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Does the Presidential Election Move the U.S. Stock Market?

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Snapshot

- Some historians and economists believe market performance generally correlates with the four-year U.S. presidential election cycle.
- While there is some connection, we do not believe it's enough on which to base a sound investment strategy.
- Although the relationship between politics and markets is interesting, investors should focus on long-term goals.

Election year is heating up. One common campaign promise from both parties is a soaring economy—which investors hope will translate into a rising stock market.

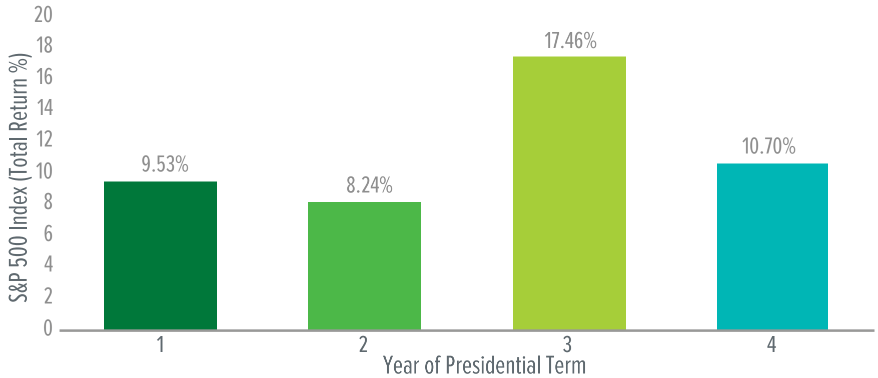
But does the election actually impact investors' portfolios?

A four-year cycle (and sometimes, eight)

Economists and historians alike have attempted to answer this since the mid-twentieth century, leading to the development of the Presidential Election Cycle Theory in the late 1960s. According to historian Yale Hirsch, founder of the Stock Trader's Almanac, U.S. stock market performance follows a predictable four-year pattern that correlates with the American presidential cycle.[1]

Until the twenty-first century, this theory held mostly true. However, the S&P 500 Index skyrocketed during the first year of the George W. Bush, Obama and Trump presidencies, as reflected in Exhibit 1.

Exhibit 1: Average Annual S&P 500 Index Returns During Each Presidential Term Year, 1928-2019



Source: SEI, Bloomberg. Total return for the S&P 500 Index (and S&P 90 Index, its predecessor, until 1957). Performance prior to January 5, 1957 is backtested. Back-tested performance, which is hypothetical and not actual performance, is subject to inherent limitations because it reflects application of an Index methodology in hindsight. No theoretical approach can take into account all of the factors in the markets in general and the impact of decisions that might have been made during the actual operation of an index. Actual returns may differ from, and be lower than, back-tested returns. Past performance is no guarantee of future results.

[1] investopedia.com/terms/p/presidentialelectioncycle.asp

First is (historically) the worst

Until the first year of George W. Bush's first term, investors tended to earn the smallest amount of stock market gains in the year immediately following a presidential election.

Yes, there is often a honeymoon period of optimism among Americans about new leadership that boosts the market. But policymakers under a new presidency may also begin to feel less restrained about introducing programs—some of which could be unpopular or restrictive—such as a tax hike or increased government spending. This may negatively impact business profits and consumers, causing the market to slump.

Second is better, third is best

During Year Two of a presidency, the economy has tended to level out. Year Three of a president's term has generally been the best, performance-wise, for the U.S. stock market. Researchers believe this is because the incumbent, thinking ahead to re-election, often introduces measures designed to stimulate the economy—to which the market responds favorably. Since 1928, the third year following a election year has been positive for U.S. stocks about 82% of the time.[2]

Fourth is fine…eighth, not so much

Market performance diverges in the fourth year of a presidential term. Incumbents are often re-elected, which creates less panic in the market compared to Year Eight of a two-term presidency, when markets tend to fall as investors despise uncertainty. Data from S&P Global Market Intelligence show that since 1944, the S&P 500 Index has only risen 50% of the time during the final year of a two-term presidency.[3]

More compelling may be the market's influence on the outcome of an election. According to Presidential Election Cycle Theory, the incumbent president has won 87% of the time (and every election since 1984) when the S&P 500 Index has advanced between July 31 and October 31 leading up to Election Day. Conversely, when the Index declined during the same period, the challenger unseated the incumbent.

Congress has the most clout

No matter who claims victory in the presidential election, their influence on the stock market is generally limited. The lawmakers in Congress have more direct impact on stock-market performance.

According to Ned Davis Research, a split Congress has the biggest negative influence on U.S. stocks, owing perhaps to term-length differences between the House and the Senate.[4] House representatives are re-elected every two years, while senators are re-elected every six. If one political party's approval rating drops amid economic policy missteps, it does not necessarily mean that it will lose both the House and the Senate simultaneously.

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[2] schwab.com/resource-center/insights/content/stock-market-performance-presidential-election-years

[3] spglobal.com/marketintelligence/en/news-insights/blog/weak-stock-returns-typically-accompanied-elections-without-an-incumbent

[4] Clissord, E. & Nguyen, T. (July 14, 2020). 2020 Election Handbook. Ned Davis Research. Issue SP20200714.

Don’t be bullied by the cycle

It’s easy to get caught up in every little market move. But for long-term investors, a four-year cycle—volatile or otherwise—should not have a lasting effect.

Theories about how the presidential cycle affects the stock market are just that—best educated guesses. Even academicians and economists don’t always get it right. No matter what phase of the presidential cycle we happen to be in—or which candidate wins the election—stay focused on long-term goals and resist the urge to react.

Important Information

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice, nor should it be construed as a recommendation to purchase or sell a security, including futures contracts. There are risks involved with investing, including loss of principal.

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