Chart of the Month

November 2014

Republicans swept the Congressional mid-term elections a week ago today, gaining control of the Senate while also adding seats in the House. The GOP also gained at least two governors (upping its total to 31 or 32 depending on the outcome of Alaska) and now has a majority in 66 of the 99 state houses (Nebraska only has one).

While one can debate whether these outcomes are bullish, bearish, or neutral for the economy and the financial markets, history shows that mid-term elections and third years of presidential terms are unambiguously bullish for stock prices.

As shown in the bar chart below, the S&P 500 rose in price all 17 times in the 12 months following mid-term elections since 1946. The average advance has been 17.5%. The index generated double-digit gains in 13 of the 17 years with a high of 33.6% in 1954-55 and a low of 3.2% in 1986-87.

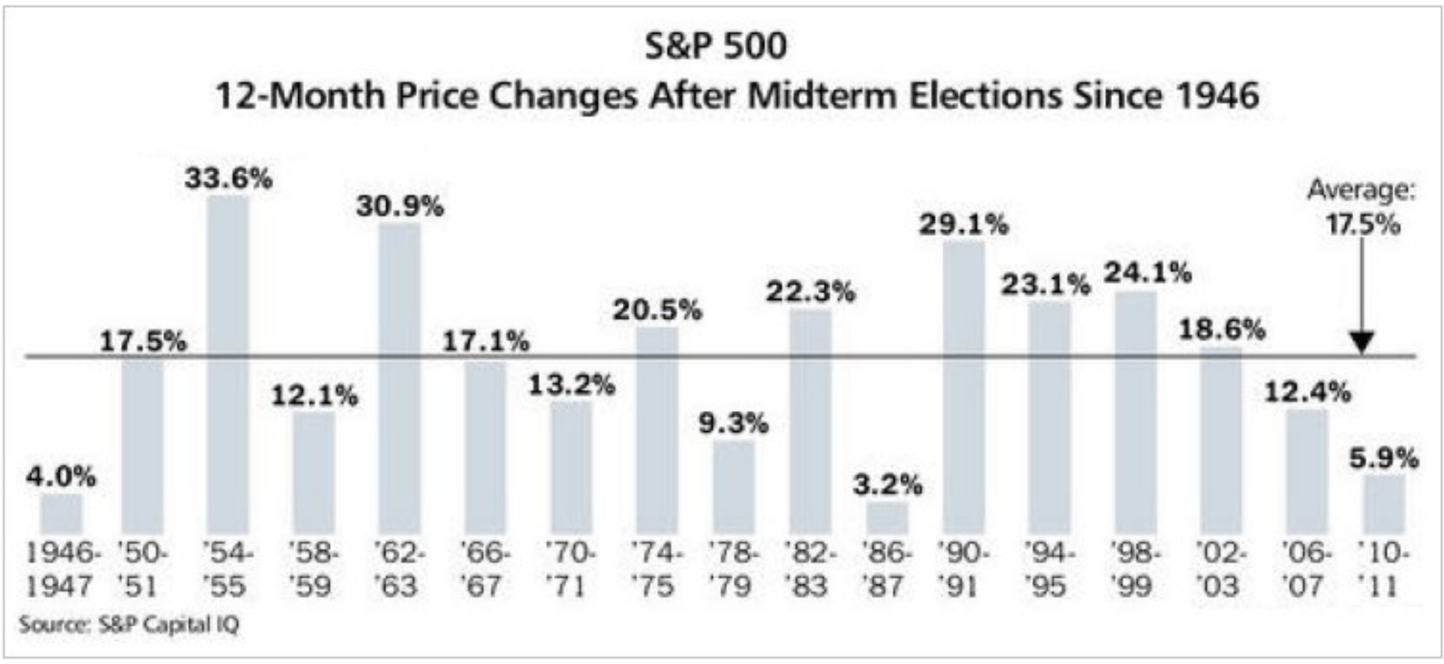
Furthermore, the S&P 500 has not experienced a loss in a year prior to a presidential election (such as 2015) since the Great Depression. The average gain has been 13.4% since 1928, well ahead of the means for the first (5.2%), second (4.5%), and fourth (5.5%) years.

Another fun fact: The S&P 500 has gone up 100% of the time in years ending in “5” over the past eight decades. The index has produced an average increase of 25.3% during these years with a high of 41.4% and a low of 3.0%.

Past performance, of course, is no guarantee of future results. History is merely a guide and streaks are meant to be broken. Nonetheless, we believe there may be something to these results. Mid-term elections tend to produce gridlock, especially when one party controls the White House and the other Congress. Gridlock, in our judgment, is generally bullish for the economy and the markets. However, shutdowns, as we learned a few years ago, are not.

Aside from the political cycles, it is important to recognize that the U.S. economy continues to improve. Over the past two quarters, Gross Domestic Product has expanded at a 4.1% annual rate. Non-farm payrolls increased by 214,000 in October, the ninth consecutive month above 200,000 and the longest such stretch since 1995. Unemployment fell to 5.8% – the lowest since July 2008 – even as the labor force participation rate inched up to 62.8%. Consumer confidence, meanwhile, is at seven-year highs.

Add everything up and it is our belief that the economic and investment outlook remains favorable. Accordingly, we maintain our constructive stance on carefully chosen stocks and shorter-term, medium-quality corporate bonds.



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