Mark Noble:
Hello. Welcome to the latest episode of Generation ETFs. Today's guest is Brooke Thackray, Research Analyst with Horizons ETFs, and the primary research and force behind the seasonal investment strategy used by the Horizons Seasonal Rotation ETF, which trades under the ticker symbol HAC, and also the author of Thackray Seasonal Investment Guide, which is sort of an annual almanac, if you will, of investment trends that I know a lot of Canadian investors and investors in the U.S. have gravitated towards as sort of the primary source to get information on seasonal trends and how they're changing in the marketplace.

Now, typically when we interview Brooke, we talk about broader trends with regards to seasonal investing, including upcoming seasonal trends in the market and potential upcoming traits. But this time around we're actually, we're going to focus a bit more on just one topic, which is a big one. The U.S. election. Now Brooke has observed there are very distinct market patterns that emerge going into and coming out of a U.S. election, at least they do historically things can always change from time to time, but there is a historical pattern associated with U.S. elections. And so we're going to discuss some of these trends, what Brooke anticipates could happen if this year follows a true to form as it has in previous election years. Of course, 2020 is definitely an outlier in terms of both the economic and political climate surrounding COVID-19, and arguably the most polarizing U.S. election in recent memory. But beneath the noise, there could be some interesting investment opportunities that we can discuss. So I'm going to first start, Brooke, thank you for coming in and joining us today on the podcast and we always love having you...

Brooke Thackray:
It's a pleasure to be on the podcast.

Mark Noble:
And what we really want to talk about is just first starting on, what is the background on the market trends at this time of year? You observed that there are some unique trends with the U.S. presidential election.

Brooke Thackray:
So let's take a look at where this comes from — the market trends at this time of the year — because this has been looked at historically over a long period of time. It really originates with what's called the presidential cycle. The premise of the presidential cycle, is that for the first few years after a president gets elected, the stock market tends not to do as well nor the economy because the president gets in and starts cutting to balance budgets. And for the next two years, the last two years of the presidential period, the stock market tends to do well as a president would get in and spend money to increase his election chances or his party's chances for the next cycle. Now that went on for decades with a budget cutting cycle and then spending, budget cutting. I t would drive the stock market.

And a lot of people looked at what was called a four year cycle. That doesn't exist anymore, per se, because once governments get in power, it doesn't matter which country it's in, which party it's in. You find today, governments get in power, they spend money right away. And so they spend more money after and then they spend more money. So this is a real spending money theme that goes on, and it's not really related to that cycle anymore. They're not really interested in balancing budgets.

But what does exist today that has existed for many, many decades over time — this is all based upon investor behavior — is that the stock market does tend to go down coming into the election. So starting in late September and going into late October.

And the reason for that, the causational factor, because you always want to have a causational factor behind this, is that investors don't like that uncertainty coming into an election. And with the uncertainty, they pull back on their risk. And so you tend to see that the stock market will actually trend down from, as I said, late September into late October.

Mark Noble:
Now, historically, then, this is what you referring to then as the presidential cycle, this is something that you observe...

Brooke Thackray:
The presidential cycle is that four-year cycle, that's just what people have called that four-year cycle. What I'm saying is that's no longer pertinent, but if you want to put a name to this, it might be uncertainty around the presidential election, a phenomenon really is what it is. This is the residual of that cycle, because that was included in that presidential cycle before.

Mark Noble:
Right.

Brooke Thackray:
But this stands alone by itself and has stood through time with the stock market on average, tends to go down at this time of the year because investors just don't like uncertainty. When they're not sure about the outcome of something, they just back away a bit until they get more certainty and then say, "Okay, now I know. I've got a vision towards what the future might look like, and now I'm willing to actually increase my risk profile."

Mark Noble:
And we've certainly seen, I think in the last few elections, the ideological divide in the United States is so polarized that there's very little movement between the two sides. So invariably you have relatively close elections meaning that this uncertainty tends to persist regardless of who the people are that are running for president.

Brooke Thackray:
Yeah. It doesn't matter. It really doesn't matter who's running for president or who might get in. Whether it's going to be the Democrats, the Republicans, who's in the lead, or who's not in the lead. There's just a lot of uncertainty that comes in. And you take a look at it, if the incumbent is going to get back in, the president who is in power is going to get back in, you would say, well, what's he going to be like... or what's the person's going to be like next time? Are they going to be different? Or if it's going to be the other party, are they going to follow through on their promises? This is something totally different again. So this uncertainty, regardless, whether of who gets in, so this just tends to bring anxiety towards investors.

