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How election outcomes impact the economy

Does a right or left leaning leader impact the economy and market differently?

Although right wing leaders are generally considered to be more pro-business than those to the left, many historical studies suggest that when a left wing leader is at the head of government, it may be generally better for the stock market (see below). However, more comprehensive studies suggest that which party is elected has little impact on economic or market performance.

- A research study called "The Presidential Puzzle: Political Cycles and the Stock Market" (2003) done by Pedro Santa Clara and Rossen Valkanof of the University of California, demonstrated that the stock market performs better under Democratic presidents. Using data from 1927 to 2003, they found that the excess returns have been about 2% for Republican presidents, but 11% for Democratic presidents. Among small cap stocks, the difference is even greater. The bottom 10% of stocks as measured by market cap showed a difference of excess returns of about 22% for Democrats compared to when a Republican held the presidential office. Furthermore, on average, the stock market volatility during a Republican administration was more pronounced than that during a Democratic administration. https://www.jstor.org/stable/3648176?seq=1

- Bloomberg News asserts that "Stocks Return More With Democrat in White House" based on the fact that the BGOV Barometer from Bloomberg Government showed that "over the five decades since John F. Kennedy was inaugurated, $1,000 invested in a hypothetical fund tracking the S&P 500 only when Democrats were in the White House would have been worth $10,920" at the close of trading on 21 February 2012 (the day before the article ran). "A $1,000 stake invested in a fund that followed the S&P 500 under Republican presidents, starting with Richard M. Nixon, would have grown to $2,087 on the day that George W. Bush left office." (*Bloomberg News*, February 2012)

- An article published in the Journal of Business & Economics Research stated that the average annual stock return with a Democratic president is 15.08% while only 7.88% for a Republican president. This isn't to suggest that the Democratic party is better for the economy, as historically, the average stock market returns are highest when there is a Democratic President and Senate and a Republican House of Representatives. It is possible that this is due to both parties being able to keep each other in check and not let any policies get too extreme on either end of the spectrum.

https://www.forbes.com/sites/duncanrolph/2016/10/26/how-president-elections-affect-the-markets/#7bca7be6fb40

https://blogs.cfainstitute.org/investor/2016/07/29/effects-of-elections-predicting-the-markets-response-to-clinton-or-trump/

However, more conclusive studies seem to suggest that economic and market performance has little to do with the leader of the government, suggesting that there is no significant or reliable impact depending on which party wins.

In "The Presidential Term: Is the Third Year the Charm?" from 2008 the authors, Scott B. Beyer, Gerald R. Jensen, and Robert R. Johnson, find that after controlling for monetary policy, the party of the president is not significant in explaining equity returns. The authors conclude that previous studies were misplaced since they failed to control for changes in monetary policy. http://docplayer.net/190389-The-presidential-term-is-the-third-year-the-charm.html

In a 2008 blog posted titled "Presidential Elections and the Stock Market," Pete Davis concluded that "most of the studies show quite an advantage for equities following the election of Democrats, but a Federal Reserve study concludes there is no consistent relationship if you correct for market volatility and test back to 1852." Again, a different conclusion depending on the data set used in the study.

Further to this, the most frequently cited paper, according to Davis, is a 2003 article in the *Journal of Finance* by Pedro Santa-Clara, professor of finance at the Nova School of Business and Economics, and Rossen I. Valkanov, professor of finance at the Rady School of Management at UC San Diego. Davis noted: "[The authors] found 9% higher stock market gains for large stocks in Democratic administrations since 1928. However, Santa-Clara and Valkanov did not correct for swings in market volatility or examine periods before the Depression, when market volatility was lower. In a 2004 paper, two Federal Reserve economists, Sean Campbell and Canlin Li, made those corrections and found that the 9% higher return dropped to 4%. They concluded that market returns don't track with which party wins presidential elections."

