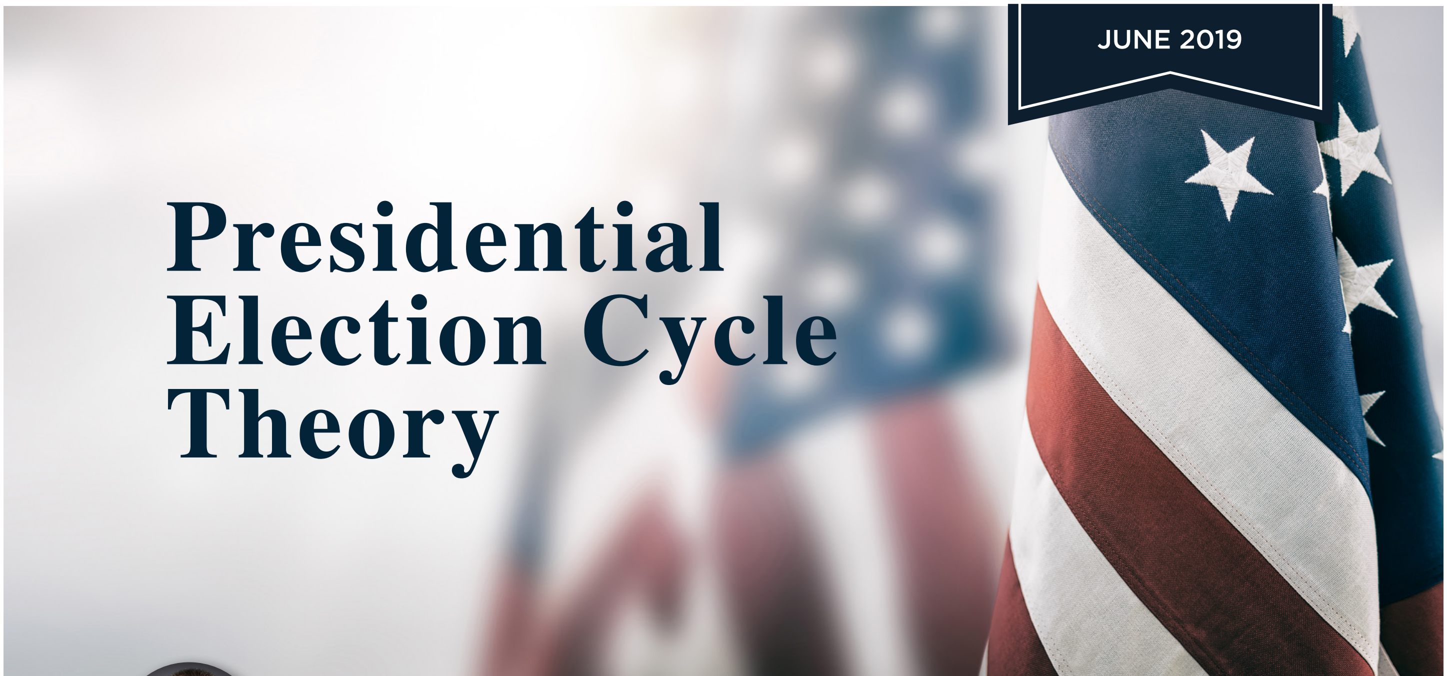

JUNE 2019

# Presidential Election Cycle Theory

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Even now, with 16 months before Americans march to the polls on November 3rd, 2020, investors are beginning to ask about the impact of the 2020 Presidential Election on financial markets.

Presidential Election Cycle theory was first developed by stock market historian, Yale Hirsch (creator of the "Stock Trader's Almanac") in 1968. This theory attempts to predict how the stock market might perform in each year of a Presidential term and is considered "conventional wisdom" by many stock investors interested in market timing. So how does this theory predict how the stock market might perform?

The fundamental assumptions of Presidential Election Cycle theory are as follows[1]:

- In years one and two of a presidential term, the President exits campaign mode and works hard to fulfill campaign promises before the next election begins. Markets may experience uncertainty as to the financial or economic impact of campaign promises. For these reasons, the first year is typically the weakest of the presidential term and the second year is not much stronger than the first.

