Market Fluctuations in an Election Year

UNDERSTANDING THE THEORIES CONCERNING POLITICS AND MARKET PERFORMANCE

By Beth Hawkins

If the common investor wisdom about the relationship between national elections and the performance of the U.S. financial markets is to be believed, most of us should be watching the polls as carefully as the stock tickers.

Academics, economists, and investment experts who advise on timing the market have used a variety of indicators to generate a host of tantalizing theories on the effects elections have on the markets. However, while the best have been able to draw correlations, causation is elusive, if not impossible. Attempting to time the market based on political events could be risky and lead to losses.

The U.S. Bank Asset Management Group has scoured the numbers and will keep balancing investors’ portfolios the way it always has: with an eye toward potentially minimizing risk, looking for long-term growth, and ensuring that each client’s unique goals and circumstances are taken into account.

Though economists have identified a variety of potential cause-and-effect relationships using retrospective data, the health of each individual portfolio may be increasingly tied to an economy that is global in nature.

ELECTION CYCLE

So just what does the data say? From a market standpoint, the most rigorously examined political event is the presidential election cycle. Armchair theorists and serious scholars agree that throughout the 1900s and early 2000s, there was a distinct pattern. In general, the stock market has historically performed sluggishly during the first half of a president’s term and robustly in the second, hitting a “sweet spot” in year three.

As calculated by Ned Davis Research for the different years of a presidential term, the Dow Jones Industrial Average’s annualized returns from 1900 to 2009 were 5.5 percent for year one, 3.7 percent for year two, 12.6 percent for year three, and 7.5 percent for year four.

A 2004 study by Marshall Nickles, a professor at Pepperdine University’s School of Business and Management, found that from 1942 to 2002, the Standard & Poor’s 500 Index did in fact follow a roughly four-year cycle with “troughs” occurring near the end of the first half of the cycle, followed by rapid growth culminating in double-digit “peaks.”

The most common explanation attached to the data about this cycle is that presidents undertake painful initiatives—wars, social reform, and so forth—early in their terms so that they can campaign for re-election in a robust economy. Another explanation is that the midterm congressional election triggers the market uptick, often by handing control of one or both chambers of Congress to the opposition party that puts the brakes on the White House.

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Research by the Leuthold Group found that since 1942, the 200 days immediately following a midterm election have produced "a remarkably consistent uptrend," with S&P 500 gains averaging more than 18 percent, regardless of who wins.

MARKET WISDOM
These numbers sound convincing, says Jim Russell, Regional Investment Director and Senior Vice President with U.S. Bank Asset Management Group, but most investors aren’t privy to the many caveats.

For instance, common wisdom has proven wrong during the last two presidential election cycles. The third year of George W. Bush’s second term marked the start of a historic market downturn and Barack Obama’s third year, in 2011, saw absolutely zero gains on the S&P 500 and an anemic 5.6 percent on the Dow Jones Industrial Average.

"Frankly none of this had much to do with George W. Bush or Barack Obama," explains Russell. "It’s just the way the economy worked during the third year of their respective administrations.

"In the case of the Bush Administration, it became apparent in the spring and summer of 2007 that the very rapid housing price appreciation that we witnessed from coast to coast over many years was over, and that a lot of debt had been built up in the economy," Russell says. "It was the first inning of the financial crisis that we have witnessed over the past several years." Obama also faces re-election in a disappointing economy, Russell notes. And in addition to the woes of the later Bush years, Obama’s third-year “sweet spot” has been tarnished by a natural disaster and recessions abroad. The tragic earthquake and Tsunami that devastated parts of Japan had major ramifications on the global economy in 2011, as did the debt crises in Europe.

that can occur when one party controls the White House and the other party controls Congress and neither is able to forge compromise. One theory suggests that gridlock may keep government out of the markets, allowing rapid growth. Maybe this has been true from time to time, Russell says. But the gridlock of recent years has not been helpful to the markets.

A GLOBAL ECONOMY
Investors can take one piece of common wisdom to heart in coming months. Markets may not favor a particular party (although some individual stocks historically have performed better under one or the other), and any predictable cycle can probably be declared a thing of the past.

However the market still likes certainty. “Markets historically have rallied after the election or once it’s apparent who’s going to win,” explains Russell. “Certain sectors of the economy, certain types of stocks may begin to rally more.”