Brian Belski, chief investment strategist at BMO Capital Markets, was quoted in 2016 for saying "diving further into the data, noting that when Republicans control Congress during a presidential election year, the S&P 500 typically performs well above average with a gain of 19.7% versus an average gain of 7.6% in years with a split Congress or 3.2% in election years when Democrats are in control. However, in the end, how stocks perform in an election year might have less to do with the candidates than the economic backdrop that will frame the battle." Belski finds that definitive conclusions cannot be drawn to link investment performance to the candidate.
https://www.marketwatch.com/story/2016-predictions-what-presidential-election-years-mean-for-stocks-2015-12-29

"Historically, whether a Republican or Democrat occupies the White House has had no statistically significant impact on US equity markets," writes Russ Koesterich, CFA, head of asset allocation for BlackRock's global allocation team.

William Watts, *MarketWatch*'s senior markets writer, examined what Deutsche Bank and S&P Capital IQ had to say about the presidential election cycle and the outlook for 2016. His conclusion? "In the end, how stocks perform in an election year might have less to do with the candidates than the economic backdrop that will frame the battle." (*MarketWatch*, December 2015)

Ron Rimkus, CFA, believes it is a fool's game to try to tie presidents and election cycles to stock market returns. In a blog post, "Elections and Stock Prices: Assessing the Impact Is an Exercise in Futility," he writes: "Oftentimes, we hear pundits ask: What US presidents were good for the stock market? How did the markets respond to a particular president? Or what political party has had more success in the markets? All of these questions are doomed to failure. Is it not possible for a president of one party to enact a policy typically favored by another party?" Rimkus notes that "most academic work ignores the vast differences and underlying nature of specific policies. So, the whole exercise of using statistical analysis to claim one party is better for the stock market than another is merely an exercise in . . . you guessed it . . . politics." (*Enterprising Investor*, 2012)

Does the variation in candidates' political leaning impact the economy and market?
If the incumbent party wins, does it impact the economy and market differently?

Depending on the competition in an election year, the markets will react differently. Again, taking the position that markets hate uncertainty and change, then it would make sense that candidates on completely different ends of the spectrum would create higher levels of volatility on average.

Market's tend to respond favourably when the incumbent party wins. If a leader is at the end of their term or a change in leadership is expected, this too would increase uncertainty. Intuitively, it would then make sense that if a right wing leader were in office, and another right wing candidate is expected to win, this will have a mild impact on markets typically. However, this does depend on the candidates platform, primarily if there are significant differences when compared to the current leader, or if there are any contentious issues at the time of election. The market, in theory, would act more favourably to similar candidates in an election, or to candidates leaning more closely to the centre.

A moderate candidate, somewhere in the middle, typically increases the chances of election as they can appease to more voters. A favoured moderate candidate will typically have mildly positive impacts to the economy as there are typically not drastic changes to policy, however, it again depends on current issues and the candidate platform. In contrast, a change from a right wing leader to a left wing leader would have the most negative effect typically.

Consistent with our analysis, T. Rowe Price states "**Presidential election years generally have coincided with favorable markets, particularly when the incumbent party wins**".

Since 1928, the Standard & Poor's 500 – a widely watched benchmark of U.S. large-cap companies – has dropped an average of 2.8% in presidential election years that don't include an incumbent seeking re-election, notes Stephan Suttmeier, technical research analyst at BofA Merrill Lynch Global Research. In fact, of the eight years in a two-term presidential cycle, the final year of the second term – when the incumbent can't run – is the only one that has averaged negative market returns, Suttmeier says. By Contrast, in years when the sitting president is up for re-election, the S&P 500 has averaged returns of 12.6%, he adds. (The average for all years from 1928 through 2014 is 7.5%.)
https://www.forbes.com/sites/merrilllynch/2015/12/15/how-presidential-elections-affect-the-markets/#11f06979335c

A significant change in leadership may also mean a change in the priorities of the government. For this reason, it is not uncommon to see businesses putting key decisions on hold during an election year to ensure the viability of a project before moving forward. When this is the case, we may also see slower credit growth, as lending would then also be on hold. However, it is also possible to see a flood of new business if there is a possibility of new leadership that is less pro-business. These types of election impacts largely depend on campaign platforms and election probabilities year to year.

The biggest risk to your investments is how you react to market volatility and not the volatility itself. Keeping a long-term perspective, staying focused on personal goals, and considering the broader economic trends will help you make wise decisions and mitigate risk.