MARKET COMMENTARY MAY 13, 2016

How Do Stocks Perform During the Presidential Election Cycle?

Let's set aside for a moment the question of what political changes the upcoming election may portend, and consider a topic that may be of more interest to traders: How do elections affect the stock market?

Researchers have looked at this issue from a lot of different angles: Do equity markets prefer a Democratic or a Republican president? Is a victory by an incumbent or a challenger better? What about a divided versus a cohesive Congress?

Not all of this research has yielded actionable insights. Stock returns are the result of many different factors, so it's not always possible to establish a direct link between developments in the stock market and the world of politics.

Nevertheless, we have been able to identify a few historical patterns in how markets have fared during different phases of the “election cycle,” or the four years leading up to each election. Of course, what happened in the past isn’t necessarily a guide to what will happen in the future, and the question of why such patterns exist remains a subject of debate. But traders may still find it interesting to take a closer look.

Breaking down the cycle

We looked at how the benchmark S&P 500® Index performed during presidential election cycles going back to 1950 and found the last year of the cycle—that is, the actual election year—has generally been good for equities.[1]The S&P 500 rose 81% of the time and posted an average return of 6.6%.

It’s worth pointing out that these results include the most bearish election year in the data set, 2008, when the S&P 500 dropped 37%. That year coincided with the collapse of Lehman Brothers and saw some of the worst losses of the recent financial crisis.

Market performance by year in election cycle

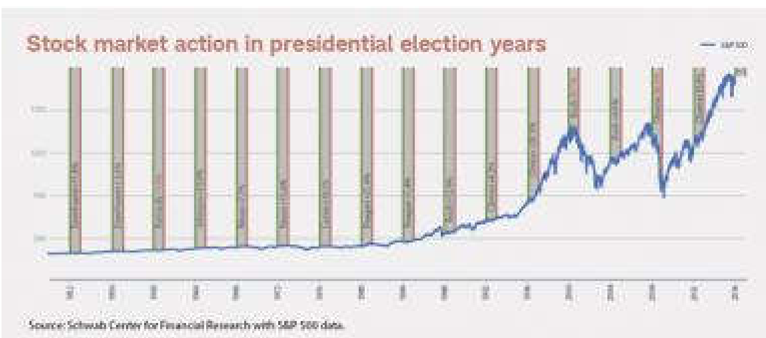
	ELECTION YEAR	ELECTION YEAR + 1	ELECTION YEAR + 2	ELECTION YEAR + 3
Number of up years	13	9	11	15
Number of down years	3	7	6	2
Average return	6.6%	6.5%	7.0%	16.4%

Source: Schwab Center for Financial Research with S&P 500 data from 1/1/1950 through 12/31/2015.

The first year of the cycle, which coincides with the first year of the presidential term, has historically been the toughest environment for stocks. In the 16 cycles studied, only nine finished with the S&P 500 in the black. This 56% success rate is only marginally better than a coin flip, though the 6.5% average return in those years compares favorably with rates in other years of the cycle.

The third year of the cycle—the year before the actual election—was generally the best one for equities. They rose in the third year in all but two of the 17 cycles covered by our research, delivering average returns of 16.4%.

The chart below shows the S&P 500 at the start (green line) and finish (red line) of each presidential election year since 1950.



Financials, utilities thrive in election years

If we drill down into this data a little further, we can see that different sectors tend to do well at different points in the election cycle. Historical data comparing sector performance isn't available as far back as the data for overall market performance, but we do have figures going back to 1992, giving us 23 years of information to analyze.

As you can see in the table below, the financial sector has been the top performer during election years, followed by utilities. Why the relative outperformance? Both of these sectors are highly regulated. Perhaps very little gets done politically during election years, meaning that there are likely to be fewer new regulations for these sectors than in other years. But again, politics and elections aren't the only factors affecting sector returns.

Consumer staples, energy and health care have also done reasonably well in election years.

Sector performance in election cycle

	ELECTION YEAR	ELECTION YEAR + 1	ELECTION YEAR + 2	ELECTION YEAR + 3
Financials	8.8%	15.7%	4.5%	8.1%
Utilities	6.2%	3.7%	0.3%	12.8%
Consumer staples	6.1%	8.5%	8.3%	10.2%
Energy	4.6%	13.9%	2.4%	19.9%
Health care	4.5%	13.1%	10.4%	14.3%
Industrials	3.5%	14.9%	3.2%	18.5%
Consumer discretionary	1.1%	19.9%	9.4%	13.7%
Materials	–3.5%	14.7%	4.7%	16.7%
Information technology	–4.3%	18.3%	15.7%	36.1%
Telecom-munications	–6.0%	5.7%	7.9%	13.5%

Source: Strategas Research Partners using S&P 500 data from 1/1/1992 through 12/31/2014.
Past performance is no guarantee of future results.

Looking ahead

Will this year look anything like election years past? It's impossible to say. But traders may still want to keep these patterns in the back of their minds as they research and execute their strategies in the months ahead.

[1] Schwab Center for Financial Research with S&P 500 data from 1/1/1950 to 12/31/2015. The period covered by our research starts in the second year of an election cycle and ends in the third year.