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THE SIGNAL RIDGE PERSPECTIVE
ON THE ELECTION AND THE MARKETS

Here we are…two weeks until Election Day. This year it seems it can't come (and go) soon enough! I learned a long time ago that it is best to avoid political conversations with coworkers, clients, and business associates. But this year these conversations seem almost unavoidable.

A recent article from the American Psychological Association (APA) reported that more than half of Americans surveyed found the 2016 election to be a "significant" source of stress. Apparently it is so bad they have coined the term Election Stress Disorder to describe the funk that people are feeling. If you fall into this camp, here are some tips straight from the APA:

- Limit your media consumption. The constant media barrage of claims and counterclaims isn't good for anyone. Read enough to stay informed and then turn off the newsfeed. Go for a walk to take in the fall foliage, book a tee time, or spend some time with friends and family to escape the negative chatter.
- Avoid conversations about election politics if there is any chance they might escalate into conflict. Be mindful of the time you spend discussing politics and try to minimize it.
- Remind yourself that stress and anxiety about what might happen is not productive. Instead, channel your concerns towards issues you care about and where you can actually make a difference.
- Whatever happens on November 8th, remember that life will go on. Our political system is the greatest in the world and has been a stabilizing platform for centuries. Our three branches of government ensure that no one person can dismantle our democracy. Try to avoid catastrophizing and maintain a balanced perspective.
- Vote! In a democracy every citizen's voice counts. So, look for balanced information to help make a rational decision, cast your ballot, and wear your "I Voted" sticker with pride.

It's natural to wonder what the election outcome might mean for your portfolio. A look at history shows that the presidential cycle does loosely correlate with stock market returns. Over the last 100 plus years, the Dow Jones Industrial Average has climbed an average of 10.4% the year before an election, and it has gained nearly 6% in the average election year. However gains have been much more muted in the first and second years of a president's term, averaging 2.5% and 4.2% respectively.

Many will say that the current cycle is far from average…and they would be right. The Dow was up 27% in the first year of Obama's second term and saw a 7% return in year two. Last year, the strongest year of the presidential cycle historically, saw a drop of 2%. So what does this mean? Probably not much! More than anything it simply shows the fallibility of market predictions.

While you may align strongly with the Democratic or Republican party, it turns out that the market doesn't care which party holds the presidency. You might think that Republicans and their "business friendly" policy bias would be better

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for the markets. Surprisingly, a review of historical returns shows that Democratic administrations have been better for stocks by about 3% per year. Before Democrats get too excited by this statistic, let me tell you that the difference can be completely explained by market volatility and is not significant enough statistically to mean anything!

Another myth that is perpetuated at election time is that a divided government is better for market performance than a united government. The theory is that a division of power limits government and allows markets to flourish. However, history tells a different story: when one party controls the White House and both houses of Congress, the S&P 500 has gained almost 17% in the two years following an election. When one party controls the White House and the other party controls both houses of Congress, the market has gained just under 16% in the two years following an election. A divided Congress has resulted in 5.5% returns on average irrespective of which party is in the White House. Perhaps some good news is that the first two outcomes are currently more likely than the latter.

While election results have not been great for predicting market returns, it turns out that the market has historically been a pretty good predictor of election outcomes. In the last 22 elections, 14 were preceded by stock market gains in the three months prior to the election. In 12 of those 14 instances, the incumbent or incumbent party won. In 7 of the 8 elections preceded by three months of losses, incumbents lost. In the three months leading up to today, the market is down by about 0.5%. Perhaps the market's action over the next week or two will tell us who our next president might be, or perhaps not.

This election cycle has certainly been quite sloppy and vitriolic, but it is important to remember that while political events can lead to short-term volatility, it is market fundamentals that are ultimately responsible for long-term returns. Here at Signal Ridge, we take the approach of stepping back to view any situation with a broad lens and focusing on what really matters to our clients. We don't put much faith in short term predictions and focus instead on building robust financial plans designed to produce results over lifetimes. We don't expect the short-term volatility around the coming election to have a lasting impact on your long-term financial plan. If anything, it may provide us with more investment opportunities—a net benefit for those with a long-term view.

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