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Election Year

Almost halfway through 2016 and markets have been on a wild ride to say the least. While most, if not all, major asset classes are in positive territory through the end of May, it surely hasn't been without some price volatility. In fact, with the S&P 500 up 3.57% and the MSCI All Country World Index up 1.85% through the end of May, we are finding that many investors are forgetting that both indices were deep in negative territory earlier this year, down more than 10%. As is said often around our office, "things *can* and *do* change quickly."

Table1: Year-To-Date Returns for the Major Market Indices

Market Benchmark	Year-To-Date (%)	Classification
Alerian MLP TR USD	9.11	Master Limited Partnerships
Bloomberg Commodity TR USD	8.76	Commodities
Barclays US Corporate High Yield TR USD	8.06	Domestic High Yield Bonds
FTSE NAREIT All REITs TR	6.53	Real Estate Investment Trusts
Barclays Global Aggregate TR USD	5.87	Global Fixed Income
Russell Mid Cap TR USD	5.02	Domestic Mid Cap Equities
Barclays US Treasury 7-10 Yr TR USD	4.50	Domestic Fixed Income
Barclays US Treasury US TIPS TR USD	4.08	Domestic Fixed Income
Barclays Global Aggregate TR Hdg USD	3.89	Global Fixed Income
S&P 500 TR USD	3.57	Domestic Large Cap Equities
Barclays US Agg Bond TR USD	3.45	Domestic Fixed Income
MSCI EM NR USD	2.32	Emerging Markets
Russell 2000 TR USD	2.28	Domestic Small Cap Equities
MSCI ACWI NR USD	1.85	Global Equities
MSCI ACWI Ex USA NR USD	0.52	International Equities
STOXX Europe 600 NR USD	-0.77	European Equities

Source: Morningstar Direct as of 05/31/2016. Data is total returns in USD.

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An Election Year

As the presidential primaries are wrapping up and conventions are right around the corner, many investors are questioning how this election might affect the stock market. There is no question that there are many variables affecting the market currently, though that is not to say this is any different just because this is an election year. I have heard some say that the investors should be worried if *(fill in the blank)* is elected. We are not necessarily of the belief that one president is better or worse for stock markets than another.

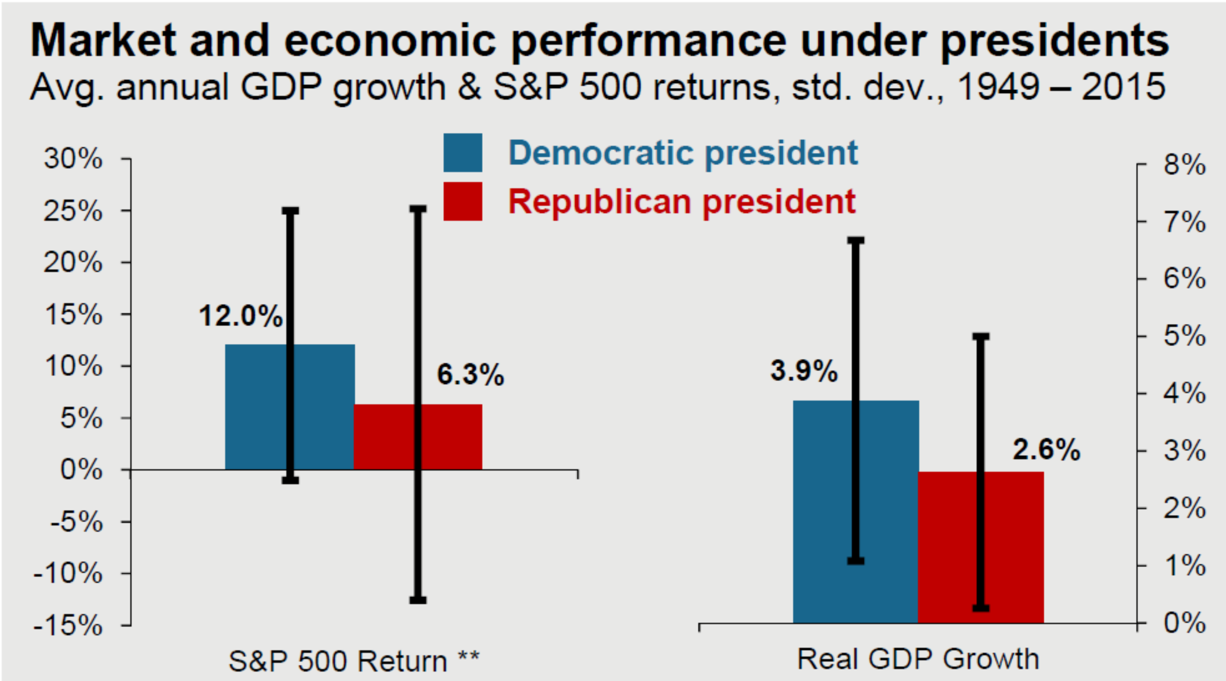
Looking at the election in basic terms, there are differences between those who are politically conservative and those who are politically liberal. Some investors tend to assume that these differences will affect the investment markets one way or the other. In general, it is often believed or assumed that a politically conservative ideology would include smaller government, lower taxes, and less spending, with a strong focus on national defense. Those who are politically liberal, on the other hand, tend to believe in bigger government, higher taxes, and stronger support for entitlement programs.

