Presidential Election without Precedent

With the presidential election now behind us, and the ensuing media madness, the question to be asked for 2009 is – what will the election of Barack Obama mean for investors, based on historical relationships between presidential parties and the stock market?

Since 1926 (the first year in which the *S&P 500™* existed as a means for measuring broad stock market performance), and through 2007 (since complete market performance for 2008 is not yet available), the White House has been occupied by a Republican for 42 years and a Democrat for 40 years. This gives us about as even a base for study as we could hope for. In addition to attempting to correlate market performance with executive mansion occupation, the table bellow shows an analysis measuring the average market return during each of the four years of each of the 21 presidential terms that have occurred in that time span. Table 1 shows the results.

TABLE 1

Party	Year 1	Year 2	Year 3	Year 4	All
Democrat	13.80	9.13	22.66	14.14	14.93
Republican	0.81	8.28	16.51	12.65	9.70
All	7.30	8.68	19.44	13.39	12.25

Ibbotson Associates® (11/04/2008)

The numbers clearly suggest two relationships: that despite conventional wisdom, markets have historically liked Democrats more than Republicans and that markets are much more upbeat during the second half of a presidential administration, particularly in the third year. Finding a rational explanation for this might be a different matter, though. For example, the reversion of the markets in 2001 and 2002 had much more to do with the "irrational exuberance" displayed by investors during the technology glory years of 1995-1999 than it did with any policies implemented by George W. Bush. Similarly, a poor overall economy drove Jimmy Carter out of office in 1981, yet the 5% decline in stocks that year gets "credited" to Ronald Reagan, despite the fact that his policies did not get fully implemented until the next year.

Perhaps a more useful study would be to look at market behavior during years when there is a one-party control in Washington versus years in which the powers of the legislative and executive branches are split. Over the same 82 year span, Democrats have controlled all three prongs of the political trident for 32 years, Republicans for a mere 12 years, and there has been some form of a two-for-one split for the other 38 years. In fact, the only Democrat president who had to work with a Republican Congress for any significant length of time was Bill Clinton, who presided over the greatest five-year run the market has ever seen (1995-99). The Republican control was split between the "Roaring Twenties" and the most

recent Bush administration. Table 2 shows how the markets have behaved under these three scenarios:

TABLE 2

Control	Avg. Return	Median Return	Best Year	Worst Year
Democrat	14.11	18.34	53.99 (1933)	-35.03 (1937)
Republican	12.44	11.26	52.62 (1954)	-24.90 (1930)
Mixed	10.62	9.79	43.36 (1958)	-43.34 (1931)

Ibbotson Associates® (11/03/2008)

Again, contrary to popular belief the numbers suggest that the markets have historically preferred Democrats most, and that they enjoy single-party rule more than a balance of power. But again, the explanation for this might point elsewhere. It is far more likely that voters are quick to remove from power whoever is in office when markets go south, as they naturally will, and that the newly-elected politicians will be forced to take the blame for circumstances that were in place before they arrived. Regardless, and while there is never a guarantee, history suggests the markets have performed best when Democrats have had control of Washington.

A Very Bleak October

October 2008 was the worst month for the U.S. stock market in twenty-one years. In October, the *S&P 500™ index* fell 16.8% and has fallen as much as 42% from its peak last October, and it represents the part of the market (large-cap stocks) that was most in favor. Small-caps, as measured by the *Russell 2000 Index*, were off 20.8% for the month, which was roughly in line with international stocks, where the *MSCI EAFE Index* of developed countries declined 20.2%. All of these fared better than the *MSCI Emerging Markets Index*, which dropped 27.4%, and the *Dow Jones Wilshire REIT Index*, which took home the "anchorman" award with a 32.4% loss. These are staggering declines on the tail of already large double digit drops through September 2008.[1]

It has been said that a rising tide lifts all boats, but in this case it might be more appropriate to say that an ebb tide grounds all boats hopelessly on shoals and reefs. There were very few hiding places in the equity markets and fixed income markets. Even high-grade corporate debt waivered in the midst of the credit crisis.