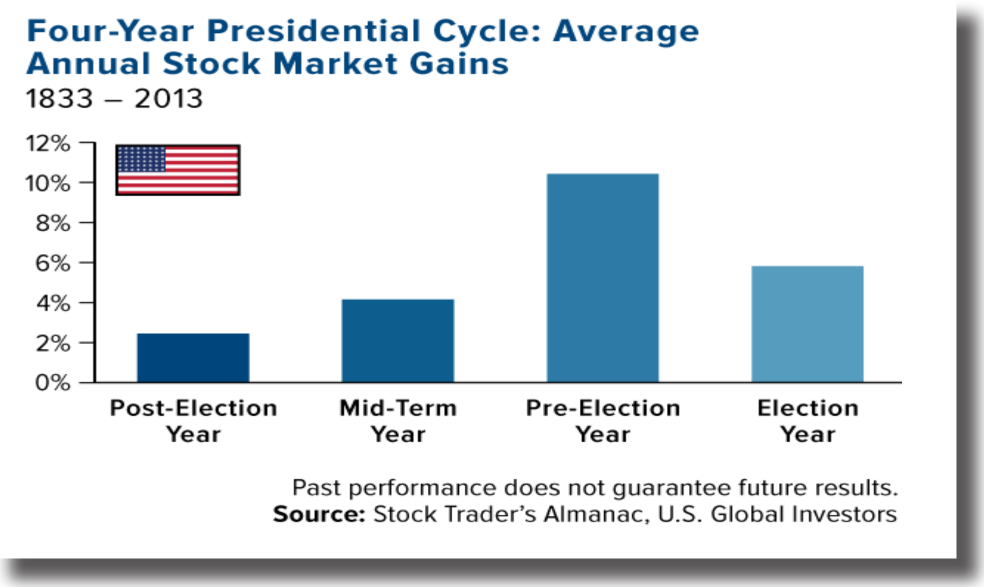
- This trend of relative weakness is because campaign promises in the first half of the presidency are not typically aimed at strengthening the economy; they are aimed at political interests, such as tax law changes and social welfare issues.

- In years three and four of the Presidential term, the President re-enters campaign mode and works hard to impact voter sentiment, while hopefully strengthening the economy and creating employment opportunities. Financial or economic impacts of Presidential policies has typically become clearer by this point. For these reasons, the third year is typically the strongest of the four and the fourth year is the second-strongest of the four.

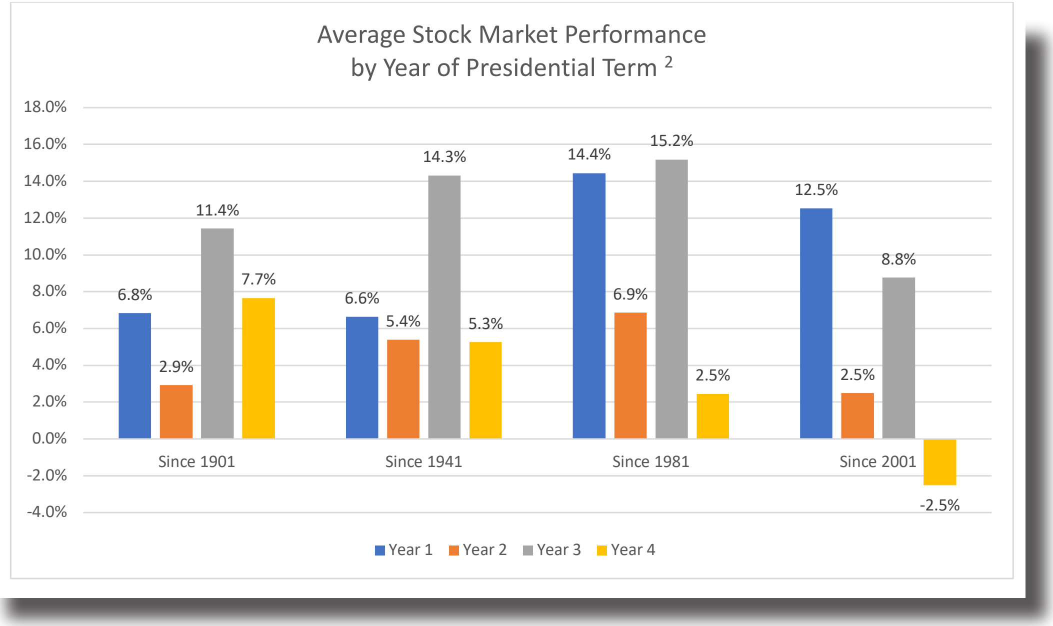
Long-term historical averages show there is some reliability to this stock market indicator. However, more recent results have been less in line with the fundamental assumptions. While this theory, and others like it, might provide framework and guidance to investment decisions, investors should always be cautious in changing their investment strategies on the possible outcome of a presidential election.