Based on these generalities alone, one might think that a conservative President is best for the stock market (and the economy). This belief comes from the expectation that the effects of supply side economics and lower taxation should lead to higher consumer spending and thus higher corporate earnings and growth rates. Some of you might remember this from the '80's with Reaganomics and the "trickle down" theory of economics, which presumed that money saved on taxes would be spent on consumption leading to higher company revenues.

On the flip side, a Democratic President typically holds politically liberal ideologies, and tends to lean toward increasing tax rates on both corporations and individuals. Further, Democratic Party views tend to back greater spending on entitlement and social programs, as well as infrastructure projects, which may lead to lower private spending and therefore lower levels of growth in corporate America (and thus company earnings and stock prices).

While the above generalities on the ideologies of the two main parties may be true, the reality of how markets react may not be all that intuitive. In the chart below, from JP Morgan Asset Management, going back to 1949, a Democratic president has served stock markets well relative to Republican regimes.

Chart 1: Stock Market Returns and Economic Growth under Political Regime



Source: JP Morgan Asset Management

**Stock market returns are price returns and do not include dividends. Average annual returns are calculated using year-end to year-end and fourth quarter to fourth quarter numbers for both the S&P 500 and real GDP, respectively.
Guide to the Markets – U.S. Data are as of March 31, 2016.

What one might also notice is that, per the above chart, not only have stock markets performed well under Democratic Presidents, but on average the US economy grew at a healthier rate as well. This too would not necessarily jive with what people would expect, in that Republican conservatism is better for private companies, and thus economic growth and consumption should be greater.

To be clear, we are displaying *average* annualized returns on the S&P 500 and *average* annualized economic growth. This is not a foolproof map to investing based on political party control. Also, keep in mind that *averages* can be misleading.

One should consider that the US economy is one of many interests over which the President must preside. In fact, one could argue that with the separation of the Oval Office and the Federal Reserve, which is the bipartisan group that monitors interest rates and unemployment, the President actually has very little control over any pure economic policy. In fact, one could easily draw on recent examples in which the President had basically zero influence on the market. For example, it seems that the tech bubble and stock market craze of the later 90's had very little to do with policy out of President Clinton's office. Or, the fact that George W. Bush took office at the peak of the technology bubble and was the sitting president for 9/11, which coincided with the bursting of the technology bubble and the ensuing recessionary environment.

Similarly, President Obama was fortunate enough to take office after the US stock market fell by 50% (in retrospect of course). Since January 1st of 2009, the effective start to President Obama's term, the S&P 500 is up roughly 170% through the end of May. Now of course one cannot say that the stock market has done well solely because it had its value cut in half, but it is an easier place to start than when the stock market is hitting all-time highs, as it did in 2000. Of course, it is true that President Obama did approve stimulus packages in his first term, including extending unemployment benefits for many US citizens, in addition to extending some of the Bush tax cuts. Additionally, President Obama also signed the American Recovery and Reinvestment Act, which was a bill to support infrastructure and jobs within many of the sectors that were hurt by the Great Recession. Without discounting the many things President Obama did while in office, most believe that the primary driver of that outstanding return was the ultra-low interest rate environment (ZIRP), which is set by the Federal Reserve, and not the president.

Does the Stock Market Care about the President?

In sum, while these statistics and analyses may be historically interesting, Presidential cycles are not a basis for an investment strategy. Nor is it a reason to be concerned. In recent meetings I have experienced Déjà vu while hearing statements such as "if ______ becomes president, then I am selling all of my stocks." Or, similarly, "if _______ becomes president, I am moving to Canada because this country is doomed." It is undeniable that an election year adds an additional variable of uncertainty in markets simply because change is not well-received by the majority of people. From our vantage point, every situation is different, meaning that historical examples are not proof of future results. Currently we have a market faced with potential rising interest rates, potentially slowing earnings growth, commodity price volatility, and many other headline concerns. This time is not different than before, or the time before that.

So does the stock market care about the President? It would seem that the answer is "no," or at most a "maybe." It has borne out over history that the stock market is fundamentally driven by long-term by earnings and expected growth in earnings. That is not to say that the market will not face some volatility in the future which could very well be driven by uncertainty regarding the candidates' policy posturing. In fact, there could be an immediate market reaction once the election results are announced, but that is not to say that the trend will continue from there. For example, from the date that President Obama was first elected on November 4, 2008 to the date of his inauguration on January 20, 2009, the S&P 500 fell by almost 20%. That of course would not have led one to believe that in the following 7+ years that same market would grow by 170%. All of these historical examples and data points may lead one to the realization that short term noise happens in markets, and if one can stay focused on the long term, they increase their odds of being rewarded.

As always, please call on us if we can be of service.

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