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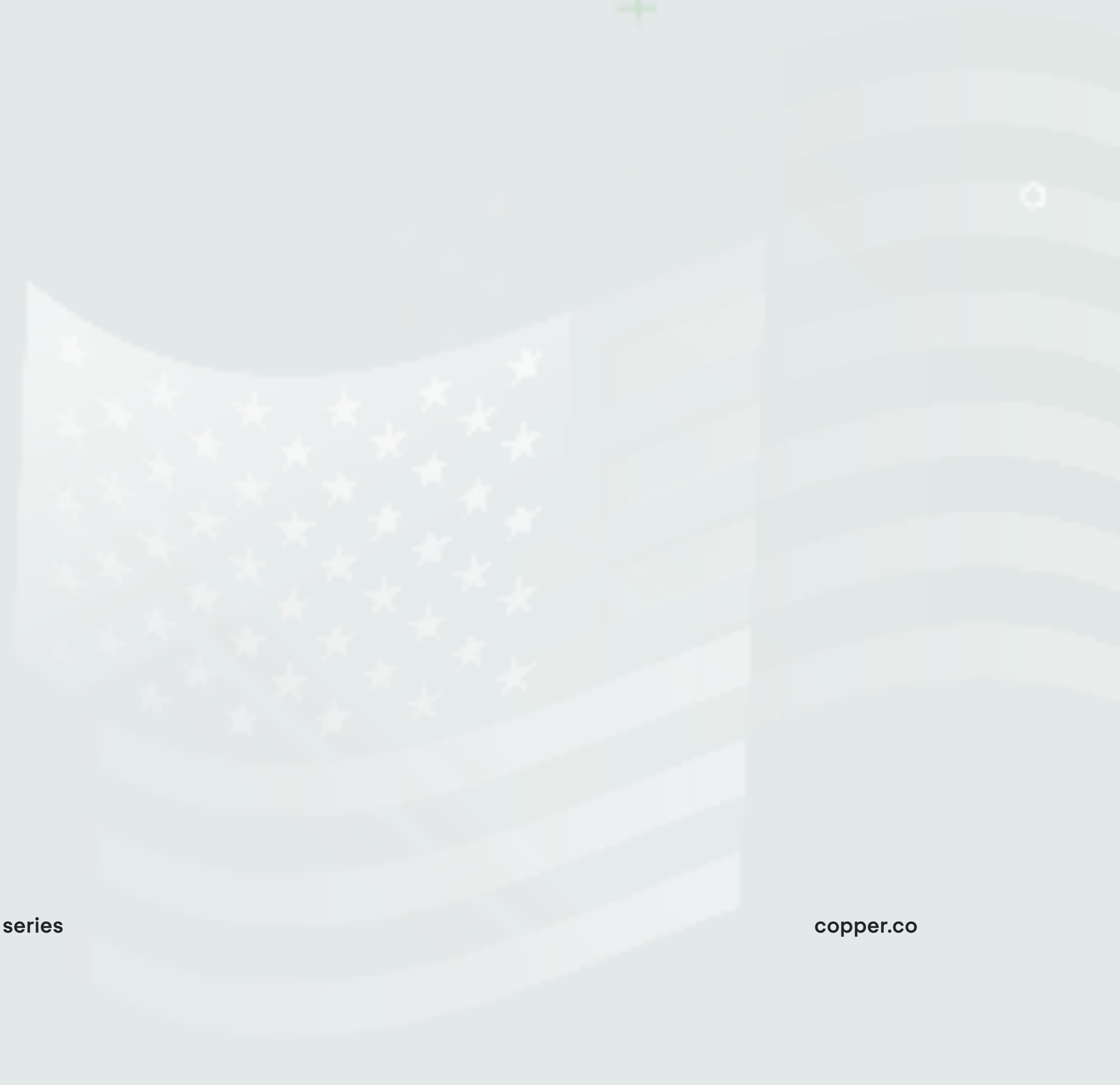
Financial scenarios for Bitcoin during and after US elections



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The upcoming US election has reignited the discussion on how the stock market will react, as it is widely recognized as a critical future economic barometer. But where does that leave Bitcoin? As Copper's previous research showed, what has become evident is that Bitcoin is most heavily traded during US market hours, indicating a clear bias tendency to the effects of western markets. And Bitcoin's correlation to global markets has become much higher than in previous years. Still, the cryptocurrency has yet to establish whether or not it is seen as a store-of-value or an asset that moves alongside the whims of equities.

