

Elections tend to create a lot of questions and uncertainty. The uncertainty wreaks havoc on markets, which are concerned about potential changes or stalls in fiscal, tax, estate, international and environmental policies.

MIDTERMS AND MARKETS

What midterm elections could mean for your financial plan

Overview

Americans are heading back to the polls. Midterm elections, scheduled for Tuesday, Nov. 8, will determine not only who has control of both the U.S. House and Senate but also who is governor in 36 states.

While midterm elections don't generally see the same level of turnout as presidential elections, some analysts say turnout could be higher than usual this November.¹ That's because this year's race seems to be centered more on hot-button social issues, which tend to drive up voter participation.

Investors are keeping a particularly close eye on this year's elections. A shift in power could mean either gridlock or advancement of political agendas. And in this hotly contested election season, it's anyone's guess which party will end up in charge. But one thing is for certain: Until the election is completed and uncertainty dies down, markets will likely stay volatile.

Who is up for election in 2022?

- All 435 House seats
- 35 of the 100 Senate seats
- 36 out of 50 state governors

Market Volatility and Midterm Elections

We don't need to look far to find examples of midterms causing trouble for markets; in fact, since 1962 the average market decline during a midterm election year is 19%.² So far, we have followed the trend in 2022, although this year's losses have been higher than average for some indexes. By mid-October, the S&P 500 was down 24.82% for the year, while the Dow Jones had declined by 18.45%.^{3,4}

But why do midterms create such havoc for markets? Uncertainty, mostly. If the presidential party also has control of the Senate and House, it could result in the passage of a host of new policies. But if the non-presidential party holds the majority in either chamber, then it could halt the adoption of new legislation until the next election cycle.

The thought of shifting legislative priorities tends to make markets squeamish, particularly when they concern changing fiscal,



environmental, tax and international policies. After all, these policies directly impact businesses and consumers, the driving forces of the U.S. economy. That's an especially nerve-wracking thought for markets this year, as high inflation, rising interest rates and a sluggish economy have everyone on high alert for a potential recession.

Still, there is good news. In the past 60 years, markets have roared back following a midterm election. On average, markets have returned 31.6% in the 12 months after midterms, with zero negative returns in that same amount of time.⁵ Whether this midterm election will continue or break the cycle remains to be seen, especially as we face strong headwinds going into the new year.

Final Thoughts

So what should investors hope for as we head into midterms? Politics aside, stocks have historically performed best under divided control. A 2020 study published by Forbes found that the Dow Jones averaged annual returns of 12.9% in the years when Congressional leadership was split, compared to the overall annual average of 8.3% between 1945 and 2020.⁶

If Republicans take control of the House or Senate, it will likely slow government spending — not necessarily a bad thing as the Federal Reserve wages its battle against inflation. Divided control will also make the passage of new tax hikes and changes to retirement-related legislation unlikely. However, it will mean an uphill battle for the Biden administration in its pursuit of expanded social and environmental programs.

No matter which political party is in charge, investors would be wise to remember that short-term events should not serve as a distraction from long-term goals. Stay focused on the bigger picture and rely on your financial advisor to help you navigate new legislation and regulations as they come.

¹ Lyon Nishizawa. Council on Foreign Relations. Aug. 24, 2022. "How Does U.S. Voter Turnout Compare to the Rest of the World's?" <https://www.cfr.org/in-brief/how-does-us-voter-turnout-compare-rest-worlds>. Accessed Oct. 17, 2022.

² Bill Stone. Forbes. Oct. 2, 2022. "Midterm Elections: The Politics of the Stock Market." https://www.forbes.com/sites/bill_stone/2022/10/02/midterm-elections-the-politics-of-the-stock-market/?sh=1d16b20d71cc. Accessed Oct. 17, 2022.

³ Morningstar. "S&P 500 PR." <https://www.morningstar.com/indexes/spi/spx/quote>. Accessed Oct. 17, 2022.

⁴ Morningstar. "DJ Industrial Average PR USD." <https://www.morningstar.com/indexes/dji/dji/quote>. Accessed Oct. 17, 2022.

⁵ Bill Stone. Forbes. Oct. 2, 2022. "Midterm Elections: The Politics of the Stock Market." https://www.forbes.com/sites/bill_stone/2022/10/02/midterm-elections-the-politics-of-the-stock-market/?sh=1d16b20d71cc. Accessed Oct. 17, 2022.

⁶ Mike Patton. Forbes. Jan. 12, 2021. "Stock Performance And The Political Party in Power: An Historical Look At The Past 75 Years." <https://www.forbes.com/sites/mikepatton/2021/01/12/stock-performance-and-the-political-party-in-power-an-historical-look-at-the-past-75-years/?sh=560a40807a64>. Accessed Oct. 17, 2022.



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