SPECIAL MARKET COMMENTARY
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# Presidential Election and Equity Markets: A Follow-up

Back in March, we published a commentary outlining our preliminary thoughts on the upcoming Presidential Election. At that time, both major parties had yet to hold their conventions and both were mired in bitter primary battles. We noted that historically, during election years, markets like the certainty of a clear election picture heading into Election Day. The examples we cited were the 2004 and 1996 election cycles.

Now both parties have a candidate, three debates have occurred, and at this point the Democratic nominee Hillary Clinton is ahead of Republican nominee Donald Trump in almost all the major polls. In fact, there is little uncertainty being discounted in the markets concerning the presidential election as this year's equity market performance is tracking most closely with prior election years when the incumbent party wins the White House. What is up in the air at this point are the down ballot elections - can the Democrats carry momentum to Senate and House elections and take control of those bodies as well as the White House?

Let us consider then the market implications of the various combinations of party leadership in the House, Senate, and the White House. Ned Davis Research recently examined these combinations, and the results are particularly relevant in this election cycle[1]. It should not be a surprise that equities do best when there is gridlock – that is either a Republican or Democrat in the White House and the opposite party controlling the House and/or the Senate. When one party controls all three bodies it introduces the possibility of sweeping reforms, new heavy-handed regulations, and adverse legislative actions

The Ned Davis study looked at the returns of the Dow Jones Industrial Average going back to 1901 and found that the Dow performs best when there is a Democratic President and either a split or Republican controlled Congress. Markets do worst historically when there is a Republican President and a split or Democrat controlled Congress. Interestingly, the performance of years under a Republican President and Republican controlled Congress versus a Democrat President and Democrat controlled Congress are virtually identical.

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[1] "What Would Congressional Combinations and a Clinton Presidency Mean for the Markets?" Ned Davis Research October 18, 2016

At the time of this writing, FiveThirtyEight, a quantitative political analysis website is putting the odds of a Clinton Presidency at 86%. The same group is currently putting the odds of Democrats taking control of the Senate at 73%.[2] Most polls show Republican losing seats in the House, but maintaining their majority. If the polls are accurate, it sets the stage for a Democrat President, Democratically controlled Senate, and a Republican controlled House – in other words, gridlock for the next four years. With odds so high, it introduces the potential for a real surprise to impact markets should polling turn out to be off base. What impact would a surprise of this magnitude have on markets? Just ask the folks in the U.K. following June's Brexit vote.

Regardless of which party wins and which party loses in a few weeks, we would reiterate that basing investment decisions on political races historically is a particularly ineffective approach to manage money. The Ned Davis study shows the market returns under various regimes, but also greatly impacting these returns are other factors such as Federal Reserve policy, inflation, and corporate profits. Election season should also reiterate the need for an evidence-based approach to asset allocation and security selection and the need to eliminate the noise created by the news cycle.



[2] http://fivethirtyeight.com/features/how-much-uncertainty-is-left-about-the-election/