With tight US elections around the corner, Copper takes a look at the historical data of how markets have moved and what the potential avenues for Bitcoin might be in light of higher correlations seen in 2020. This research isn't a political viewpoint. Instead, this study shows the effects of various political outcomes on global markets before, during, and after the ballots have been tallied.

The relationship between elections and their effects on stock markets has been studied time and time again. The stock market has been used as a vital tool by politicians, economists, and the public to assess whether or not there is growth in output. Effectively, markets are a meter of optimism or pessimism.

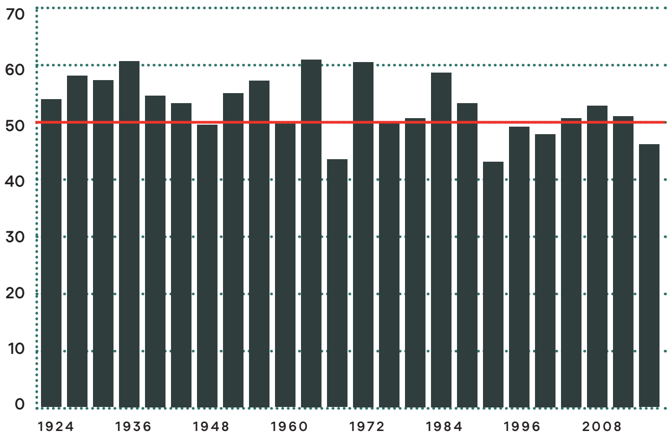
'Wash' Trading

On the short-term horizon, data shows that the stock market does not have a bias to a particular political party win. A study published soon after US President Donald Trump's shock victory in 2016 by the Journal of Financial Markets examined the relationship between elections and the stock market. The research posits that "individuals become more optimistic and perceive markets to be less risky and more undervalued when their preferred party is in power."

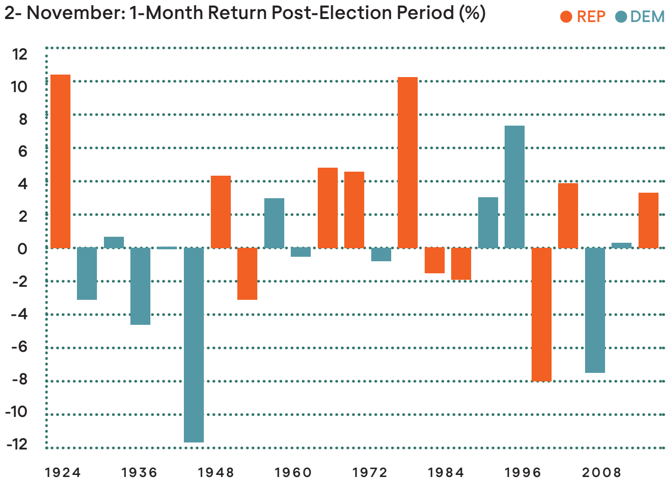
This means that one group of voters believe their party win is a positive outcome, and vice versa.

But a quick glance at popular vote margins in the US election shows that, for the most part, election ballots (who are market participants) are evenly split (see chart 1).

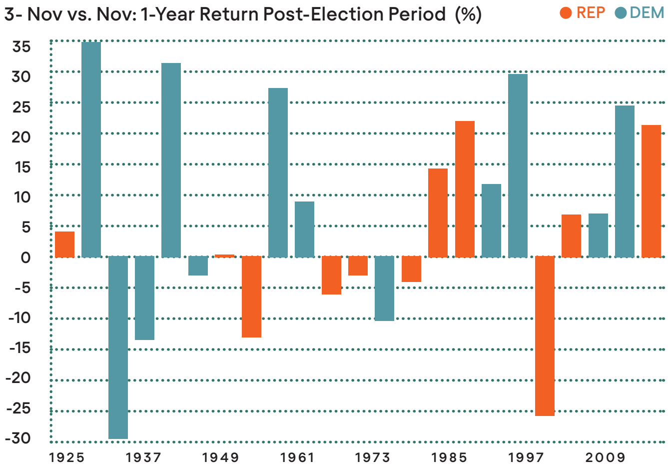
1 - US Elections Popular Vote Divide (%)



