# Mitch on the Markets

## How Midterm Elections Affect Stocks

By Mitch Zacks
Portfolio Manager

Stocks are generally not influenced by a single factor. It is usually a multitude of factors pushing and pulling prices at any given time. Earnings may serve as tailwinds breathing positive momentum into stocks, while tariffs could do the opposite and serve as headwinds. Leading economic indicators may boost investor sentiment and the relative attractiveness of stocks, while high valuations could discourage some investors from buying. At any given time, the confluence of these factors determines the direction of stock prices, in our view.

One such factor that gets little airtime, but that we'd like to discuss this week, is midterm elections. At Zacks Investment Management, we are politically agnostic in our approach to investing, favoring no party over the other. Our concern is on policy and how it may affect property rights, corporate profits, and economic growth. It doesn't matter what side of the aisle it comes from – but it does matter.

Perhaps that's why historically, stocks have tended to get jittery in midterm election years, as the balance of power in Washington undergoes a potential shift. Let's look at some of the historical data first, and then we'll explain why we think stocks have behaved this way in midterm election years.

**Volatility in a Midterm Election Year: By the Numbers**

Let's start by taking a look at the last four midterm election years. The table below takes a look at S&P 500 corrections during years of midterm elections, but then also takes a look at what the market did in the 12 months following the correction[1]:

| Midterm Election Year | Market Correction During the Year | Market Performance 1-Year After Correction |
|---|---|---|
| 2002 (Bush) | -34% | +34% |
| 2006 (Bush) | -8% | +24% |
| 2010 (Obama) | -16% | +31% |
| 2014 (Obama) | -7% | +9% |

As you can see from the table, stocks have tended to display a volatile streak in midterm election years. Going back even further to 1962, the average correction during a midterm election year was an eyebrow raising -19%.[2]

But here's the kicker: since 1962, the average bounce for stocks following the midterm correction was a sturdy +31%. The table also shows that in the last four midterm election years, stocks have rebounded considerably following the downside volatility enduring during the year.

Going even deeper, if we look at the average monthly returns of the S&P 500 in midterm election years (going back to 1962), we find that from April to September the S&P 500 has posted negative returns.[3]

Bottom line, stocks have tended to wobble, and we think there's a reason why. Because midterm election years can mean a shift in the balance of power in Congress, it also means that there is an increased risk of one party enacting new laws and/or policies in the lead-up or once the power dynamic is set. Markets, in our view, do not like policy uncertainty.

But we see a flip side to this hypothesis – once midterm elections happen and the markets know how the table is set, so to speak, the uncertainty fades and corporations (stocks) have a better idea of what to expect from Congress in the coming two years. Perhaps this is why since 1946, the S&P 500 has not declined in the 12 months following a midterm election, with the average price return in the 12-month period following a midterm election from 1950 – 2014 being +15.3%. [4]

We do not think 2019 will be the exception.

## Bottom Line for Investors

In my view, investors would be wise to brace for a noisy, sometimes ugly fight in this midterm election cycle, and we wouldn't be surprised if markets responded with increased volatility – as has often been the case throughout recent history. But as we mentioned earlier, we do not believe stock prices are influenced by one factor alone. While the mudslinging surrounding midterm elections may create some headwinds for stocks, the positive news surrounding earnings, jobs, income, and spending may help support the longer-term upward trend. History has also shown that corrections in midterm election years are often followed by solid positive returns in the years that follow, and we could very well see that being the case in this cycle as well.

**About Mitch Zacks**

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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[1] Strategas Quarterly Review in Charts, July 2, 2018, pages 55-58
[2] Strategas Quarterly Review in Charts, July 2, 2018, pages 55-58
[3] Strategas Quarterly Review in Charts, July 2, 2018, pages 55-58
[4] Strategas Quarterly Review in Charts, July 2, 2018, pages 55-58