The U.S. markets got off to a shaky start on October 1 when Congress passed version two of the financial services bailout Bill, which would use upwards of $700 billion of our tax dollars to restore liquidity to the credit markets. Investors reacted poorly to this news, although one can speculate that they would have reacted poorly if the Bill had been defeated as well. As the month wore on, many other countries followed suit in having their governments intervene in their financial sectors, and what resulted was a war of attrition among most major world currencies.

[1] Morningstar (November 7, 2008)

Table 3 shows the October stock market return for eight major markets, as well as the appreciation of the dollar against the local currency for that market. Remember that a strengthening dollar will drive down returns in non-U.S. markets.

TABLE 3

The Strengthening Dollar			
Country	**Total Return in $US**	**Total Return in Local Currency**	**% Change of US Dollars relative to Local Currency**
Australia	-25.56%	-11.00%	14.56%
Canada	-27.16%	-16.70%	10.46%
England	-19.13%	-10.78%	8.35%
France	-22.43%	-14.13%	8.30%
Germany	-22.97%	-14.67%	8.30%
Japan	-14.79%	-21.06%	-6.27%
South Korea	-26.12%	-20.98%	5.14%
Switzerland	-12.27%	-8.60%	3.67%

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According to the chart above, Japan has escaped the global decline in currency values largely because housing has been so unaffordable there for so many years that they are not experiencing the same mortgage crisis that has plagued the United States and Europe.

Not out the woods yet

The liquidity crisis that has plagued global financial markets and economies remains intact, though there has been some tangential evidence that the enormous stress in the credit markets have begun to receed. The financial markets have rallied, bouncing off the lows in mid-October, but in all likelihood we will probably retest the lows established last month before a meaningful rally begins. Also, given the losses incurred this year, there will probably be a good amount of tax loss selling between now and year-end, placing an excess supply of stock in the marketplace. However as we have stated in several past communiqués, we believe there is a high likelihood that we have experienced the worst, and though there will be more bumps in the night, and market bottoms take a while to form, we think the opportunity for many years of recovery are truly exceptional. Remember, the average duration of past *S&P 500™* bear markets has been twenty months , including the 62 month "outlier" bear market which ended in April 1942.[2] If you eliminate that bear market from the mix, the average has been thirteen months. Following prolonged bear markets, the potential prolonged upside growth period has often stretched for several years and while there is no guarantee, several recoveries have previously provided triple digit returns. The average one year return of the *S&P 500™* after

[2] Los Angeles Times

a bear market is 36.5% and 168.5% from the trough of the bear market to the following peak.[3]

Thank you for your continued trust and confidence,

Kelly Trevethan, CIMA ®

[3] Yahoo Finance

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- *The Standard & Poor's S&P 500™ Index is a market value-weighted average of the performance of 500 stocks of the largest US companies as measured primarily by market capitalization.*
- *The Russell 2000 Index is a market value-weighted average of the performance of the 2000 smallest US company stocks in the Russell 3000 Index as measured primarily by market capitalization.*
- *The MSCI Global Standard Indices offer investors a set of investable regional, country, and industry indices that share a consistent methodology, a rigorous approach to data collection and quality control, and a unique historical data set reaching as far back as 1969.*
- *Morgan Stanley Capital International Europe, Australia, Far East Index (MSCI EAFE) is a market value-weighted average of the performance of more then 900 securities listed on the stock exchanges of countries in Europe Australia and the Far East.*
- *The MSCI Emerging Markets Index is a free float-adjusted market capitalization index. As of August 2005, the index consisted of the following 26 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey and Venezuela.*
- *The Dow Jones Wilshire REIT Index is a subset of the Dow Jones Real Estate Securities Index and includes only REITs. Its objective is to provide a broad measure of publicly traded REITs.*