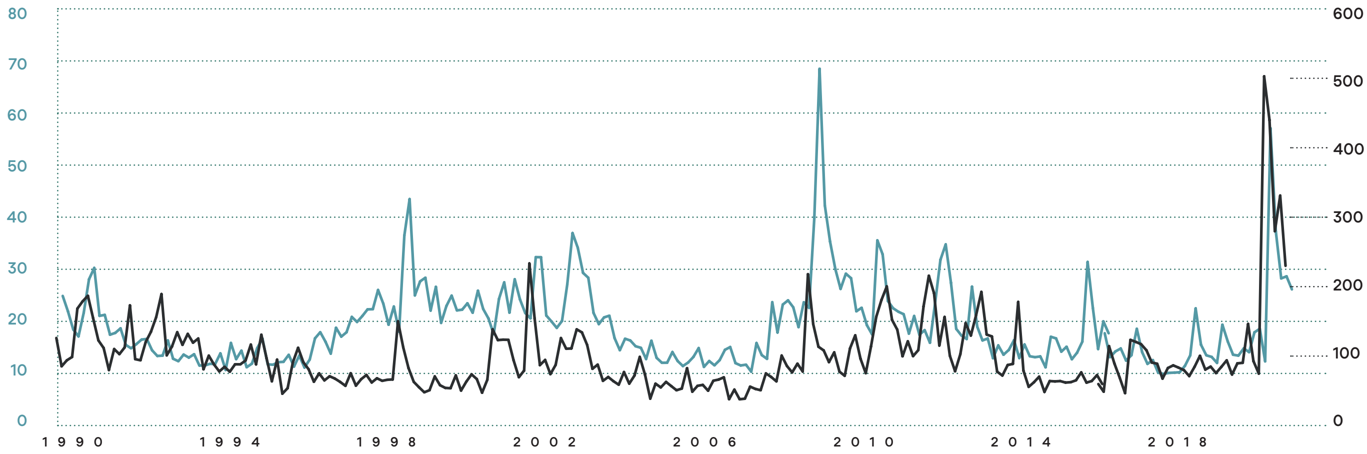
2- November: 1-Month Return Post-Election Period (%)



3- Nov vs. Nov: 1-Year Return Post-Election Period (%)



4 - VIX vs. Economic Uncertainty Index ● VIX (LH-Axis) ● EPU

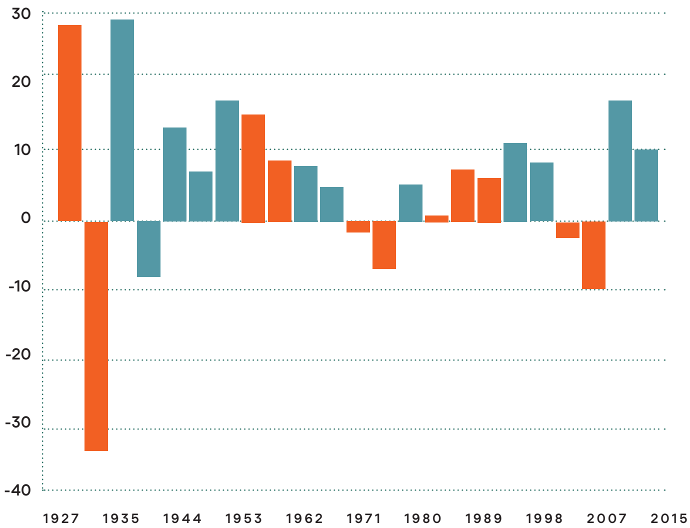


This means there is no universal truth or input for stock market outcomes as investors aggregate all participants' expectations. This, in turn, sets a price equilibrium and does not veer to one political view.

