How This Presidential Election Will Impact Your Investments

Understanding How Election Cycles Affect Financial Markets

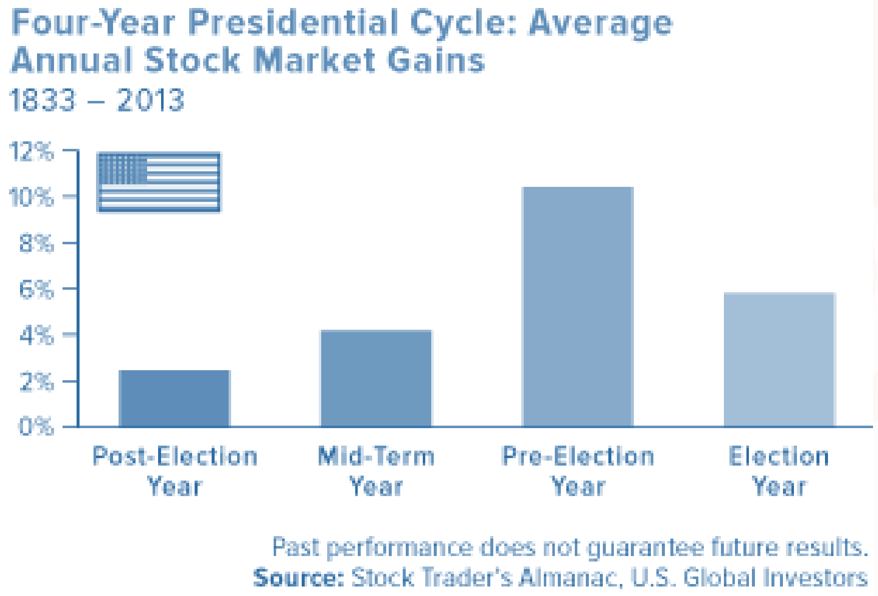
a short guide by Capital Investment Advisors

Capital Investment Advisors

The Correlation: Financial Markets and Election Cycles

As the 2016 presidential election quickly approaches, many investors are paying close attention to the stock market to see what will happen with their investments. Should we be concerned that the U.S. economy might slip into another recession, both during and after this election year? Probably not. Though economic growth was considered to be stagnant in 2015, economists generally aren't anticipating another recession within the next year.

Nevertheless, there are many schools of thought when it comes to how an election year impacts the financial markets. Some analysts believe there is no correlation at all, while others draw conclusions based on in-depth statistical data analysis. One of the most popular sets of data around election cycles is the Presidential Election Cycle Theory. Developed by Yale Hirsch (and updated by his son), creator of the Stock Trader's Almanac, this 1960's theory suggests that there is a huge impact– not during election year– but during the third year of a presidency or pre-election year. The theory suggests that, on average, the S&P 500 has 17.5% gains in the third year of a president's first term and 11.5% returns during the second term. Of course, there are exceptions to this trend.



On the other hand, during the first year following an election, volatility tends to develop as the market adjusts to change and stabilizes again during the second year of the cycle. The cycle continues to wax and wane as other factors have an impact on the performance of the markets. The chart to the right gives a rough illustration.

This short guide will explore different studies which have shown how the U.S. stock market can be impacted during a presidential election year, how it may impact your retirement, and how you can prepare yourself no matter the outcome.

How Presidential Elections Impact The Market

One question that may come to mind about the financial markets during an election year is whether or not political party affiliation plays a factor. Is the party that wins the election relevant to the stock market? Does a presidential campaign impact stock returns at all?

According to research by Forbes contributors, gauging market performance or behavior based on political party influence has one big advantage: candidates are somewhat consistent with regard to where they lie on the political spectrum. If someone is a Democrat, you can fairly confidently assume they fall somewhere left of center. The chart below displays annual average returns based on political party during election years.

