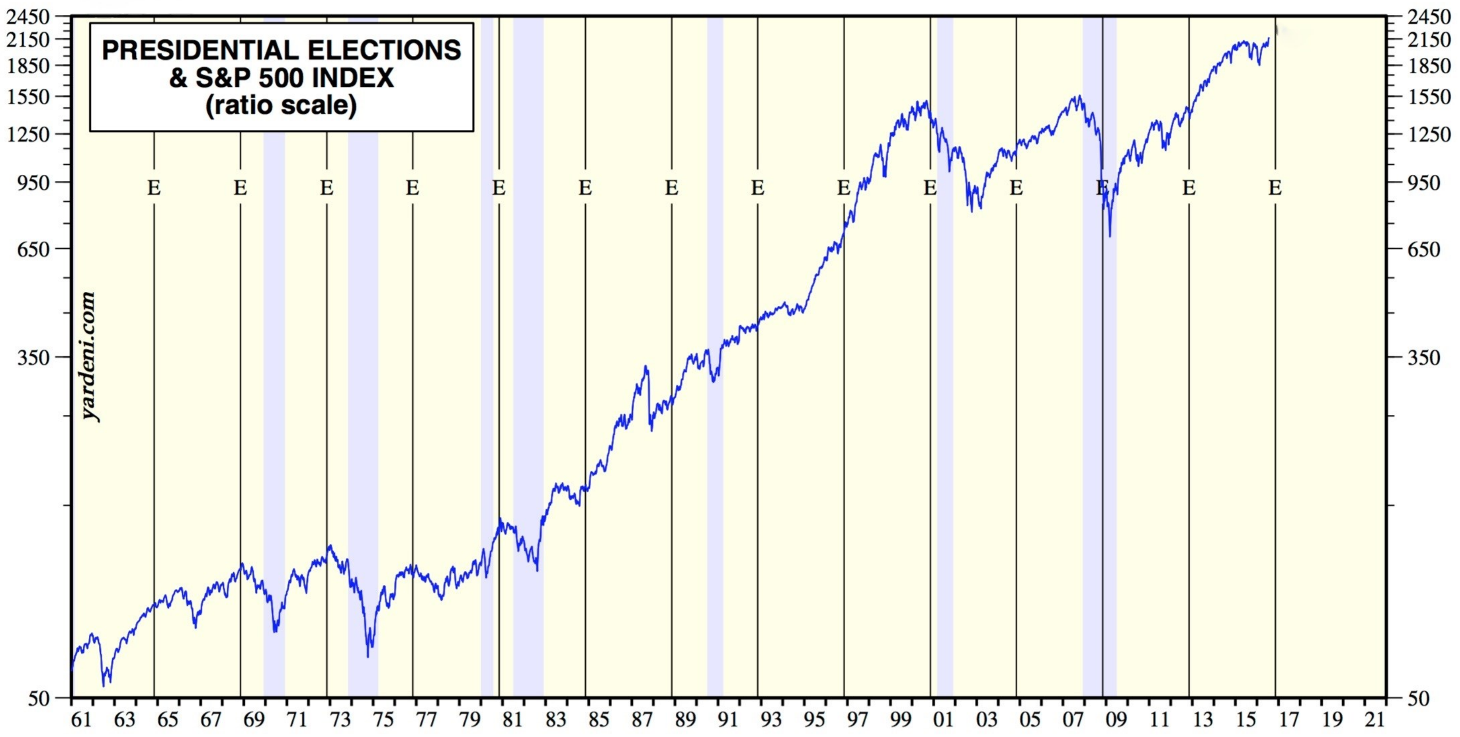
Chart of the Month

August 2016

Presidential Election Cycles



Note: Vertical lines (E) are presidential election dates. Shaded areas denote recessions according to the National Bureau of Economic Research.
Source: Standard & Poor's.

With the Republican and Democratic National Conventions now in the rearview mirror, the focus of the November election will soon turn toward the three debates between the presidential candidates on September 26, October 9, and October 19. In the meantime, it's important for investors not to get overly distracted by the 24/7 coverage of politics and instead pay attention to the economy, corporate profits, and interest rates.

Irrespective of one's like or dislike of Donald Trump or Hillary Clinton, the election is once again expected to be decided by the outcomes in the so-called battleground states (with Ohio and Florida topping the list). A candidate needs a simple majority of 270 electoral votes out of a total of 538 to win the White House. In the past six presidential elections, 18 states and the District of Columbia have voted for the Democratic candidate every time. These "blue" states represent 242 electoral votes. Over the same period, 13 states have chosen the Republican nominee every time. These "red" states amount to 102 electoral votes.

As a result, recent history suggests that Trump has a much steeper hill to climb to win the presidency than Clinton. First of all, no Republican has ever been elected President without winning Ohio. Secondly, Florida has 29 electoral votes. Therefore, if Clinton can secure all 242 electoral votes from the traditionally blue states and the 29 from the "purple" Sunshine State, she will become the 45th President of the United States.

