LPL RESEARCH
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ARE THE POLLS WRONG AGAIN?

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The race for the White House is down to the homestretch, and although presidential candidate Joe Biden is comfortably ahead in the election polls, various market and economic-based indicators suggest the election may be much closer than many are expecting.

SUPPORT FOR A BIDEN VICTORY

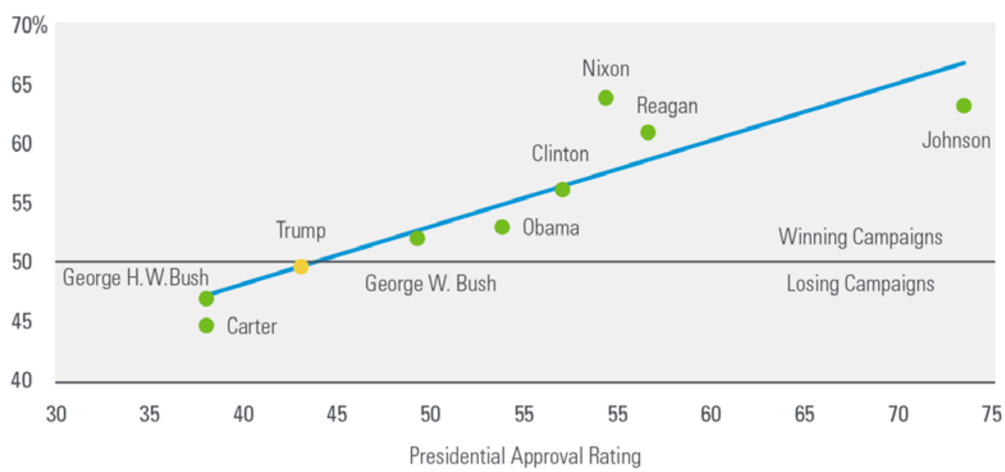
Various polls show former Vice President Joe Biden comfortably in the lead in the 2020 presidential race, although in some battleground states the race appears to be quickly tightening. Influential states like Ohio and Pennsylvania may even be a coin toss at this point.

Not surprisingly, approval ratings can play a large part in forecasting the overall percentage of the votes in an election. Only two presidents have lost reelections since the Great Depression: George H. W. Bush and Jimmy Carter. Not surprisingly, both had low approval ratings leading up to the elections. If the people don't approve of the job you're doing, you may not serve a second term.

Recent Gallup polls suggest that President Donald Trump's approval rating is 43%. Using a regression of previous elections, this equates to less than half of the two-party vote [Figure 1]. Of course, Trump received less than half of the popular vote in 2016, but he still won the election because he had more than 270 votes in the Electoral College. Still, the polls currently favor Biden, and this appears to be his race to lose.

1 APPROVAL RATINGS MATTER FOR REELECTED PRESIDENTS

Presidential Approval Ratings and a President's Reelection Share of the Two-Party Vote Are Highly Correlated



Source: LPL Research, Strategas, Gallup 10/22/20

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How well specific "Biden stocks" have done could be another clue that a Biden victory may be around the corner. Our friends at Strategas Research Partners created a basket of stocks likely to benefit from either a Trump or Biden presidency, and the Biden portfolio has done extremely well lately. Areas like green energy and solar have experienced huge moves before this election, while defense companies and financials—considered friendly to Trump—have not performed as well.

Also, recessions have been reelection killers. Since the Great Depression, there have been four recessions within two years of an election, and the incumbent party lost every single time. The 1924 election with President Calvin Coolidge was the last time the incumbent party candidate won when there had been a recession ahead of the election.