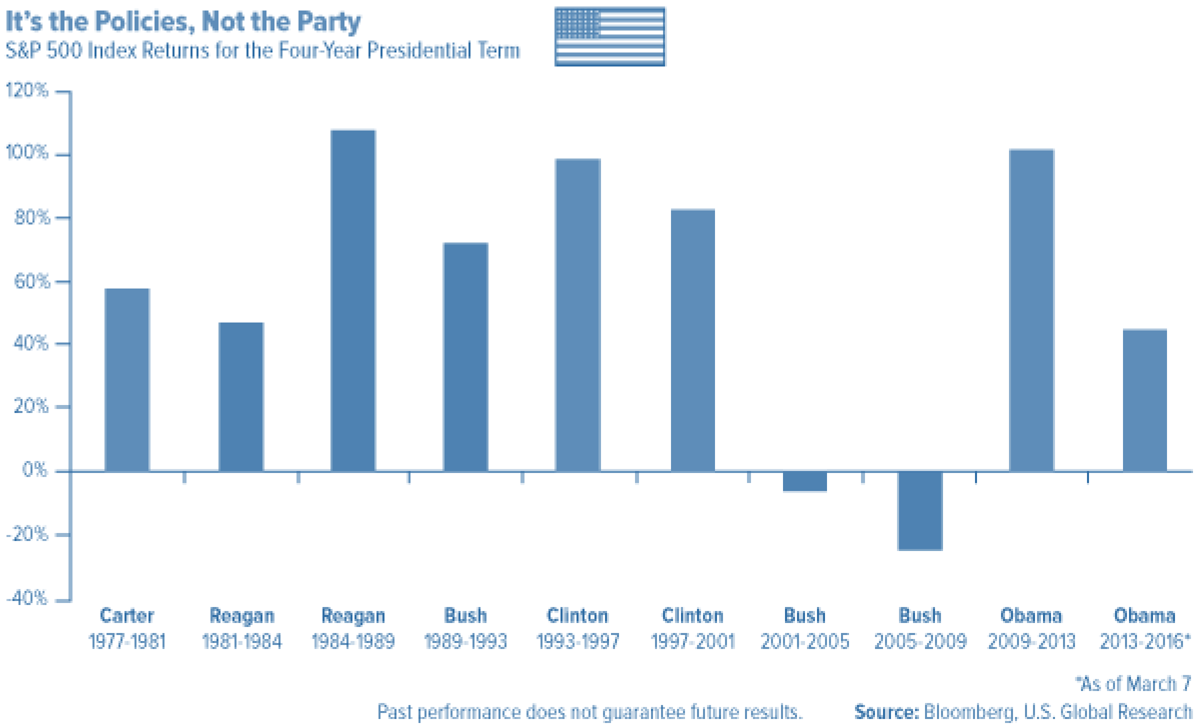
This chart suggests investors get the best returns with a Democratic president. However, the important thing to remember, according to these researchers, is that markets don't respond to people—they respond to information. How the market reacts to this new information, such as changes in the economy, market condition or other factors, as the elections progresses will simply determine whether it goes up or down. For short-term investors, this might be cause for concern, but for long-term investors the uncertainty should not cause any worry.

	Average Annual Return	Standard Deviation	Number of Years
Democratic President	15.08%	17.32%	48
Democratic President (with a one-year lag)	12.36%	16.95%	47
Democratic House	11.54%	20.17%	64
Democratic Senate	12.71%	19.26%	60
Unified Democrat (Pres., House, & Senate)	15.07%	18.21%	35
Democratic President and Senate, Republican House	15.94%	14.36%	4
Democratic President, Republican House and Senate	14.76%	16.61%	9

	Average Annual Return	Standard Deviation	Number of Years
Republican President	7.88%	22.38%	42
Republican President (with a one-year lag)	11.02%	23.17%	43
Republican House	12.17%	20.17%	26
Republican Senate	10.48%	21.79%	29
Unified Republican (Pres., House, & Senate)	9.22%	24.34%	13
Republican President and Senate, Democratic House	5.01%	23.97%	8
Republican President, Democratic House and Senate	8.15%	21.58%	21

How Presidential Elections Impact The Market

Whether a Republican, Democrat or Independent ends up the White House—the four-year presidential cycle has consistently impacted stock performance. But it's more about the policies than it is the political party. In both Republican and Democratic administrations, the market has both climbed and tanked. This is often for reasons beyond the actual president's control. A few specific factors that contribute to this performance during or just after a presidential election year are:



Reelection of an incumbent. Markets often do well when presidents seek reelection because they tend to focus heavily on economic growth and promote market-friendly policy. There is a high correlation between statistics such as unemployment and economic growth that make for a more favorable market and well-supported business cycle.

Fluctuation in global markets. The U.S. financial markets often set the tone for the rest of the world, but it's important to pay attention to what's going on in other markets. In some instances, the U.S. financial markets might experience short-term volatility in response to economic events around the world.

Congress. If it's the policies and not the party impacting the market more than anything else, then the composition of Congress has a definite impact on the outcome.

How This Election Might Impact Your Retirement

You get recessions. You have stock market declines. If you don't understand that's going to happen, then you're not ready. You won't do well in the markets.

Source: Peter Lynch

This election year might impact your retirement, and it might not be for the reasons you think why. Looking back at the eighth and final years of two-term presidencies going back to 1928, stocks have actually lost an average 4%. With a new president and new leadership comes new government policies, and this is the type of uncertainty that can contribute to investor jitters.

As you prep for retirement, it's important to focus on the big picture. Yet many investors get nervous when they see their retirement accounts fluctuate. Financial advisors can still help you to prepare for this volatility so you are prepared.

As you assess your financial blueprint for 2016 and meet with your advisor, here are three questions to consider asking that will help you evaluate if you are prepared for any changes, big or small, that might occur during this election cycle:

- Is my portfolio adequately positioned against market volatility?
- How would a more sustained downturn in the markets affect my retirement savings?
- How should developments in the daily news affect my investment decisions?