# History and Accuracy

The table below summarizes historical stock market performance in each year of a Presidential Term over the past 180 years. It is clear that the latter half of a Presidential term has averaged better performance historically then the first half.



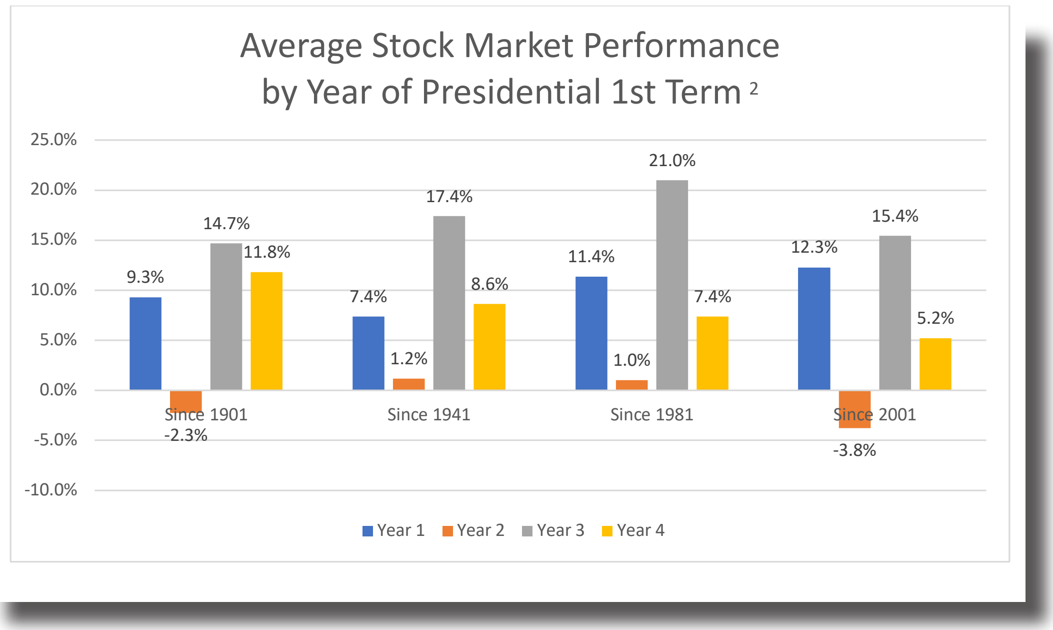

Analyzing the data across more recent periods indicates similar patterns, but with a modern shift where years one and three are strongest and years two and four are weakest (with year four being the weakest of all).



