July 1, 2016

Hardly any market theory seems to get more attention than the relationship between the presidential elections and the markets. And rightly so. With an upcoming change in president, Americans are nervous about the future of the country. Since we can only speculate about the future, can history shed any light for investors about presidential elections and markets? Should investors be worried right now?

While history is not a guarantee of future returns, we feel there are at least two points worth noting about market returns during election years in the past.

The first point is this:

1. Overall, returns in election years are usually solid. Going back to 1946, the stock market as measured by the S&P 500, excluding dividends, has gained an average of 6.1% in election years versus an average of 8.8% in all years since 1946. So market returns in election years have been a little below average.

Now this doesn't mean the market was up in every election year, rather this number of 6.1% is the average returns of all election years, including those election years when the markets were down. And some of those election years, the markets have really been down. You only have to look back as far as 2008 to find an election year when we had a down market. However, a down market in an election year has not historically been the majority case. In fact, the stock market has risen in almost 3/4 of the election years since 1946 (about 76% of the time) and has been down in 1/4 of election years (about 24% of the time).(1)

But what about the election years when the market has been down?

That brings us to the second point we feel is worth noting:

2. Going back a little further in time we find that in election years since 1900, the market has performed on average -1.2% in the last year of a president's second term. In point number one above, we are looking at election years in general going back to 1946. In this point, we are going back further in time and looking at election years following a president's second term. Things don't look so rosy when you look at them from this angle. Not only have the average returns been noticeably lower in the final year of a president's second term than returns in all election years in general, but the percent of times the market has been down is quite a bit more than in the final year of election years in general. In the final year of a president's second term, the market has been down a little more than half the time (down about 56% of the time) since 1900.(2)

What kind of conclusions, if any, can we draw from the above points?

We think it would be fair to say that historically election years in general have not been bad for the markets. In fact, the markets, as noted above, have been up in about 3/4 of election years. As far as whether or not markets have been up in election years in the last year of a president's second term, we think the most that can be said is that historically it has been a "fifty-fifty" ballgame with markets being down in a little more than half the time in those election years.

So should investors be worried right now?

You might say this time is different based on things like the state of the economy, the size of our national debt, the uncertainty surrounding interest rates, the candidates we have running for office currently…and we might agree. But we feel the guide (not gospel) of history seems to suggest that making investment decisions purely based on theories about presidential cycles and markets returns may not help an investor's situation.

We do agree with those who say there is cause for concern, but we measure those concerns against the backdrop of economic conditions, market fundamentals and trends. We still believe the best long term investment strategy is a proactive approach to managing money that looks to reduce risk during significant market downturns and participate in growth opportunities as the trends and market conditions dictate. We think the worst thing for investors to do right now is stick their head in the sand with a buy and hold approach, or sell everything, put their money underneath their mattress and run for the hills. Investing is a careful balance between managing risk and participating in market returns. While investors might have good reason to be worried in an election year, history suggests that investors' fates are not sealed just because it's an election year. While we may be investing during a time of increased risk right now, we think the best approach during times like these, and all times actually, is a proactive strategy to try to control risk and capitalize on growth opportunities—which is a primary objective of investing, in our opinion.

This is why we are watching things—as always. We will make changes to your portfolio when we deem it necessary. And we will keep you posted as things develop.

Sincerely,

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Notes:
(1) "Outlook 2016: Rates, Recessions and Elections," *Sam Stovall's Sector Watch: Standard and Poor's Equity* Research, Sam Stovall, Dec. 8, 2015.
(2) "Why markets tend to fall during a presidential election year," *CNBC*, Bryan Borzykowski, Jan. 13, 2016