CLUES IT MAY BE CLOSER THAN THE POLLS SUGGEST

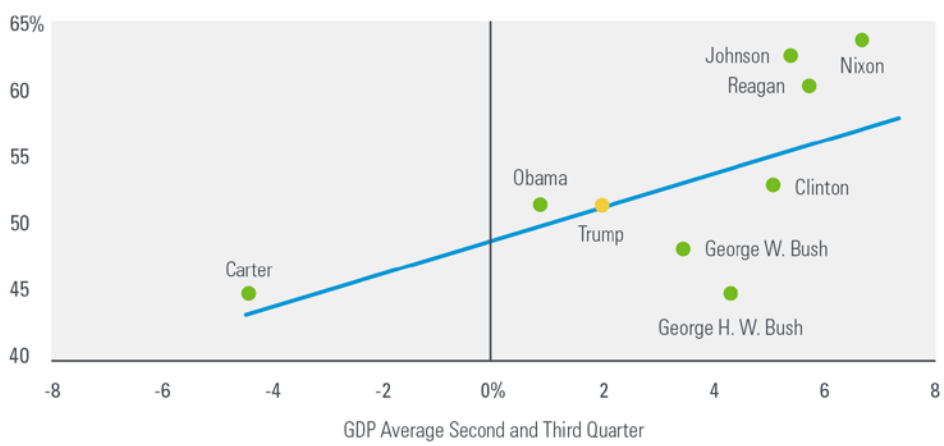
The majority of Washington insiders we track think Biden has at least a 60% chance of winning this election, with many thinking the odds are much higher. However, there's a good chance things could be much closer, and here's why.

- **Gross domestic product (GDP) is set for a huge surge in the third quarter**, with the Atlanta Federal Reserve GDPNow estimating a jump of 35.3% when the number is released October 29. That would be the largest quarter-over-quarter increase ever and would bring the average for the previous two quarters to a respectable 2.1%. That's not bad considering GDP was down more than 31% in the second quarter of 2020. Using regression from previous elections, a 2.1% GDP print comes out to 51.9% of the two-party vote, exactly what President Barack Obama received in 2012 [Figure 2]. Note that the only president who had negative-GDP growth ahead of the election was Carter, who lost his reelection bid in 1980.

  As we mentioned above, if the economy is in a recession before the election, reelection odds decline, while here we are demonstrating that a strong economy right before an election is good. This sums up 2020—things are just really confusing!

2 GROSS DOMESTIC PRODUCT (GDP) MATTERS TO VOTERS

Average of Second and Third Quarter GDP Correlates with a President's Reelection Share of the Two-Party Vote



Source: LPL Research, Factset, Strategas 10/22/20

- **Stocks are strong.** Historically, the stock market is a great predictor of who will be in the White House. In fact, in 20 of the past 23 elections (87%), the S&P 500 Index has accurately predicted who would win. If stocks have been higher the three months before the election, the incumbent party usually has won, and if they were lower, the incumbent party usually lost. Remember 2016 when nearly everyone thought former Secretary of State Hillary Clinton would win? Well, stocks didn't buy it, as the S&P 500 fell ahead of the election and signaled a change in party. Since August 3, the S&P 500 is up 5.6%, which would support Trump in this election.

- **Incomes are rising.** It also turns out that if people are making more money, they tend to reelect presidents. The higher real (inflation-adjusted) per capita disposable income growth has been from January through October of an election year, then the higher the two-party vote an incumbent president has received. This statistic has increased 3.4% so far this year, and a regression analysis suggests this could amount to 57% of the two-party vote based on previous elections. Carter and George H.W. Bush both had weak income growth (less than 1%), and they both lost their reelections, while Presidents Richard Nixon, Lyndon B. Johnson, and Ronald Reagan all saw nice wage growth, and all won comfortably.

  The issue with this analysis for the current election is that the CARES Act included stimulus checks to many Americans, as well as enhanced unemployment insurance, which have inflated incomes despite the high unemployment rate. We would put this signal in the favor of Trump, but with an asterisk next to it.

- **The US dollar is weak.** A weaker US dollar before the election historically has signaled an incumbent-party victory. Similar to when stocks are higher, a lower dollar tends to occur when things are calm, and in many cases improving. Thus far, we've seen a weak dollar ahead of this election, similar to 1988, 2004, and 2012, and in all those cases, the incumbent party won the election.

  What makes 2020 so unique is some believe that Biden's policies, such as more regulation, higher taxes, and reduced tariffs, may weaken the US dollar, putting the accuracy of this signal in question.

LPL RESEARCH'S BOTTOM LINE

While Biden may be ahead in the polls, there are several clues that this race could be much closer than many are expecting. This could influence the makeup of Congress as well, where a close race may suggest a greater chance of divided government. Ultimately, we the people determine which signals are right this time around, so get out there and vote!

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The Standard & Poor's 500 Index (S&P500) is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

All index data from FactSet.

Please read the full Midyear Outlook 2020: The Trail to Recovery publication for additional description and disclosure.

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