And short-term market returns directly following elections proves this. Neither party are able to claim any positive influence over the stock market despite political campaign soundings (see charts 2 & 3 on page 1).

On the yearly horizon, following November elections, when US ballots are cast, there has not been any significant difference in average returns either. Assessing market return since 1926, the Democrats have had a slight upper-hand in returning 11.9% versus 10.6% when Republicans hold office. This study will further unravel the potential reasons for this difference and whether there is a more telling story in the long run.

5 - Full Presidential Term Stock Market Returns (%) ● REP ● DEM



Rattled Economy, Not Nerves

Around election time, stock market volatility can spike – especially during tight elections. A study that was published by Vanguard titled "[With greater uncertainty comes greater volatility]" shows that while short-term outcomes do not sway stock market prices, volatility spikes can be seen during close elections such as those held in 2000, 2004, and 2016.

Ultimately, short-term returns are not set to see any significant change from any election outcome, despite markets running slightly amok during the run-up to the polls.

The argument put forth, which supports the notion that investors aggregate all market participant expectations, is that the volatility seen isn't a result of perceived election results but a reaction to economic uncertainty at the time. The two are seen to be closely linked together (see chart 4 above).

Time Heals All

A more pertinent question might be to assess the long-term effects of either political party during the full length of party specific Presidential terms.

While a study found no evidence of significant stock price changes before, during, or immediately after elections, the long-term outlook does shows a difference.

The research shows that Democrats have been able to deliver an average of 11% more on stock market returns than under Republican leadership (see chart 5 above).

While it would seem logical to make the assessment that the 'Grand Old Party' scuppers stock market returns, researchers take the approach of looking at rational market sentiment to answer why such an outcome happens so consistently.

The findings show that the excess returns under the Democrats cannot be explained by business cycles or policies but can be explained when looking at the *timing* of winning the White House.

History shows that Democrats are likely to sweep Washington during periods of economic crisis as voters demand more government intervention (i.e., stimulus) – (see table). Investors become less prone to risk, which increases the equity risk premiums – and thus – the average returns.

The inverse is true when a crisis risk is low – voters are more likely to cast the ballots for the Republicans for increased business risk. Markets under a right-leaning government are not seen as a risk but opportunistic (see diagram).

Table: Democrats have regained or held onto power 64% of the time during economic crisis. Republicans have managed to achieve an overturn only once.
Note: The small 1980 recession had seen stock market highs by election time.

Recession Period	In Power	Next Election Won By	
Great Depression	Republican	Democrat	●
Recession of 1937–1938	Democrat	Democrat	
Recession of 1945	Democrat	Democrat	
Recession of 1949	Democrat	Democrat	
Recession of 1953	Republican	Republican	
Recession of 1958	Republican	Democrat	●
Recession of 1960–61	Republican	Democrat	●
Recession of 1969–70	Republican	Republican	
1973–75 recession	Republican	Democrat	●
1980 recession (see note)	Democrat	Republican	●
1981–1982 recession	Republican	Republican	
Early 1990s recession	Republican	Democrat	●
Early 2000s recession	Republican	Republican	
Great Financial Crisis	Republican	Democrat	●

Elections come during an economic crisis → Democrats elected for increase in social spending, increase in taxes → Increase in risk aversion due to crisis → Increase in stock market returns as there is a precieved increase in taking on investment risk

↓

Unemployment drops and economy rebounds, as does the stock market → Investors shift back into risk taking → Republicans win elections for more favourable low tax envoirnment → Growth Slows

GDP Growth Avg:
Democrats 3.9%
Republicans: 2.5%

↑ (back to: Elections come during an economic crisis)

Democrats To The Rescue?

Stock markets are quick to adapt to an economic crisis. Alongside unemployment levels, the stock market is an indicator of crisis fears. Including 2020, there have been 15 recessionary periods since the Great Depression.

In times of economic crisis, particularly when unemployment is high, the Democrats have been elected overwhelmingly (see table).

Ultimetly though, long-term returns on the stock market by either party leadership have proven to be positive. And varying degree of returns can also be seen in the prices of gold.

Golden Crisis Opportunity

Much like the stock market, gold also doesn't respond to election outcomes in the short-term. However, long-term effects during crisis tell a different story (see table on next page).