And we saw that back... If you take a look back in even the last election... Let's go back and take a look at what happened. It was really fascinating to see what took place.

So in 2016, we had Hillary Clinton running against Trump. Clinton was a favourite to win the election.

Mark Noble:
Resounding favourite.

Brooke Thackray:
The resounding favourite. Yeah.

Brooke Thackray:
So the polls were way off and all that, and it was... And who knows? They could be off once again as well. I think people were really quite skeptical about the polls overall, but the stock market actually started to pull back in August a little bit coming into the election. And then we started to see the decline in October taking place. So the stock market pulled back substantially. Now, the stock market actually bottomed two days before the actual election in the U.S., and don't forget, Hillary was expected to be the winner. And we start to see the stock market rally.

Now, when Trump was elected, we saw the stock market, with the futures overnight, go way down, a little bit down, then way up on the other side. And then the stock market took off the next day. And I want to say that, if Hillary Clinton had got elected, the stock market probably would have rallied as well. It didn't matter who won. I mean, because the market thought that Hillary Clinton was market friendly. And there's also some articles at the time. So this is just... This uncertainty cycle that took place with a lot of uncertainty coming into the election. And once that uncertainty was removed, people had taken a lot of money and put it on the sidelines to say, "Well, okay, the uncertainty's gone. Let's back in now." And so I don't think it really mattered who would have won whether it was Hillary Clinton, or Donald Trump...

Mark Noble:
I remember that vividly because I... Being in our business on the asset management side, the thing that we're most concerned about is what happens with a potential radical presidency, which Trump was viewed at the time? We can argue about that till we're blue in the face... What's happened since then. But at the time, what happens with the Trump presidency? And I do remember the futures dropping precipitously after the election. And then something happened, I guess, in the hours between the market open where I guess... Did the market observers decide that it was going to be kind of status quo? That either one of those presidents was going to engage in significant fiscal stimulus. Monetary policy was likely going to remain the same. And the market just took off. So I guess what you're suggesting is unless someone's bringing something extremely radical like communism or some sort of reshaping of the landscape, you could see this trend continue regardless if there's a Biden or Trump win.

Brooke Thackray:
Absolutely. Yeah, sure. Of course. And you take a look at the... If we take a look at Biden versus Trump here in this one, and even if you say, "Oh, Biden might come in and start to implement taxes," because that is part of his platform. But it's going to be very difficult to do that in a pandemic. And so he may be forced to hold back on that. So there's going to be a lot of rationalization about, well, especially if there's a split house in the States between the Republicans and the Democrats. Oh, maybe it's just a gridlock. Although he's President... so there'll be a lot of rationalization. I think it's just the uncertainty being removed and all of a sudden everybody goes, "Okay, well, that's behind us now. Let's get on with it." And as you say, unless it's something really very shattering, like a huge move towards one way or the other.

Mark Noble:
Historically, does the market sort of bottom then... You've mentioned that the market's sort of bottoms, or let's not say bottoms, but it's more volatile going into the election. Do we also then see that historically, that the market tends to rally a bit more, historically, after the election?

Brooke Thackray:
Yeah. So, I mean, if you take a look, just to go over some figures here, to some going back to 1952 to 2016. If we take a look on my... The dates that I've got is the stock market on average starts to peak out around September 22nd. And this year, we've seen the stock market pull back four weeks in a row. So maybe it has a little bit of an uplift here. We can talk about what's taken place specifically as well in here. But so from 1952 to 2016, on average, the stock market has lost 2.7% in election years.

And it's only been positive 41% of the time. So we see that overall downtrend that takes place. But on the other side... And I want to say that the trend isn't really that the stock market bottoms on election day... Because the stock market's forward-looking.

Mark Noble:
Right.

Brooke Thackray:
Stock market tends to bottom a few days before the election actually occurs, on average, because people finally go, "Okay, that's enough. We've accepted what's going on." So on average, the stock market is bottomed on October 25th.

And so if we look at, from the other period from October 26th, which is just a few days before the election to the end of the year, December 31st... For all of those election years, from 1952 to 2016 stock market has risen an average of 3.9%. Let's call it 4% being positive, 76% of time. Huge difference between coming into the election and after the election.

Mark Noble:
Right.

