



Basis Points – Midterm Election Update

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One Very Important Thing Happened Last Night: The polls closed, the votes were counted, the winners were declared and now the market can move on. The markets hate uncertainty, and the clearing of that uncertainty is the most important thing for the market today.

Interesting Notes

Americans went to the polls in droves this election season, as 114 million people voted in the election. That large number smashed the previous record for participation in a midterm election and even outdistanced recent projections for 108 million.

There are 16 quarters in each presidential term. Since 1950, the best quarters for stock market performance have been the fourth quarter of the second year (the quarter we are in now) and the first and second quarters of the third year. We are now in the best performing three-quarter period in a presidential cycle.

Historically, the average annualized equity market return when there is a Democratic House, a Republican Senate and a Republican White House is 10.8 percent.

Election Outcome

The outcome was in-line with consensus expectations. The Democratic party gained about 26 seats in the House and now have a thin majority. The Republicans strengthened their majority in the Senate after gaining two seats and will hold 53 Senate seats. We now have a divided Congress. President Trump will have many new challenges in dealing with a Democratic House that he did not have before, and it will be much harder to pass any new partisan legislation without reaching across the aisle.

How the Election Results Affect the Financial Markets

- The markets can now worry about other things. Historically, the performance of the economy and financial markets is unrelated to election outcomes, or which party holds power in D.C.
- The economy is still performing well. Corporate profit growth has been very strong. Inflation is low and in check. Unemployment is very low. Consumer confidence and business confidence is very high. Energy prices are down. Worker wages are rising. These are the factors that will take center stage now.
- The tax reform bill was passed in 2017 and will not be rolled back. These tax law changes have been the most important stimulus for the economy and stock market in the last two years, and even if the White House is denied any new legislation, the tax reform stimulus will remain in place.

Stock Market Performance Following Midterm Elections

- The period leading up to a midterm election is typically very volatile, as the average stock market correction during midterm election years is a loss of 19 percent. However, after the election results are known, the stock market has not declined in the 12 months after a midterm election since 1946. In these 17 separate post-midterm years, the average gain was 31 percent.
- The reason for this post-election strength is twofold: First, the uncertainty surrounding the election has been lifted. The market hates uncertainty most of all, so the absence of it is a positive thing. Second, the sitting president begins to worry about getting re-elected, so typically enacts programs and economic stimuli to ensure that the economy remains in good condition through the election two years later. This stimulus is positive for the stock market.

- Stock market performance post-election is not dependent on the results of the election. All that matters to the market is that the uncertainty is now gone.

Issues to Watch for

- Look for a trade deal with China to be signed in the coming months. It is in the best interest of both the U.S. and China to agree on a trade deal that ends the threat of a trade war between the two countries. The White House does not want to have a trade war dragging down the economy heading into a presidential re-election year.
- New economic stimulus measures could include an infrastructure spending package, indexing capital gains to inflation by executive order, putting pressure on pharmaceutical companies to cut drug prices, and an increase in the minimum wage.
- How will the Democrats use their new power position in the House? Democrats could issue a subpoena to obtain President Trump's tax returns. Nancy Pelosi, the probable new Speaker of the House, has not seemed enthused to use her party's new influence to pursue impeachment of the president as the votes are not there, and that long, hard fight would distract her party from using the next two years to enact new Democratically-led legislation and reform.
- Wild card: The Mueller investigation has been very quiet lately, and appropriately so in the months leading up to an important national election. Discussion of the release of a final report could increase over the next few months.

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