A democratic win will be seen as more favorable for gold. But should the theory of risk aversion hold – the yellow metal will see an increase in price not because of the election outcome and economic policies that the left candidate party brings to the table. Gold would rise because the election outcome indicates that voters believe that the economy is in crisis. This leads to a lower-risk taking environment following the election that needs an expansionary monetary policy for social programs.

As far as this year's election goes, President Trump hasn't been shy in pushing for stimulus. But the question on voter's minds might be – is it enough?

Gold prices surged (as did equities) after the first round of stimulus from the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) at the end of March 2020.

The oldest store-of-value has already recorded the third-highest return since the start of the stock market crash through till the end of September 2020 versus previous recession periods.

> "A close look at historical gold price movements in the aftermath of previous U.S. presidential elections suggests little evidence of a clear relationship between the gold price and the election outcome based on party affiliation."
>
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Bipartisan Bitcoin?

Correlations are increasingly high for Bitcoin against both S&P500 and the gold. And this correlation might very well bode well for the cryptocurrency in the long-run, depending on how investors perceive the asset class.

In the case of a Democrat win, gold prices will surge, and equity returns will be higher in the long-run. A Republican win will see gold prices muted, and equity returns will be positive, despite a potential lower difference in the total return versus a Democrat win.

But the market is still clearly undecided as to what asset class Bitcoin belongs to. September correlations continued a positive trend (see chart 7). Notably, though, for the first time correlations for Bitcoin measured against both the S&P500 and Gold are neck-and-neck.

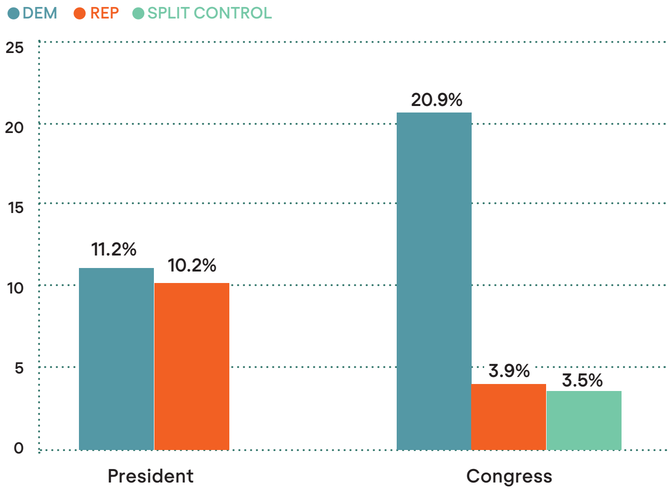
Whilst the correlation result might be construed as not being very strong, albeit positive, Bitcoin's global presence does not seem to veer off US market hour patterns.

Table: Major Asset Class Returns During Economic Recession Periods (%)

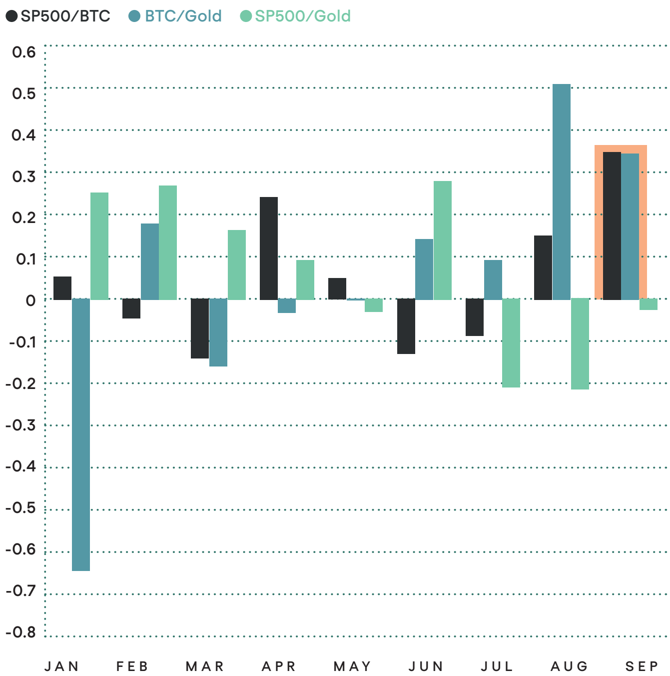
Recession	1973	1980	1981	1990	2001	2007	Avg.
Gold	83.7	20.0	3.3	-0.5	3.4	19.2	21.5
US Equities	-17.6	16.4	15.7	7.2	-7.3	-35.1	-3.4
US Corporate	-1.0	4.6	42.7	8.3	6.8	2.7	10.7
US Treasury	9.7	7.5	34.4	8.6	5.3	8.4	12.3
US Dollar	-0.5	0.3	11.5	1.7	4.4	5.5	3.8
Commodities	31.8	10.0	2.2	27.0	-26.4	-39.8	0.8

