MV CAPITAL MANAGEMENT

Weekly Market Flash

Political Drama and Market Indifference

September 27, 2019

It has been a dramatic week in the world of US politics. In the world of US markets, not so much.

On Tuesday, House Speaker Nancy Pelosi announced the initiating of impeachment proceedings against Donald Trump in connection with a whistleblower's report addressing potential improper dealings with a foreign government (Ukraine) in exchange for personal political benefit. Impeachment has dominated the news cycle ever since, with new developments by the hour as the wheels of this distinctly American political machinery creak into motion.

Over in market-land, though, there wasn't much parsing of the meaning of "though" or "favor" in phone transcripts or poring over what polls say about attitudes towards impeachment among Iowa voters. Equity markets focused on their usual suspects: the latest from the front lines of the trade war, Fed policy and the latest batch of macro headlines (consumer confidence down a bit, durable orders higher than expected, PCE still sitting below two percent, Eurozone manufacturing in the dumps).

Does the market's apparent indifference to impeachment make sense? We argue that it does, and that whatever happens in the political arena over the coming weeks and months should not, by itself, be a cause for any rethink of your current portfolio positioning.

A Sample Size of Two

Impeachment does not happen often. Specifically, in the age of organized securities markets an impeachment process has happened twice (we exclude poor Andrew Johnson from this data set since his impeachment proceedings took place more than a quarter century before Charles Dow gave the world his eponymous stock market index). Richard Nixon resigned before his impeachment process resulted in an almost-certain removal from office over Watergate. Bill Clinton was impeached over Monica Lewinsky and remained in office after the Senate did not amass the two-thirds majority necessary to convict.

That's it as far as sample size goes. It makes no sense to analyze "how markets react to impeachment" because there is insufficient data and because correlation does not equal causation. Lots of things were going on in 1974 and lots of different things were going on in 1998, and lots of yet again different things are going on in 2019. It is hard to see how trading algorithms could be programmed to trigger buy and sell actions on the basis of how these impeachment proceedings play out (of course there probably will be a bunch of too-cute-by-half trader bots out there trying to do exactly that, but they will be statistically irrelevant noise and most likely cancel each other out).

Non-business As Usual

What about the effect of the impeachment process on the regular business of Washington? Shouldn't that be cause for concern? Perhaps it would be, if there were actual policymaking taking place that could have a material impact on the economy – a giant infrastructure program, say, or an actual bottom-up reforming of the tax code, or a comprehensive bipartisan, business-minded plan for dealing with climate change. But the reality is that the policy agenda has been frozen since the tax cuts enacted in late 2017 and is likely to remain gridlocked all through the contentious 2020 political season. Impeachment does not so much change that calculus as underscore it.

On the one Washington-related issue that does matter to markets – the trade war – there is really nothing to suggest how impeachment could impact possible outcomes. Will China sense political weakness and make a move? Will Trump become more desperate for a quick “win” and opt for an early fold? The only way to answer any of these questions is idle speculation with an absence of enough evidence even to assign meaningful probabilities to alternative scenarios.

Here Today, Gone Tomorrow

It’s too early to predict with much certainty how long this process is going to take, but the tea leaves suggest that neither side is going to want this to drag out longer than necessary. The latest intelligence from Congressional insiders is that articles of impeachment could be presented as early as October, which would imply a process that would likely end before the December holidays. Moreover, it is perfectly reasonable to anticipate how the process will end: the Democratic-controlled House will formally impeach, the Republican-controlled Senate will not come up with the two-thirds majority to convict (just as they didn’t in the 1998 Clinton case) and everyone goes home for Christmas turkey and a short winter’s nap before the Iowa caucuses.

Now, while all of this is going on, markets will be going up and going down as always. There may be days when a major market move happens to coincide with some dramatic development in the impeachment process. No doubt any such coincidence will be treated as the Story Of The Day on CNBC with lots of breathless, flush-cheeked commentary. Here is where you repeat our mantra over and over: correlation does not equal causation! And you ignore the handsome, sweaty pundit on the screen urging you to reconfigure your portfolio now(!) and you pour yourself a cinnamon tea (or other beverage of choice) and you relax.

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