

Stocks typically struggle during midterm election years

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INVESTING

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There is a “Presidential Cycle” for stocks, a pattern of performance coinciding with various years of a presidency. In particular, Year 2 of a presidency is a Mid-term Election Year (“MTEY”), with Congressional elections held in November. Historically, stock prices have been weaker in MTEYs than in Years 1, 3 or 4 of a Presidential Cycle.

We are at the halfway point of 2018, a MTEY, so it’s instructive to review past performance in similar years. While past performance is no guarantee of future results, studying historical patterns may give clues as to what to expect in the weeks and months ahead.

According to Sam Stovall, Chief Equity Strategist of CFRA, stocks are challenged during MTEYs, possibly due to the uncertainty associated with the change in the presidential party’s representation in Congress. Indeed, as shown in the table, the party controlling the White House lost an average of 22 House seats and 4 Senate seats in the 18 MTEYs since 1946. Further, for the six-months leading up to the election, the S&P 500 fell in price in 50% of all observations, declining an average of 1.1% and slipping by double-digits in five of nine times.

For **first-term** midterm elections (like 2018), the S&P 500 dropped an average of 3.0% in the same six-months and declined 60% of the time.

As shown in Stovall’s second table, the S&P 500 recorded the worst 6-month stretch of the entire 16-quarter Presidential Cycle during the second and third quarter of Year 2, with average declines of 1.9% and 0.9%, respectively. Fortunately, the two worst quarters of the Presidential Cycle were followed by the three best.

Mid-Term Election Year	S&P 500		Pres. Party Change	
	% Changes Apr. 30-Oct. 31	House	Senate	
1946	(20.9)	(54)	(12)	
1950	8.1	(28)	(5)	
1954	12.1	(18)	(1)	
1958	18.2	(48)	(12)	
1962	(13.4)	(4)	2	
1966	(11.9)	(48)	(4)	
1970	2.1	(12)	1	
1974	(18.2)	(48)	(4)	
1978	(3.8)	(15)	(3)	
1982	14.8	(26)	2	
1986	3.6	(5)	(8)	
1990	(8.1)	(8)	(1)	
1994	4.8	(54)	(9)	
1998	(1.2)	5	0	
2002	(17.8)	8	1	
2006	5.1	(30)	(6)	
2010	(0.3)	(64)	(6)	
2014	7.1	46	(9)	
2018	???	???	???	
All 18	(1.1)	(22)	(4)	
First Term	(3.0)	(25)	(3)	

Source: CFRA, S&P DJ Indices. Past performance is no guarantee of future results. Data: 4/30/46-10/31/15.

Further, the MTEY price weakness phenomenon was even more pronounced for small-capitalization stocks, with the Russell 2000 index dropping -2.5% and -6.7% in the second and third quarters in MTEYs since 1978 and losing 3.8% for the year.

Pres. Cycle	Average Price % Changes				Year	Frequency of Price Gains					Year
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	Year	
Year 1	(0.1)	2.6	1.3	3.8	8.2	53%	58%	63%	79%	63%	
Year 2	1.1	(2.0)	(0.9)	7.5	5.7	47%	53%	61%	89%	61%	
Year 3	6.6	4.6	0.6	3.1	15.2	89%	72%	56%	71%	88%	
Year 4	1.2	2.3	0.6	1.8	6.3	61%	67%	56%	78%	78%	
All Years	2.2	1.8	0.4	4.1	8.8	62%	62%	59%	79%	72%	

Pres. Cycle	Average Price % Changes				Year	Frequency of Price Gains					Year
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	Year	
Year 1	1.2	7.4	3.0	5.6	17.0	60%	100%	70%	80%	90%	
Year 2	3.7	(2.5)	(6.7)	2.4	(3.8)	70%	33%	33%	89%	56%	
Year 3	8.9	7.1	(0.1)	1.4	17.0	80%	60%	50%	70%	60%	
Year 4	2.8	2.2	3.8	1.5	10.9	67%	67%	67%	67%	78%	
All Years	4.1	3.7	0.3	3.0	11.0	70%	67%	56%	77%	72%	

Source: S&P Capital IQ, Yahoo.com. Russell 2000 from 1979-1994, S&P SmallCap 600 thereafter. Past performance is no guarantee of future results.

If historical patterns hold, stocks will tread water ahead of the November 6 midterm election, but better returns should be ahead.

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