Source: Bloomberg, State Street

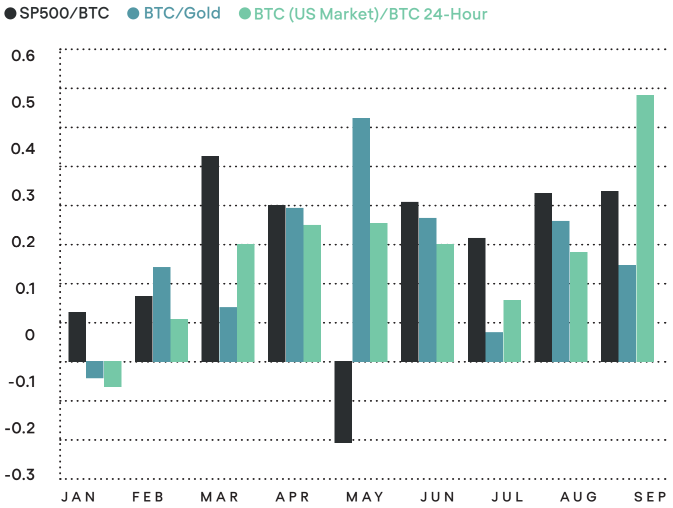
6 - Gold Performance Under Different Presidential Party Lines



7 - 2020 US Market Hour Non-Rolling Monthly Correlation



8 - 2020 Non-Rolling Monthly Correlation (BTC 24-Hour UTC vs US Market)



Assessing correlation results across a full day period against the S&P 500 and gold shows that the relationship remains strong. The increase in global correlation around the clock versus US market hours can be explained by how other markets from Asia to Europe assess US market movements.

Research has shown that US sentiment for Bitcoin has been a key driver for whether or not the cryptocurrency will hold onto its gains from the preceeding day. And Bitcoin's own correlation with itself (US Hour Market Returns vs. Global Hours) has hit a new high.

Unclear Elections, Unclear Markets

Noteworthy is the fact that gold's correlation to the S&P500 is now hardly a negative one. Markets might be factoring in an increase in stimulus, or the potential for the economic crisis to further unravel.

What is clear, however, is that in the long-term, investors need not be concered about party politics and the stock market per se. The stock market will do what the stock market will do. Post-election stock market data reveals that continous investments will keep markets rallied. In fact, since 1926, only 7 years following an election year has the stock market made a negative return.

For Bitcoin, investors seem to be grappling with what the cryptocurrency represents. The long-term potential looks positive as Bitcoin's volatility has now hit new lows following the global market upheavel seen in early 2020.

And despite some negative news in recent weeks within the cryptocurrency sphere, Bitcoin has continued to maintain a price floor above the $10k mark four-months straight indicating that the cryptocurrency has matured beyond any single point of failure.

