

EQUITY RETURNS IN OPEN ELECTION YEARS

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With the World Series over and the fourth Republican primary debate scheduled for tonight, the reality that a new presidential election year is less than a year away is rapidly settling in. [Bull](#) markets tend to climb a wall of worry, and next year's "open election," where there is no incumbent in the race, may present a new obstacle for the stock market to overcome. [As I pointed out in an August blog on the night of the first republican debate](#), with grassroots voters in each party coalescing around nontraditional candidates, not only are the early poll results a signal of wider discontent in the electorate, they also widen the possible policy outcomes that could follow next November's elections. On the one hand, there is nothing particularly notable about presidential election years. We have had 54 of them back to 1800, and the total U.S. stock market has returned 10.1% on average in those calendar years. That is very close to the 9.7% average calendar year return between 1801 and 2014. However, in the last 100 years, the stock market has returned only 2.1% on average during open election years. Of the eight open election years over the last century, the [Dow Jones Industrial Average](#) has seen negative returns in 2008, 2000, 1960 and 1920. Put another way, the odds of a "down year," which is typically one in four, rises to one in two in open election years over the past century, if you use the Dow as your proxy.

Table of U.S. Stock Market Returns in Presidential Election Results, 1912-2012

Year	Total U.S. Market Return	Election	Dow*
1912	8%	Rep Incumbent	8%
1916	9%	Dem Incumbent	-4%
1920	-19%	Open	-33%
1924	26%	Rep Incumbent	26%
1928	39%	Open	49%
1932	-8%	Rep Incumbent	-23%
1936	32%	Dem Incumbent	25%
1940	-7%	Dem Incumbent	-13%
1944	21%	Dem Incumbent	12%
1948	2%	Dem Incumbent	-2%
1952	13%	Open	8%
1956	8%	Rep Incumbent	2%
1960	1%	Open	-9%
1964	16%	Dem Incumbent	19%
1968	14%	Open	8%
1972	17%	Rep Incumbent	18%
1976	27%	Rep Incumbent	23%
1980	33%	Dem Incumbent	21%
1984	3%	Rep Incumbent	1%
1988	18%	Open	16%
1992	9%	Rep Incumbent	7%
1996	21%	Dem Incumbent	29%
2000	-11%	Open	-5%
2004	13%	Rep Incumbent	5%
2008	-38%	Open	-31%
2012	16%	Dem Incumbent	10%

Average Calendar Year Return in Election Years, 1801-2012, Total U.S. Market **10.10%**

Average Calendar Year Return in Open Election Years, 1912-2012, Total U.S. Market **2.10%**

*Dow Jones Industrial Average returns prior to 1963 are price returns; thereafter they reflect total returns

Source: Professor Jeremy Siegel, "Stocks for the Long Run," updated to 2015.

Past performance is not indicative of future returns.

What explains the underperformance in open election years? One answer may be as simple as recent open election years having coincided with the end of business cycles. By 2000 and 2008, for example, the [Federal Funds Rate](#) had already been raised above 5%. Similarly, the first year of a new presidential term is often the year when political capital is spent to make the hard choices required to govern. Sometimes that involves raising taxes or cutting the rate of future spending, both of which can impact consumer and business confidence and slow [gross domestic product \(GDP\)](#) growth. But I suspect another part of the answer is that equity markets hate the uncertainty that accompanies open election years. Investors may prefer the challenge of overcoming policies they know and do not like rather than divining what future policy may be. The smartest course in such years may be to sit on the sidelines and wait until clarity emerges. Compounding this is the fact that in 2017 the range of potential policy outcomes is wide ranging depending on who gets elected in 2016. Dividing up the spoils of victory very much depends on not just who sits in the White House but who runs the agencies and which leaders control Congress. The billions that get contributed to political campaigns are not the result of an outburst in patriotism during election years. More often than not, the fund-raising comes at a price, a political return on investment that takes the form of tax expenditures embedded in the tax code; pork barrel spending or government contracts; regulatory waivers or outright relief; and varying interpretations about how aggressively to implement or enforce existing laws. Assuming Republicans maintain control of the House and Senate, a Republican in the White House could result in a substantial shift in tax, energy, healthcare, regulatory and entitlement policy. On the other hand, a Democratic victory could mean more divided government and a political stalemate in Washington. Or, if bipartisan compromise does emerge, it could mean more intervention into the private economy and higher taxes to help finance programs and benefits for qualifying beneficiaries. **Conclusion** Given the range of potential outcomes in 2016, investors, consumers, business owners and executives may take a wait-and-see attitude in the coming months until greater clarity emerges later next year. Net-net such political uncertainty is, I believe, a negative for the U.S. equity market, creating an additional obstacle to overcome

on the wall of worry.

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DEFINITIONS

Bullish : a position that benefits when asset prices rise.

Open Election : An election where there is no incumbent candidate.

Dow Jones Industrial Average : The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the “policy rate” of the U.S. Federal Reserve.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.