Regardless of who is elected, Congress and the president may have less influence on the markets overall. "The international

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“It’s very clear that we still have a fragile recovery at hand,” says Russell. “We still have very high unemployment and Obama is in his fourth year. This issue is personally painful to most people. Everybody either has been personally impacted on the employment side from the financial crisis in recent years or knows somebody who has been.”

Russell is anxious to debunk a less well-known theory about the intersection between politics and market performance: the so-called gridlock effect. Gridlock, of course, being the product of the standstill community, the economics of the globe seem to matter exponentially more now than they used to,” says Russell. “Those influences, in which politicians play only an indirect role, loom large in the global economy.”

Beth Hawkins is a Minneapolis-based freelance business and finance writer.
My Life Insurance is Fine…I Think

By Andrew Shapiro, MSM, CLU, ChFC

Annual physicals, 5,000 mile oil changes, and quarterly furnace filter changes are all important and necessary things. Without them, expensive and potentially devastating things can happen. The same rules apply to your life insurance. Without periodic reviews your family may find that your beneficiary designation is wrong or worded incorrectly. You may have overlooked a simple rule that would make your life insurance proceeds taxable. You might simply have way too little or way too much coverage for your situation. We pay attention to things that can cost us a few hundred dollars. Why would we not spend an hour reviewing something that could cost our family thousands of dollars?

SO WHAT’S CHANGED IN YOUR LIFE SINCE YOUR LAST POLICY REVIEW?

• Are you married, divorced, or a new parent?
• Do you have a new job, or do you find yourself downsized and looking for a new position?
• Did your company cut back on benefits because of the economy?
• Did you give up smoking or lose some weight?

WHAT ABOUT THINGS YOU MAY NOT BE AWARE OF?

• Is your policy performing as it’s supposed to?
• Did you take a loan that’s eating away at the policy value?
• Is your carrier as strong as it was when you bought the policy?
• Is your money invested wisely, or is it still in the original accounts because nobody tracks the performance?

WHEN WAS THE LAST TIME YOU LOOKED AT THE MARKETPLACE?

Insurance products change often. If your contract is more than a few years old it probably isn’t using the new actuarial tables. There have also been new products introduced that guarantee your death benefit or provide long term care coverage.

CAN THESE THINGS REALLY IMPACT YOUR FAMILY?

Well, let’s look at some typical examples we see all the time.

Example 1

A husband has a $500,000 term insurance contract on his life. His wife owns the contract because someone told them it was a good idea to keep the proceeds out of the husband’s taxable estate. So far, so good. But here’s a potential problem: the three grown children are the beneficiaries of this policy. Much to everyone’s surprise, the death benefit is now taxable as a gift. And the party that has to pay the tax is the wife.

Example 2

A woman has a cash value contract that was originally illustrated at 8%. During the first few years of the contract, it may have performed better than illustrated. To finance her son’s college education, she borrowed against the contract. Unfortunately, the policy has fallen far short of the anticipated 8% growth. By adjusting the death benefit she may be able to maintain the coverage without any additional premium. Without adjusting

Life insurance products change often—a review with your Financial Advisor can ensure that your coverage is the best option for your situation.

the death benefit, the policy may not just lapse, she may owe income tax on the outstanding loan when it does.

It’s always a good idea to sit down with your Financial Advisor and review what you have. Make sure there aren’t any problems lurking over the horizon. Make sure your coverage is still appropriate for your situation and that your solutions are appropriate to your goals.

Andrew Shapiro is Director of the Advanced Consulting Group of Nationwide®.

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COLLECTING YOUR FEEDBACK

On a yearly basis, we conduct a client survey to collect your feedback and help us improve your experience. In December 2011, we partnered with The Gallup Organization to conduct our annual client experience survey.

We spoke to 1,450 clients via telephone, who were randomly selected. The survey lasted between ten to fifteen minutes, depending on the client’s products, services, and relationship with us.

The insights gained are helping us establish protocols that will improve every client’s overall experience.

CONTINUOUS IMPROVEMENT

In 2012, we will survey throughout the year to ensure we receive continuous feedback. What we learn from the results will help us to make improvements where necessary, and reinforce what is working well.

If you are called to participate in this survey, you can generally expect the call to take less than 10 minutes. We sincerely appreciate your time to share your opinions. Your feedback matters, and will help strengthen our relationship.

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