Brooke Thackray:
So there's... And that's because all of a sudden investors go, "Okay. We've got what we've got. Whether it's gridlock, whether who gets in power now. At least we know what we're dealing with," and they rationalize it won't be so bad.

Mark Noble:
Yeah. Or they have some certainty on where to deploy their capital. Right?

Brooke Thackray:
Yeah. They can start to take a look and say, "Well, maybe we'll move into this sector of the market, or this other sector represents a better opportunity with this particular person in power," as well.

I also want to point out too, that it's not just the stock market price movements as well. It's also volatility.

If you take a look at volatility, volatility tends to rise typically from August into October. And that's seasonally, over time, on average. I'm talking about realized volatility. So I'm going back to 2000… sorry, 1950 to 2019, and saying in that time period, you tend to see that phenomenon with realized volatility.

The VIX is implied volatility, but they have the same general trend. And I've gone back and used the standard deviation with 20-day look back, and taken a look at volatility. And you tend to see in election years, you tend to see the volatility rise in that seasonal pattern, just like it normally does. But volatility lasts a little bit longer as well. So volatility can actually last in the stock market into the beginning of November. Now, I just said the stock market tends to bottom in late October, but volatility can still increase. Volatility, works both ways up and down, of course, both sides. So that's the one difference in election years as compared to non-election years. You tend to still have that volatility trend increasing in October, but it can actually go a little bit longer into November.

Mark Noble:
Hmm. And I mean... I guess one of the challenges for you though, and just for those who aren't familiar, is that core to the seasonal strategy that you promote and that you use in Horizon Seasonal Rotation ETF, HAC, is that you're typically in the market by the end of October. How do you manage the entry timing of this strategy during election year? Do you have to make any adjustments to your strategy with this information at hand?

Brooke Thackray:
Well, okay. So we don't know who's going to win the election. We don't know what the outcome's going to be. And if you go back to 2016, exactly the same scenario took place.

Mark Noble:
Right.

Brooke Thackray:
We didn't know it was going to be Trump. We didn't know if it was going to be Hillary Clinton that was going to get in. And so you can get all emotional about, oh one, person's going to be good for the economy or one person's not, but you just don't know who is going to get in. And like I said before, the overall average trend is stock market tends to go up. So as far as managing that actual allocation goes, on a historical basis, it's better to not wait until the actual election to actually make that allocation, but actually to increase equities before that, in late October. And that's when HAC has traditionally done that as well.

So HAC has traditionally increased equities for what we call a favourable six-month period, which lasts October 28th until May 5th, in that time period. So HAC has taken on equities in that time period. And in an election year, it lines up with that as well.

Mark Noble:
Right.

Brooke Thackray:
This year too, there's a lot of talk, Mark. I'm sure you've heard it and everybody's heard it, that "Oh, we don't know who's going to be declared a winner and when." Right? This is... Because there's all sorts of rumours going on up there, about whether Trump will leave the White House or won't... Or got late ballots coming in. So this time, it might be a little bit different where you may see the election with the stock market. Maybe it starts to bottom in late October, but not start to have a significant rally until a little bit later on while some of these issues get resolved and that uncertainty is removed.

Because traditionally, uncertainties are actually totally removed on election night when the declared winner is put forward. But maybe that doesn't happen this year. But once again, you don't want to bet on that.

Mark Noble:
It might be two or three weeks later, but the central idea of the trend likely holds, right? Once they're certain...

Brooke Thackray:
Absolutely. Yeah, exactly. Because... So maybe there is some continued uncertainty, but the trend would still be the same. Where you still expect the trend to be the same. And you wouldn't want to try to say, "Oh, I think that there's going to be uncertainties. So therefore, we're going to react differently to this, and make some big, huge adjustments to that."

Mark Noble:
Interesting. And, in terms of, what I'm understanding is, your seasonally strong, favourable period is generally around October 28th and runs through to the first week of May, more or less? And maybe this year, while you're still deployed to that marketplace, you may see the favourable season, you will be entered into the end of October, but you may not see it hit its momentum until there's maybe certainty in the election season. But it doesn't change the fact that you're still going to be in the market during this period. It's just that when we see the momentum of the market will likely shift around when we have certainty around who's president. Am I understanding that correctly?

Brooke Thackray:
Sure, absolutely. So you may see the market start to actually really start to increase as well from that period.

Mark, it's actually interesting that this is a little bit what's taking place with the COVID-19 as well.