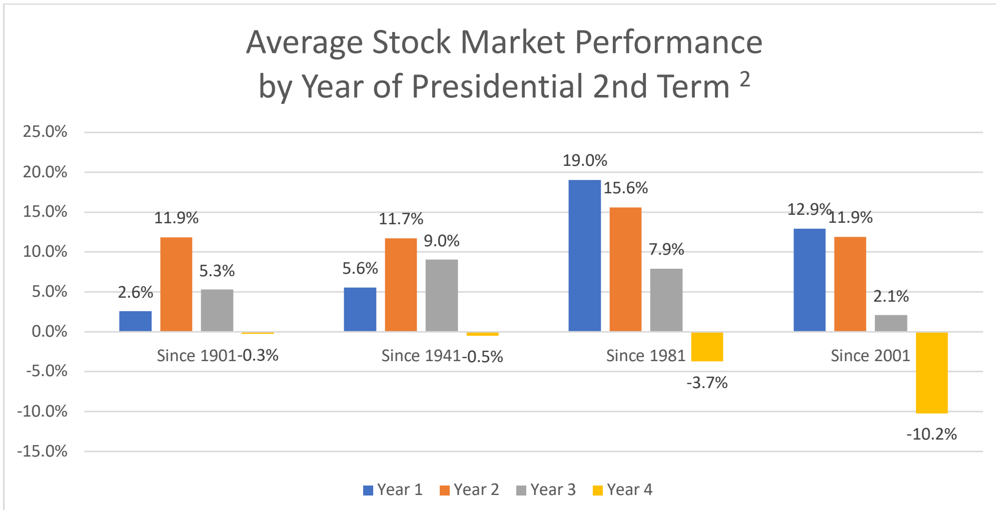
As with any data tabulation based on averages, the overall pattern of investment performance related to the Presidential Election Cycle may be convincing, but the pattern does not guarantee consistent results in a specific cycle!

For instance, stock market performance in the first two years for each of Barack Obama's presidential terms was much stronger than his third years. During Bill Clinton's presidency the fourth year of his first term produced better performance (26.0% on the Dow) than in any other year of his presidency (including the 2nd term) except the third year of his first term (33.5% on the Dow). One final example, stock market performance during the Reagan administration was strong during the second year of both terms (19.6% and 22.6% respectively on the Dow).

A deeper analysis comparing first term versus second term results sheds some interesting light on the matter. First terms tend to look very much like the original theory predicted, with year three being the strongest economic performance year.




However, when a President is elected to a second term, the potential for political change is dramatically reduced and the equity markets like the "certainty" of knowing future policy. The data table below shows that the first half of a President's second term is usually quite bullish. Years three and four reveal a considerable drop off in market performance as the reality of a change in the nation's highest elected official is guaranteed. This trend is especially pronounced since 1981 – a period where we have seen only one single term president (George HW Bush).




## Do Presidential Politics Cause or Simply Correlate with Movement in the Stock Market?

The overriding caution with any market timing strategy is that the strategy is never reliable enough to remove market risk, which exists primarily due to the random and unforeseeable nature of economic and market conditions. It's a classic example of confusing causation with correlation. When considering Presidential Election Cycle theory, it's likely more accurate to say that the relationship between the President's actions (or inaction) is coincidental when it comes to financial markets.

So is 2019's reasonably strong performance to date the result of it also being the third year of a Presidential Term? Or are other factors in play? We believe that 2019's performance is most directly attributable to a recovery from the overdone selloff in Q4 2018 and the clear and consistent signal by the Federal Reserve that they are on the sidelines for now and will procced with extreme caution in the future. But it's interesting to wonder if Presidential politics still might be behind it all.

Hopefully, you get the idea: Don't bet the farm on any single pattern or study. At the same time, a prudent investor wouldn't bet against repeatable patterns either and should consider the Presidential Election Cycle as only one of many factors influencing economic and market conditions. Certainly, politics do play a role in financial markets and the legislation passed in Congress (often originating from a sitting President's agenda) does have a significant impact on corporate earnings.

Sometime later this Fall, we plan to revisit Presidential politics in a piece analyzing which combination – Republicans or Democrats in Congress and the White House – has historically proven itself most favorable to financial markets.

1 Presidential Election Cycle Theory is described in The Stock Trader's Almanac 2019. Language used here can be found on Investopedia.com.

2 DJIA data taken from: https://www.forecast-chart.com/historical-dow-industrial.html
US Presidents data taken from: https://www.presidentsusa.net/presvplist.html
Chart analysis was internally prepared

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