Commentary
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Does the Presidential Election Affect the U.S. Stock Market?

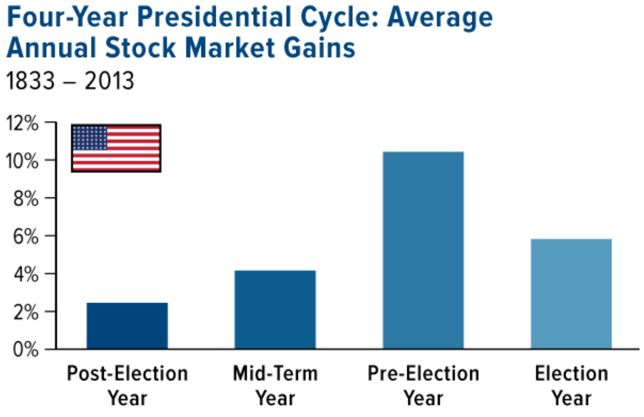
- Some historians and economists believe market performance generally correlates with the four-year U.S. presidential election cycle.
- The market tends to slump in year one, picks up in years two and three, and becomes less predictable in year four.
- While the relationship between politics and markets is interesting, investors should focus on long-term goals.

Americans are witnessing what might be the most contentious presidential campaign in recent memory — which begs the question, How does the presidential election impact the stock market?

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 stock market historian Yale Hirsch, founder of the Stock Trader's Almanac, U.S. market performance follows a predictable four-year pattern that correlates with the American presidential cycle (Exhibit 1).

Exhibit 1



Past performance does not guarantee future results.
Source: Stock Trader's Almanac, U.S. Global Investors

First is the Worst

Investors tend to earn the smallest amount of stock market gains in the year immediately following a presidential election. Yes, there might be a honeymoon period of optimism among Americans about new leadership that could boost returns. But policymakers under a new presidency may also begin to feel less restrained about introducing programs — some of which could be unpopular or restrictive — which may involve a tax hike or increased spending. This could 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 tends to moderate, and in the third year, the market typically improves further. Researchers believe this is because the incumbent, thinking ahead to re-election, introduces measures designed to stimulate the economy — to which the market responds favorably. Since 1939, there has never been a down year in the third year of a four-year term, according to financial firm UBS.

Fourth is Fine, Eighth Not So Much

Market performance diverges in the fourth year of a presidential term. Research on the relationship between presidential incumbency and market performance by S&P Global Market Intelligence indicates that in the final year of a first-term presidency, performance is generally positive. Incumbents are usually re-elected, which creates less panic in the market compared to year eight of a two-term presidency. However, in the final year of a two-term presidency, markets tend to fall, as investors do not like uncertainty. Data from Global Market Intelligence shows that since 1900, the market has only risen 44% of time during the final years of a two-term presidency.

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. No matter what phase of the presidential cycle we happen to be in, or how the markets respond in a given year, stay focused on your long-term goals and resist the urge to react.