initiatives and increased infrastructure spending. A Trump victory with a divided Congress would imply a continuation of the status quo.

Americans may not wake to a clear election result on Nov. 4. For one, mail-in voting is expected to be widely used nationwide, and it will take time for all ballots to be counted.

This suggests to us that market volatility may extend well beyond Election Day. We believe it is times like these, when the broad indexes may be up and down, that **active investing** can provide the detailed analysis and discernment to help navigate nervous markets.

Tony DeSpirito
BlackRock Fundamental Active Equity Investment Team

Antonio (Tony) DeSpirito, Managing Director, is Chief Investment Officer of U.S. Fundamental Active Equity. He is also lead portfolio manager of the BlackRock Equity ...

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*U.S. equities represented by the S&P 500 Index from 1/1/70 to 6/30/20 and IA SBBI U.S. large cap stocks index from 1/1/26 to 1/1/70. **Past performance does not guarantee or indicate future results. Indexes are unmanaged and it is not possible to invest directly in an index.**

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