No matter what happens politically, big trends, like emerging markets and growth in the technology sector, will have a significant economic impact. No matter who is in the White House, it's important to follow these trends.

How This Election Might Impact Your Retirement

If you're curious about specific factors to watch out for, here are some to consider that could impact your retirement during any election cycle.

Your retirement accounts might improve temporarily. The S&P 500 Index has risen in 13 of the 16 election years since World War II, and it gained more than 13% during the last presidential election in 2012. While this may play out in the short-term, be careful about trying to time the market or shifting your investments. Long-term investing is a more sustainable approach.

Interest rates could go up. Your emergency savings or personal savings could actually earn interest. Low interest rates have currently led to underfunded pensions and low rates on fixed annuities. If you're a baby boomer close to retirement or already there, this could fatten your wallet.

Tax rates might change. This may positively or negatively impact people. The current presidential candidates are all discussing tax reform, which will impact retirees one way or another. Tax rates could go up or down depending on who is elected. There could be changes in estate and capital gains taxes.

You might have to adjust your retirement date. The Social Security system may undergo some type of reform, as it can only pay full benefits for the next 20 years. This might impact the age that future retirees can claim benefits.

It's a good idea to discuss these factors with your spouse and financial advisor to determine if any of these changes might impact you and to what extent. You can prepare for any drastic changes to your retirement portfolio by building alternate streams of income now, investing your income, or altering your investment strategy to weather any market volatility that may occur temporarily.

How This Election Might Impact Your Retirement

Your own agenda – rather than those of political candidates – should be the most important determinant in managing your portfolio.

Source: CFB Board, Consumer Advocate

What's fueling the factors you need to watch out for? Political agendas and policies of the current presidential candidates can leave consumers and investors anxious and concerned about any anticipated shift in the U.S. economy and their personal investments. The Certified Financial Planner Board of Standards, Inc. (CFP Board) did some research and made recommendations on how to properly prepare your finances for any election outcome and here is what topped their list.

Consumer confidence. Markets do not respond well to uncertainty. You can prepare your portfolio by doing some volatility-proofing. The CFP Board recommends that investors consider dividend-paying stocks rather than aggressive growth stocks, and modest increases to high quality bonds and cash.

Business cycle. As a savvy investor, pay attention to any new tax policies proposed prior to the election and just after the new president is elected. As you do this, consider the possible impact on your portfolios.

Interest rates. It is recommended that investors take their direction from the Federal Reserve when making adjustments in the quality, currency and duration of their portfolios.

Unforeseen events. We don't know what lies ahead, but any sudden events that occur during the remainder of this election year but we'll certainly see them. The turn of events could shift the market and it's best to ensure you are prepared when the time comes.

How This Election Might Impact Your Wallet

Beyond your investments, presidential elections can also have an impact on your daily budget. Here are a few factors that might have a direct impact on your daily spending in the upcoming election.

Student Loan Debt Could Get Harder to Repay. The debt your kids or grandkids owe is getting worse as the cost of college tuition continues to increase. Student loan debt has become a key talking point for presidential candidates as more than 43 million Americans have over $1.2 trillion in student debt. If you took out student loans to support the education of your kids or grandkids, be prepared for changes during this election cycle that might impact your monthly payments.

Taxes. Always up for debate. A change in a presidential administration could always affect tax law, for better or worse. Changes often affect estate taxes and capital gains tax after the sale of property. Tax reform may change how we are taxed for services, like healthcare. The current candidates remaining in the race each have a different outlook on the nation's tax policy. No matter who is elected, be prepared for taxes to change in some way.

Small Business. If you are one of the millions of Americans running a small business, there are several key financial issues that could impact you. The Affordable Care Act, minimum wage, and anti-union sentiment "right to work" legislation stands at the forefront during this election. Be sure to monitor how this could impact your cash flow and short-term financial planning.

Healthcare. There's rarely an election where healthcare isn't front and center. Healthcare costs have continuously risen over the past few decades, and there's no sign of change. It is important to consider your long-term healthcare needs during retirement. Start planning now so you can be prepared for unfavorable changes in the future.

How To Ensure You Are Prepared

Overall, there's no magic chart or data analysis that can accurately predict what might happen with a financial market during an election year. However, the trends can give some insight, and understanding patterns in economic cycles can help us prepare. You can review the data and draw your own conclusions.

Despite the benefit of investment strategy based on objective analysis, there will be always be some degree of market speculation that will drive emotional investing. Thus, some investors focus on short-term gains instead of taking a long-term view of the market.

You can prepare for market volatility by consulting with a financial advisor you trust and reviewing your portfolio to ensure your investments are ideally positioned for any economic scenario. Watch the trends and ask questions, but remember that investing is a long-term endeavor and you should always think ahead.

Our team at Capital Investment Advisors is available by phone, appointment, or chat to provide objective answers to any questions that you may be faced with. Give us a call at 888-531-0018 or request a free one-hour consultation.

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