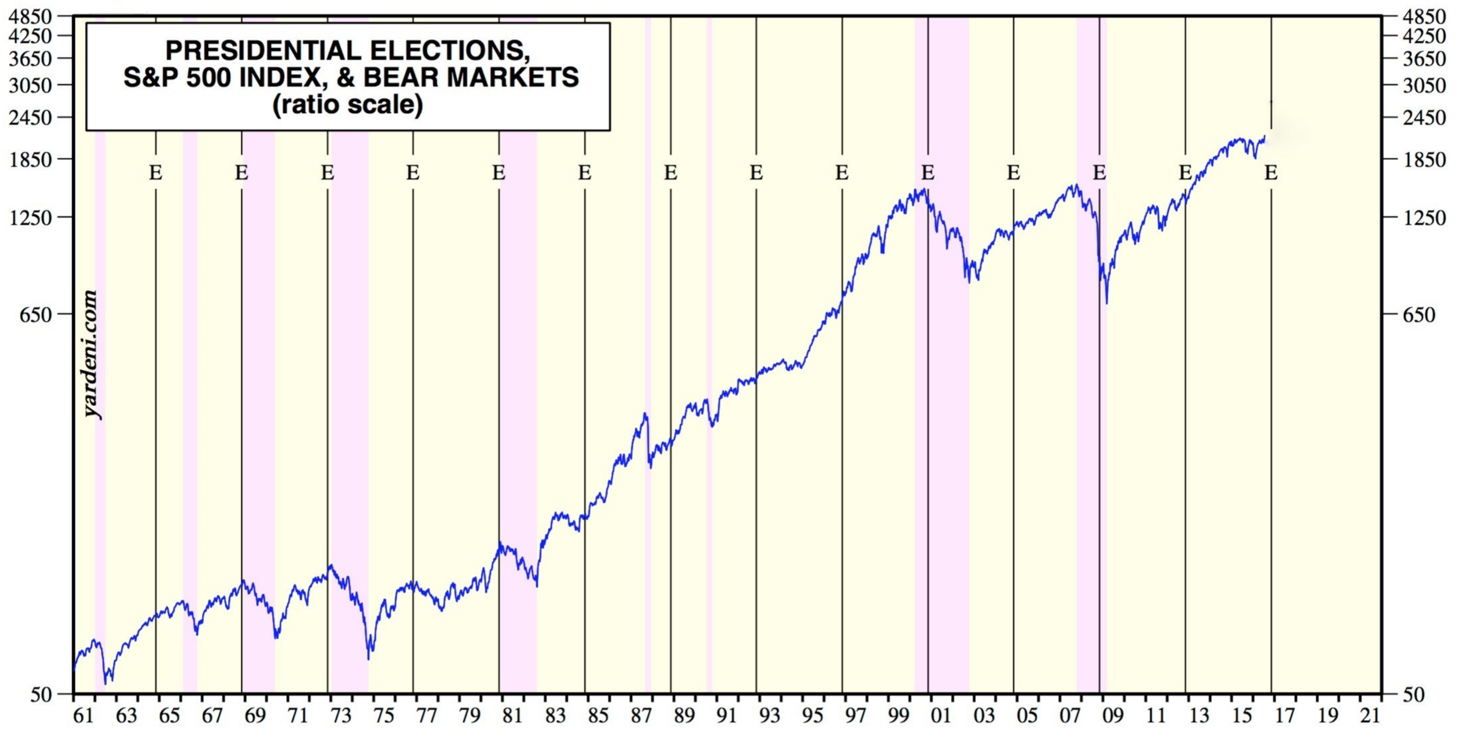
Meanwhile, the results of the Congressional elections should not be minimized. Republicans currently have a 54-46 majority in the Senate. The Democrats, however, believe they can wrest control of the Upper House because 24 Republicans are up for re-election compared to just 10 Democrats. No matter which side prevails, the margin of victory is likely to be very narrow — 51 to 49 or 52 to 48.

Regarding the House of Representatives, the Republicans presently hold their largest majority (247 to 188) since 1928. With a dozen more Republicans retiring or running for other office this year than Democrats (30 to 18), it would follow that the GOP is susceptible to losing seats but probably still in position to retain control of the Lower House.

As detailed in our October 2012 Chart of the Month, the stock market has performed the best when the Republicans have had control of the President, Senate, and House. The next-best combination has been a Democrat president and a split Congress, followed by a Democrat sweep in the White House and Congress, and a Republican president and a split Congress. Importantly, the average annual returns have been positive in all cases.

As shown in the graphs above and below, the risk of a recession and, most notably, a bear market has historically increased in the year prior to or following a presidential election. Coincidentally or not, the longest downturns have occurred when there has been a change in power from one party to the other (as was the case in 1968, 1980, 2000, and 2008). On the other hand, the elections of second-term presidents have almost universally been kind to the stock market (namely 1984, 1996, 2004, and 2012). The last time that a party extended its leadership beyond two terms was in 1988 when George H. Bush succeeded Ronald Reagan. The economy and the market performed well through the first half of 1990 before slipping into a shallow recession and a short-lived bear market.

While the past may or may not be prologue, we will continue to manage portfolios based on our economic and investment outlook in conjunction with each client's goals and objectives.



Note: Vertical lines (E) are presidential election dates. Shaded areas denote bear market declines of 20% or more.
Source: Standard & Poor's.

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