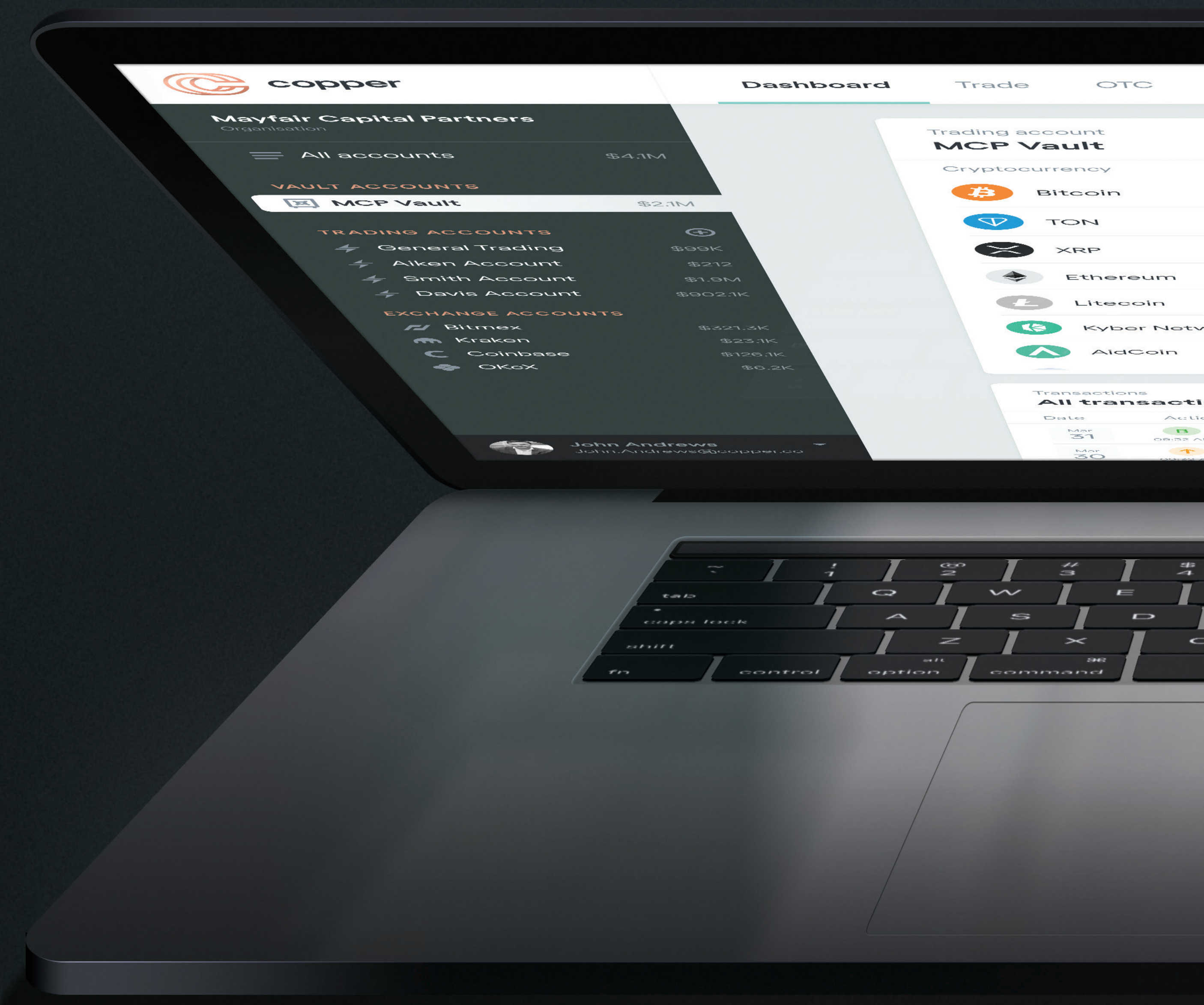
2020 US Election Voter Conundrums

Amid the COVID pandemic, the US unemployment rate hit record levels in 2020 after dropping to a near 70-year low. With this factor being a historical reason for a Democrat sweep, voters will have to decide just how lenient they will be with the Trump administration in light of a global pandemic.

Voters will have to assess the severity of the economic crisis caused by the pandemic. While older voters may be sounding alarm bells on health concerns raised by re-opening the economy, stock market returns (and their retierment funds) remain to be strong hitting new highs.

Meanwhile, young voters who have not been hit by unemployment, may find the economic crisis muted (for them personally). With asset prices increasing across the board, and 30-year fixed mortgage interest rates at an all-time-low, the Trump administration might find a receptive audience with those who want to step onto the property ladder.

Ready when you are.



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