If you go back to March, let's just go back to March and take a look now. And from March, we saw all sorts of Federal Reserve stimulus packages, government stimulus packages, all throughout March, all the way down, but the market put in a bottom on March 23rd, and there was a big package that came out from the Federal Reserve at that time as well. But what also took place, once again, was, we did see the number of COVID cases in Europe on a daily basis start to go down.

And investors looked at that data and said, "Oh, we're getting, we're starting to see a little bit of certainty here. Things are changing a bit." And they became very positive in the marketplace. So the same phenomena might take place in that time period if we do see a delay being met with the proclamation of a president, where all of a sudden, we start to say, "Oh! We understand. We have more certainty that this may be resolved in either Trump or Biden's favour." If this does take place, and there's some sort of resolution looking to take place, and that the market might respond to that very possibly and rally from that time.

Mark Noble:
Of course. I mean the second big fiscal package has been delayed primarily because of the election. So again, that's another gift to the market that might occur once there's some certainty in terms of the composition of the House, the Senate and the presidency.

Brooke Thackray:
Yeah, Mark, these things are always hard when you're predicting... When you're working with stimulus packages, whether they're going to come out, or they're not going to come out. Those are not very easy to predict. They could, or they could not. But it maybe it does get delayed until this all takes place after the election. That's totally possible at that time.

Mark Noble:
So my final question for you has a little bit less to do with... It has to do with the election, but a little bit more interested on the HAC side, in terms of your risk management going through this. Because as you've highlighted, you do have volatility that sort of pops in around what is typically a favourable seasonal period for equities. So, under the assumption, you're in the equity market, if things, for whatever reason start to go sideways, what do you do? Or what should it, potentially, should investors consider as some risk mitigation tools? If for whatever reason this cycle is not intact if we start to see volatility pop up post-election.

Brooke Thackray:
Well, obviously you have to operate within the parameters of your risk tolerances as well within that, but when you're actually in that particular part of the cycle, you can't, you don't know exactly that the market is moving sideways or down. It's easy post-facto to make that determination, but let's just go back to March.

So March, the market was going down substantially, and a lot of people would say, "Oh, my risk mitigation strategies, just exit it altogether from the market."

Mark Noble:
Right.

Brooke Thackray:
And at the time, that's an emotional decision from that. So, I mean, so if the market does start to go down, after October 28th or let's say in November, and this has happened before over the last few years, the market may start to go down as well from that. But you really don't know if it's turned down until after the fact itself. Maybe this isn't just a small correction itself, but on average, Mark, I want to say that.

So the best positioning, from a seasonal perspective, is to follow — obviously within risk tolerances — to follow, from our perspectives, is to follow the seasonal trends. So not to make the exceptions to go, "Oh, we think that this may happen." The market may continue to go down, so therefore we're not going to necessarily be in equities at this time. We're not going to... which would be an emotional decision and not really a seasonal-based decision on what the market tends to do with that time. So, on average, the stock market tends to go up from late October over the next six months. So yes, it always has downturns in that six-month period. But on average, over the whole six months, it tends to do well. So post-facto the election, if we do see a correction, that could be a good opportunity to actually get into the market or to actually increase the risk preferences within the tolerances as well. So...

Mark Noble:
Great point.

Brooke Thackray:
Yeah, so it's not, "Oh, now we're past the election. Things aren't quite working out what we expect." Because they can turn it around once again, very fast. Maybe there's a narrative that's come along and said, "Oh, this was what might happen." It catches on but then it gets quickly squashed or there's more stimulus that comes out that wasn't expected to come out and the markets can do well. So from a seasonal basis is six months is still intact on an average basis. So that makes sense not to react after the fact, even if we do see a little bit of a pullback in that period.

Mark Noble:
Perfect. Well, Brooke, thank you again for joining us today. This has given us a decent amount to think about. I think it's become laser-focused over the next few weeks about what's happening south of the border. Hopefully, we can find some opportunities in terms of seeing some of these trends appear and maybe even deploy them effectively. Of course, if you want to put it in the hands of a capable professional, you can always look at the Horizon Seasonal Rotation ETF, HAC, where all of this commentary and research is already baked into the strategy that's deploying into the marketplace. So thank you once again, Brooke, and thank you our listeners for joining us. And until next time, we'll chat again. All right. Take care.

Brooke Thackray:
Thank you.

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by Mirae Asset